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First-Quarter Securities Class Actions Respond To Outbreak

By **Nessim Mezrahi** (April 10, 2020, 4:27 PM EDT)

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Transparency is paramount in the securities class action arena. Directors and officers, as well as institutional investors, rely on the rule of law and the duty of candor of their lawyers to seek and attain justice through the judiciary process.

Amid the current pandemic-driven economic correction, U.S. publicly traded corporations — and their insurers — are in pole position to showcase the resiliency of the American economy.[1] On March 26, Thomson Reuters reported that "there are plaintiffs' lawyers who will try to take advantage of the [COVID-19] crisis, just as there are defense lawyers and companies who will do the same."[2]

Opportunistic frivolity by lawyers on both sides of the aisle will lead to business and judicial inefficiencies that may hinder a sound economic recovery. As Joseph Conrad wrote in the 1902 novel "The Heart of Darkness": "What saves us is efficiency — the devotion to efficiency."[3]

The primary issue presented in the strategic plan for the federal judiciary is: "Scarce resources, changes in litigation and litigant expectations, and certain changes in law challenge the federal judiciary's effective delivery of justice."[4]

To address the issue, the plan's primary strategic focal point is to "[p]ursue improvements in the delivery of justice on a nationwide basis."[5]

A disciplined effectuation of data science is necessary to promote transparency in support of the plan. Transparency leads to efficient data-driven decision-making by officers of the court, particularly when working towards the adjudication of claims that arise from alleged violations of federal securities laws under Section 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder by the U.S. Securities and Exchange Commission.

The Exchange Act ensures that the U.S. capital markets — the fuel of corporate America — maintain the gold standard for global investors.

On Feb. 27, in Arkansas Teacher Retirement System v. State Street Corporation, U.S. District Judge Mark Wolf of Massachusetts wrote a notable and important opinion that reached the core of the class action mechanism:

> Judges trust lawyers. … Every lawyer is an officer of the court [and] has a duty of candor to the tribunal. … If judges are appropriately skeptical and do the work necessary to discharge their duties as fiduciaries for a class, its members will be protected and the integrity of the administration of justice will be promoted. This effort may sometimes be arduous. It will always be important.[6]

The promotion of transparency, through greater dependence on data science, strengthens the integrity of the settlement process in securities class action litigation. The court's reliance on empirical analysis is the basic tenet that provides independent support for the judicial approval of billions of dollars in settlement distributions that stem from the adjudication of claims that allege violations of the Exchange Act.

Data science is essential for a verifiably transparent and efficient delivery of justice in securities class action settlement proceedings. As per In re: Signet Jewelers Limited Securities Litigation:

> [J]udicial approval of a class action settlement is a two-step process. First, the Court performs a preliminary review of the terms of the proposed settlement to determine whether to send notice of the proposed settlement to the class. Second, after notice has been provided and a hearing has been held, the Court determines whether to actually approve the settlement. … This standard for preliminary approval of class action settlements was established by amendments to rule 23(e) that became effective on December 1, 2018.[7]

Since March 11, when the novel coronavirus was officially characterized as a pandemic by the World Health Organization, the U.S. securities class action litigation exposure to alleged violations of Rule 10b-5 directly related to COVID-19 has amounted to $2.7 billion.[8]

Data and analysis indicate that investors have not sued publicly traded corporations indiscriminately on COVID-19 related issues, even as the pandemic took hold of the equity markets on March 9, when an automated circuit breaker halted trading in the New York Stock Exchange for the first time since 1997.[9]

The securities class actions that have been filed in the first quarter of 2020 directly related to COVID-19 amount to 4.32% of $63.5 billion of the total U.S. securities class action Rule 10b-5 exposure.[10]

According to reporting by Thomson Reuters, plaintiffs lawyers that the reporter spoke to "said they have no intention of filing reflexive class actions alleging the companies slammed by the pandemic failed to provide adequate risk warnings to shareholders."[11] This remains to be seen throughout the remainder of 2020 as the legal disclosure ramifications from the COVID-19 pandemic continue to shape the global securities class action landscape.

