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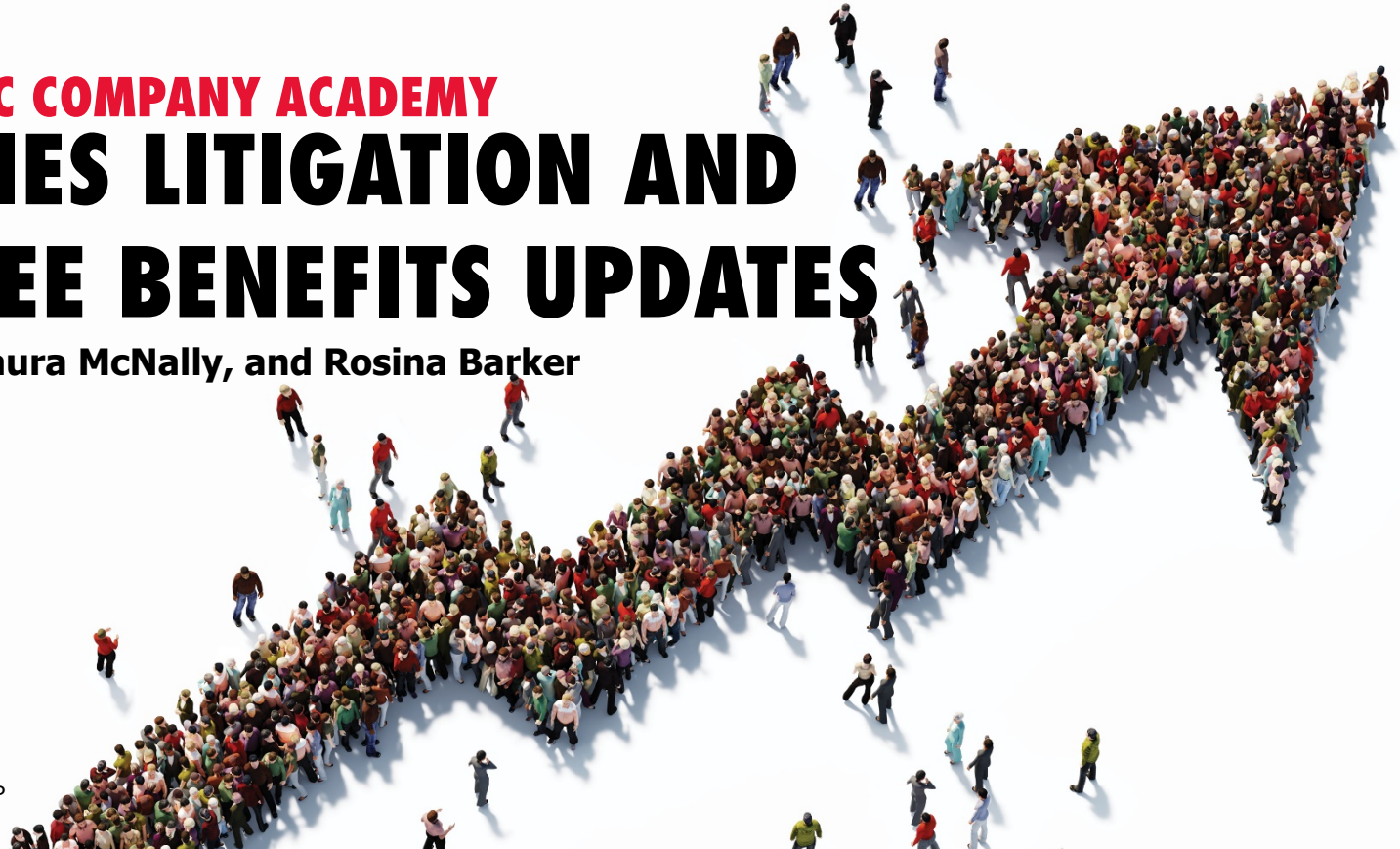
GLOBAL PUBLIC COMPANY ACADEMY

SECURITIES LITIGATION AND EMPLOYEE BENEFITS UPDATES

Mike Blanchard, Laura McNally, and Rosina Barker

May 12, 2021



Presenters

Rosina Barker
Partner, Washington, DC

Michael Blanchard
Partner, Hartford

Laura Hughes McNally
Partner, Philadelphia

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TRENDS IN SECURITIES LITIGATION