Notably, the increase in frequency of Exchange Act securities class actions since 2018 has coincided with the end of the longest running bull market in U.S. history.[12][13]

As a result, more fervent shareholder recovery efforts can be expected as the fiduciary duties of institutional investment managers are tested and global investors in the U.S. capital markets seek nontraditional equity investment returns. After all, "[t]he empirical evidence on the [Private Securities Litigation Reform Act's] lead plaintiff provision suggests that courts should continue their preference for institutional over individual plaintiffs in securities class actions," says St. John's University Law School law professor Michael Perino.[14]

According to Institutional Shareholder Services Inc., $5.84 billion in 2018 and $3.17 billion in 2019 was made available for distribution to investors that bought and sold shares in the U.S. capital markets.[15] ISS expects that figure to increase in 2020.[16]

According to Jessica Erickson of the University of Richmond School of Law:

> To accurately distribute settlement funds in a securities class action, claims administrators need certain information about the damages suffered by individual class members. Damages in a securities class action are based on, among other things, the difference between the price that an investor paid for the corporation's stock and the value of this stock had the corporation not lied to the market.[17]

The class action settlement recovery process is an essential component of the greater class action mechanism. Settlement recovery provides fair and appropriate monetary recompense to investors from alleged fraud on the market by directors and officers of U.S.-listed corporations.

Settlement recovery services have become increasingly dependent on data science to ensure equitable redress for global investors in the U.S. capital markets. According to Epiq's Stevie Thurin: "A plan of allocation [POA] is a stated methodology by which a class action recovery is allocated among eligible claimants; literally, it is a plan for allocating the settlement fund."[18]

Data science is also used and relied upon to attain material limitations to aggregate damages demands made by securities class action plaintiff lawyers that do not evaluate price impact prior to filing a class action complaint.

Effective data science serves to efficiently implement the tools the U.S. Supreme Court afforded U.S. public corporations in Hallibuton II, such as price impact. Stock price reaction on an alleged misrepresentation is referred to as direct or front-end price impact, and stock price reaction to a corrective disclosure is referred to as indirect or back-end price impact.[19]

Claimed aggregate damages can be limited by disqualifying alleged corrective disclosures that are allegedly related with stock price declines that do not exhibit price impact. Disqualification will compromise an alleged corrective disclosure from comprising a certified class and restrict the attribution of damages to the related stock price decline.

In other words, if the corrective disclosure's related drop in stock price does not exhibit a statistically significant stock price return after controlling for general and industry-specific factors, the court should be reluctant to approve the related stock price decline as a source of potential damages in a certified class.

Event studies were conducted on each of the 65 Exchange Act claims filed in the first quarter. These event studies were performed by first conducting multivariate regressions to measure statistical relationships between the defendant company stock price returns and market and industry indices for control periods of either one year or 100 trading days prior to either the alleged class periods or the first alleged corrective disclosures, depending on data availability.

The results of these regressions were used to calculate t-statistics and perform t-tests on the residual one-day stock price returns corresponding to alleged corrective disclosures. According to the results of the t-tests, residual returns with p-values greater than 5% have been classified as having no back-end

price impact; residual returns with p-values of less than 5% have been classified as having back-end price impact.

After excluding all alleged stock price declines that do not exhibit back-end price impact, the market capitalization losses of the surviving stock price declines are accumulated to estimate the aggregate U.S. securities class action Rule 10b-5 exposure of companies that trade on U.S. exchanges.[20]

The application of event study analysis indicates that 72 claimed stock price declines alleged in 41 Exchange Act claims filed in the first quarter of 2020 do not exhibit back-end price impact.[21]

According to David Tabak and Frederick Dunbar at National Economic Research Associates Inc.:

> Event studies are also used to measure the size of a stock price movement as the basis for a damage calculation. For example, in cases of securities fraud, it is common to measure changes in the alleged inflation in a stock price by the movement in that stock price in the wake of a corrective disclosure, after controlling for market, industry, and other company-specific influences. This is because inflation is removed from the stock price with the disclosure, and an event study measures the change in inflation in the stock at the time of the disclosure. Often, it is then assumed that this is the best estimate of the inflation per share if defendant had a duty to disclose the same information that was revealed in the corrective disclosure. As a result, an event study is a common method that serves as the basis for quantifying damages in security fraud cases. ...
>
> The most important reason to consider the use of an event study is that it is likely to provide a highly objective methodology for calculating the magnitude of damages and the materiality of the event that may have caused damages.[22]

Event study results indicate that $6.8 billion out of $70.3 billion of claimed market capitalization losses are not a verifiable source of potential classwide damages in the corresponding filed claims made in the first quarter.[23] Eleven Exchange Act claims filed in the first quarter contain at least one alleged stock price decline that does not exceed a t-statistic of -1.96 to support sufficient back-end price impact to warrant inclusion in a certified class.[24]

For example, in the case Linenweber v. Southwest Airlines Co., none of the alleged stock price drops related with the four alleged corrective disclosures exhibit indirect price impact at the 95% confidence standard.[25]

> [A] defendant can rebut the Basic presumption with evidence that the alleged misrepresentation was not associated with "negative price stock-returns," i.e., there was not statistically negative, "back-end" impact on stock following a corrective disclosure. Virtus Inv. Partners, 2017 WL 20162985, at *4. A corrective disclosure occurs when the truth about an earlier allegedly fraudulent statement or omission is revealed to the market. ...
>
> However, for class certification purposes, when Plaintiffs are able to show an alleged misrepresentation had statistically significant front-end price impact, Defendants are not entitled to rely on these additional back-end arguments to rebut the Basic presumption.[26]

Stock price impact evaluation, through the application of event study analysis, also serves to attain more accurate measures of exposure — and aggregate damages — on Exchange Act claims made against non-U.S. issuers.[27] Non-U.S. issuers use American depositary receipts, or ADRs, to access capital in the U.S.

public markets through the New York Stock Exchange, NASDAQ or over-the-counter markets.
On Jan. 28, in Automotive Industries Pension Trust Fund v. Toshiba Corp., U.S. District Judge Dean Pregerson denied the defendant's motion to dismiss the second amended complaint in a California federal court.[28] Based on this ruling, "[e]ven companies with unsponsored Level I ADRs trading in the U.S. can be subject to liabilities under the U.S. securities laws if the claimants are able to establish that the ADR transactions are sufficiently domestic," according to the D&O Diary's Kevin LaCroix.[29]

In the first quarter, six non-U.S. issuers were sued for alleged violations of the Exchange Act, amounting to $11.7 billion in ADR U.S. securities class action Rule 10b-5 exposure.[30] A total of 14 alleged corrective disclosures were claimed by investors in ADRs of non-U.S. issuers. $824 million of claimed shareholder losses in ADRs in the first quarter do not surpass thresholds of indirect price impact.[31]

In the first quarter, global securities class action Rule 10b-5 exposure amounts to $75.2 billion.[32] $63.5 billion are related to U.S. issuers of common stock in U.S. exchanges (U.S. securities class action Rule 10b-5 exposure) and $11.7 billion to non-U.S. issuers (ADR U.S. securities class action Rule 10b-5 exposure).[33]

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[1] On March 11, 2020, the World Health Organization stated that "COVID-19 can be characterized as a pandemic." See, "WHO Director-General's opening remarks at the media briefing on COVID-19 – 11 March 2020," World Health Organization, March 11, 2020. https://www.who.int/dg/speeches/detail/who-director-general-s-opening-remarks-at-the-media-briefing-on-covid-19---11-march-2020.

[2] "'Corporations don't get a free pass because of COVID-19'-Robbins Geller's Randy Baron," Alison Frankel's On The Case, Thomson Reuters, March 26, 2020. https://www.reuters.com/article/us-otc-covid19/corporations-dont-get-a-free-pass-because-of-covid-19-robbins-gellers-randy-baron-idUSKBN21D3JC.

[3] Joseph Conrad, The Heart of Darkness (New York, US: Oxford University Press, 1990 – Reissued as Oxford World's Classics Paperback 1998), Pg. 140.

[4] U.S. Strategic Plan for the Federal Judiciary, September 2015, Judicial Conference of the United States, Issue 1: Providing Justice. https://www.uscourts.gov/statistics-reports/strategic-plan-federal-judiciary.