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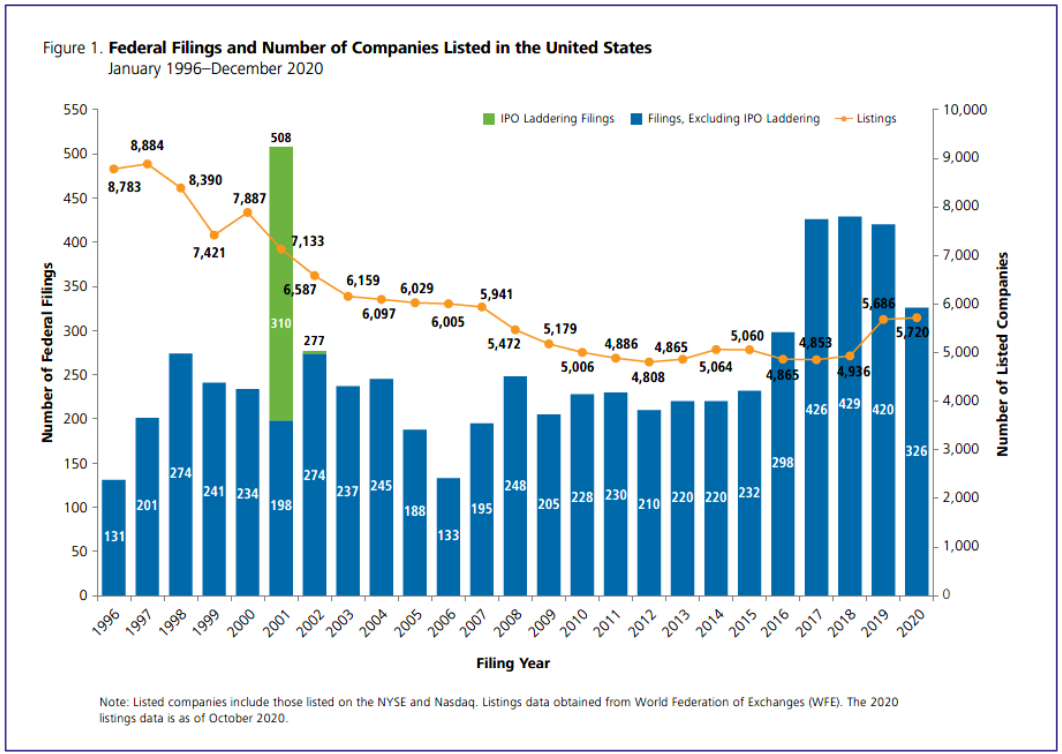
Securities Suits Decreased in 2020

NERA reports there were 326 federal securities class actions filed in 2020. This marks a 22% decline from 2019, primarily driven by fewer merger objection cases filed.



Salzberg v. Sciabacucchi: Mitigating the Rise of Post-*Cyan* Securities Act Cases in State Court?

- In 2018, the US Supreme Court held in *Cyan, Inc. v. Beaver Cty. Emps. Ret. Fund*, 138 S. Ct. 1061 (2018), that both state and federal courts have concurrent jurisdiction over claims brought under the Securities Act of 1933, as amended (the Securities Act)—most often misstatements or omissions in registration statements or prospectuses.
- The *Cyan* decision prompted a significant shift in the securities litigation landscape, as plaintiffs increasingly filed Securities Act claims in state court, to evade the procedural protections of the PSLRA.
- Companies sought to limit their exposure to duplicative state court litigation by adopting federal forum provisions in their corporate charters requiring that all Securities Act claims against the company be brought exclusively in federal court.
- In *Salzberg v. Sciabacucchi*, 227 A.3d 102 (Del. Mar. 18, 2020), the Delaware Supreme Court held that federal forum provisions are facially valid under Delaware law.
- In 2021, two California state courts ruled federal forum provisions under California law, but it remains to be seen whether courts outside California will enforce these provisions.

Pandemic-Related Securities Suits

- Suits are focused on companies directly involved in the response to COVID (e.g., pharmaceutical companies), or directly impacted by the pandemic (e.g., travel industry), as well as companies less directly impacted by COVID based on alleged misstatements and misrepresentations about how COVID-19 impacted financial results:
  - Misstatements include company statements about the use of federal money in connection with COVID-related programs (Kodak, Vaxart)
  - Misrepresentations include company statements about how the pandemic has impacted the company's financial health (Forescout Technologies)

Director Diversity and Derivative Lawsuits

- Several companies' directors have been sued for breach of fiduciary duty and securities violations due to the lack of diversity on their board of directors.
  - The Gap, Danaher, NortonLifeLock, Qualcomm, Monster, Oracle, Advanced Micro Devices, Inc., Cisco Systems, Inc., and Facebook.
- The underlying premise of these cases is that while companies have announced their commitment to diversity to shareholders and the public via proxy statements and other means, they have failed to create meaningful diversity on their boards and within company leadership.
- In recent months, two of these cases—brought against The Gap and Facebook—have been dismissed.

THE NEW WORLD OF STOCKHOLDER LITIGATION: WHY YOUR BOARD MINUTES MATTER

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Director Liability For Breach of the Duty of Oversight (Loyalty) – The Historical *Caremark* Context

- Under *Caremark*, a director must make good-faith efforts to oversee the company's operations and risks.
- Because of 102(b)(7) exculpation, *Caremark* liability is typically predicated on a breach of the duty of loyalty by demonstrating bad-faith failure in oversight.
- Bad faith occurs under *Caremark* when "the directors (1) fail to implement any reporting or information system or controls[,] or (2) having implemented such a system or controls, consciously fail to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention."
- A "*Caremark* Claim" was historically recognized as "[p]ossibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment.

The Historical *Caremark* Context

"At issue is the duty of loyalty; a board's efforts can be ineffective, its actions obtuse, its results harmful to the corporate weal, without implicating bad faith. Bad faith may be inferred where the directors knew or should have known that illegal conduct was taking place, yet took *no steps* in a good faith effort to prevent or remedy that situation."

Oklahoma Firefighters Pension & Retirement System v. Corbat, 2017 WL 6452240, at *17 (Del. Ch. 2017)

Impact of Evolving Section 220 Practice and Jurisprudence

- The modern context – plaintiffs' current pervasive use of the "tools at hand" has reshaped *Caremark* threats
- An explosion of Section 220 litigation has rapidly changed Delaware's books and records jurisprudence
- The "proper purpose/credible basis" standard for obtaining books and records, historically reputed as the lowest burden known to Delaware corporate law, has loosened even further
- The types of books and records plaintiffs might get has expanded
- And the inferences plaintiffs receive on a motion to dismiss are becoming more plaintiff-friendly

If It's Not in the Minutes, It Did Not Happen

"The complaint's allegations support a pleading-stage inference that the board never established its own reasonable system of monitoring and reporting, choosing instead to rely entirely on management. The Company could have produced documents in response to the plaintiff's Section 220 demand that would have rebutted this inference. The absence of those documents is telling because [i]t is more reasonable to infer that exculpatory documents would be provided than to believe the opposite: that such documents existed and yet were inexplicably withheld."

Hughes v. Xiaoming Hu, 2020 WL 1987029, at *16 (Del. Ch. 2020)

JANDER DECISION: DISCLOSURE DUTIES UNDER ERISA

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Jander: Insiders' Disclosure Obligations Under ERISA

Issue: When a 401(k) plan has an employer stock fund, what are the pleading standards for plaintiffs alleging that plan fiduciaries who are corporate insiders breached their ERISA fiduciary duties by failing to disclose negative inside information?

- *Fifth Third Bancorp v. Dudenhoeffer*, 573 US 409 (2014), set forth the "more harm than good standard" for stock drop complaints: complaint based on fiduciary's alleged failure to disclose negative inside information (or halt trading in stock) will not survive motion to dismiss unless plaintiffs plausibly allege that no prudent fiduciary could have concluded that such action would do more harm than good to the stock price
- *Jander v. Ret. Plans Comm. of IBM*, 910 F.3d 620, 632 (2d Cir. 2018) (Jander I), set forth the "inevitable disclosure" standard: Plaintiffs met *Dudenhoeffer* pleading standard by alleging that any prudent fiduciary woud have known that (i) negative inside information—in this case, existence of impaired asset—"inevitably" would be disclosed, AND (ii) negative impact of concealment on stock price would grow over time. Under the "inevitable disclosure" standard, ANY prudent fiduciary would conclude that concealment would do more harm than good to the stock price

Jander (continued)

- Supreme Court granted cert.
  - Defendants argued that corporate officers have no additional disclosure obligations under ERISA by virtue of their service as ERISA fiduciaries
  - Court declined to rule on the merits, reasoning that defendants' arguments were not pled below, reversed, and remanded. 140 S. Ct. 592 (2020)
- Second Circuit reinstated decision: defendants' arguments not properly pled. 962 F.3d 85 (2d Cir. 2020)
- Supreme Court denied cert. 141 S. Ct. 816 (Nov. 2020)
- Second Circuit's low pleading bar creates circuit split: Fifth, Sixth, and Ninth Circuits have adopted higher pleading standard. Eighth Circuit expressly disagreed with *Jander* in *Allen v. Wells Fargo & Co.*, 967 F.3d 767 (8th Cir. 2020)
  - Insiders who are ERISA fiduciaries might have disclosure duties outside of securities laws, at least in Second Circuit
  - Basic issue has not been addressed: Are securities laws the sole source of disclosure obligations?
  - Solutions: Forum-selection clause in plan document

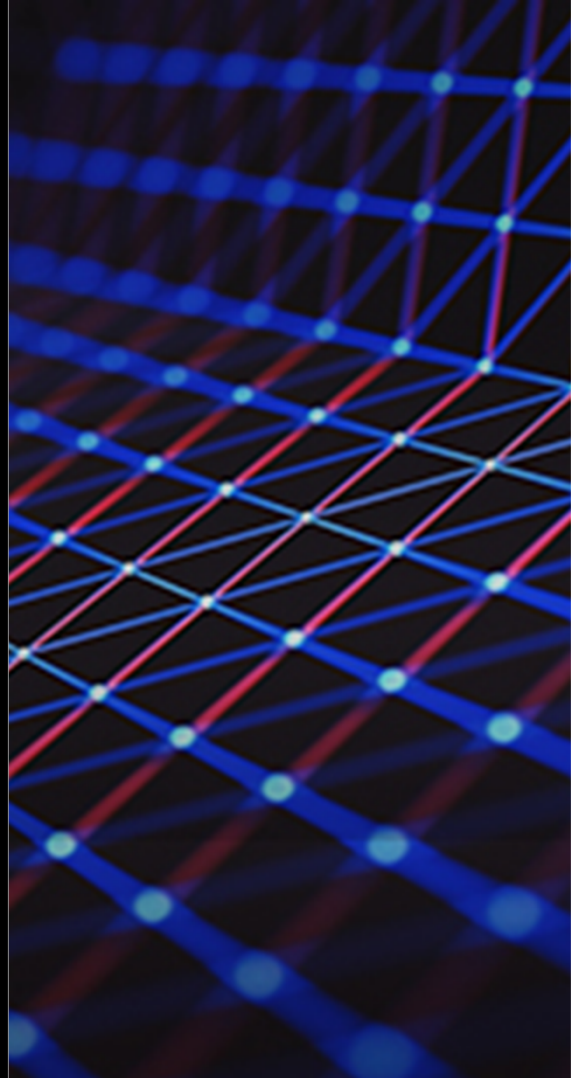
QUESTIONS?

Coronavirus COVID-19 Resources

We have formed a multidisciplinary **Coronavirus/COVID-19 Task Force** to help guide clients through the broad scope of legal issues brought on by this public health challenge.

To help keep you on top of developments as they unfold, we also have launched a resource page on our website at **www.morganlewis.com/topics/coronavirus-covid-19**

If you would like to receive a daily digest of all new updates to the page, please visit the resource page to **subscribe** using the purple "Stay Up to Date" button.



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Biography

Rosina B. Barker
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Rosina counsels clients on the Employee Retirement Income Security Act (ERISA), tax, and securities law aspects of their employee benefits and executive compensation plans. Her practice ranges from sophisticated defined benefit pension plan matters to complex executive compensation issues. Rosina is a nationally known author on Internal Revenue Code Section 409A compliance, and numerous companies engage her specifically to provide counsel in this area. She has drafted and amended multiple equity, deferred compensation, and incentive pay plans for compliance with Code Sections 409A, 83, 162(m), 457A, and 280G, and she advises clients on the many tax, fiduciary, and governance issues arising from these plans.

Biography

Michael D. Blanchard
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Michael's practice focuses on all facets of shareholder litigation: books and records demands, derivative actions, securities class actions and enforcement, directors and officers compensation, indemnification and advancement. He counsels boards responding to shareholder litigation demands, and frequently serves as independent counsel to special committees. Michael works closely with the firm's shareholder activism defense and crisis management practices. He has successfully tried cases to judges and juries alike, including numerous appeals, and has obtained multiple dismissals, including, for example, the dismissal of a 1933 Act class action which Forbes magazine called a "stunning class action victory."

Biography

Laura Hughes McNally
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Laura defends clients in class and individual actions brought under federal securities law, challenges to mergers and acquisitions, derivative suits, and appraisals. She also represents clients in investigations by the US Securities and Exchange Commission (SEC). Laura focuses her practice on civil litigation and regulatory investigations under the federal securities laws as well as state law claims arising from corporate transactions, such as suits seeking to enjoin mergers and acquisitions and appraisals. She also defends companies and boards of directors in derivative suits challenging corporate decisions or alleged failure to supervise. In federal court, Laura has successfully argued multiple motions to dismiss putative class actions alleging violations of the federal securities laws, which dismissals were upheld on appeal and which involved issues of first impression.

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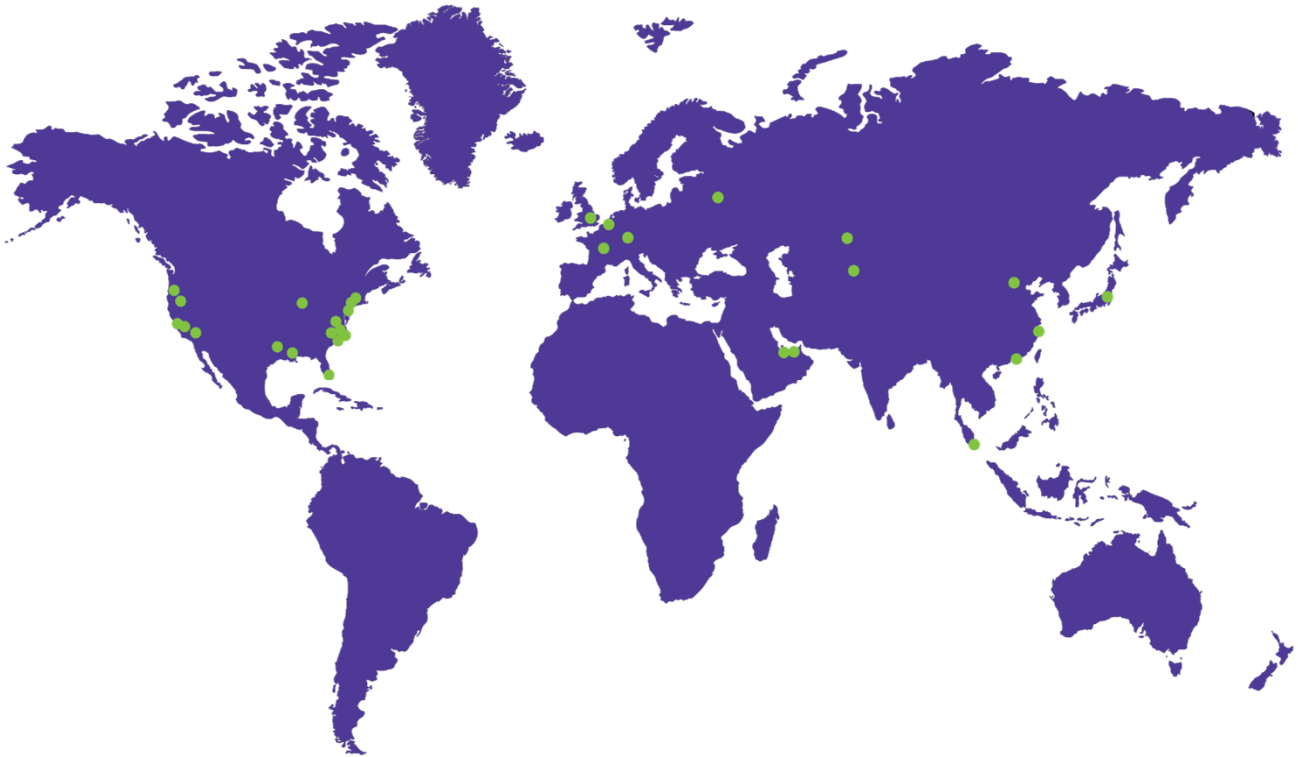
Washington, DC
Wilmington



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