[5] Id.

[6] Arkansas Teacher Retirement System v. State Street Corporation et al., Case No. 1:11-cv-12049-

MLW, Opinion and Order, Feb. 27, 2020.

[7] In re Signet Jewelers Limited Securities Litigation, Case No. 1:16-cv-06728-CM-SDS, Memorandum of Law in Support of Lead Plaintiff's Unopposed Motion for Preliminary Approval of Settlement and Authorization to Disseminate Notice of Settlement, March 26, 2020.

[8] Securities class action exposure in McDermid v. Inovio Pharmaceuticals, Inc. et al, Case No. 2:20-cv-01402, amounts to $431.8 million. Securities class action exposure exposure in Douglas v. Norwegian Cruise Lines et al, Case No. 1:20-cv-21107, amounts to $2.3 billion. A second Exchange Act claim was filed against Norwegian Cruise Lines on March 31, 2020, in Abraham Atachbarian v. Norwegian Cruise Lines et al, Case no.: 1:20-cv-21386. U.S. securities class action Rule 10b-5 exposure related to COVID-19 does not account for Defendants that have been sued multiple times for seemingly related alleged violations of the Exchange Act.

[9] "Circuit Breaker Halts Stock Trading for First Time Since 1997," The Wall Street Journal, March 9, 2020.

[10] "SAR Securities Class Action (SCA) Rule 10b-5 Exposure Report – 1Q 2020," April 10, 2020, SAR. SAR.https://bit.ly/SAR_1Q_2020_Exposure_Report.

[11] "Shareholders' class action lawyers: We're not rushing to bring COVID-19 cases," Alison Frankel, Alison Frankel's On The Case, Thomson Reuters, March 17, 2020. https://www.reuters.com/article/legal-us-otc-covid19/shareholders-class-action-lawyers-were-not-rushing-to-bring-covid-19-cases-idUSKBN21445P.

[12] "U.S. Stocks Poised to Enter Longest-Ever Bull Market," The Wall Street Journal, August 21, 2019. https://www.wsj.com/articles/u-s-stocks-poised-to-enter-longest-ever-bull-market-1534843800.

[13] "Dow Jones Industrial Average's 11-Year Bull Run Ends," The Wall Street Journal, March 11, 2020. https://www.wsj.com/articles/global-markets-calmer-after-two-hectic-days-11583899913.

[14] Michael Perino, "Have Institutional Fiduciaries Improved Securities Class actions? A Review of the Empirical Literature on the PSLRA's Lead Plaintiff Provision," St. John's School of Law Legal Studies Research Paper Series #12-0021, November 2012. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2175217.

[15] "The Top 100 U.S. Class Action Settlement of All-Time," Institutional Shareholder Services, as of Dec. 31, 2018. https://www.issgovernance.com/library/the-top-100-u-s-settlements-of-all-time-as-of-december-2018/.

[16] "The Top 100 U.S. Class Action Settlement of All-Time," Institutional Shareholder Services, as of December 31, 2019. https://www.issgovernance.com/library/the-top-100-us-class-action-settlements-of-all-time-as-of-december-2019/.

[17] Jessica Erickson, "Automating Securities Class Action Settlements," Vanderbilt Law Review, Vol. 72:6:1817. Introduction to the article available here: https://corpgov.law.harvard.edu/2020/01/03/automating-securities-class-action-settlements/.

[18] "A Guide to Settlement Plans of Allocation in Securities Class Actions," November 15, 2018, Stevie

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Association: https://www.americanbar.org/groups/litigation/committees/securities/articles/2018/fall2018-a-guide-to-settlement-plans-of-allocation-securities-class-actions/.

[19] Halliburton Co. v. Erica P. John Fund, Inc., 134 S. Ct. 2398 (2014).

[20] "SAR Securities Class Action (SCA) Rule 10b-5 Exposure Report – 1Q 2020," April 10, 2020, SAR. SAR.https://bit.ly/SAR_1Q_2020_Exposure_Report.

[21] Id.

[22] David Tabak and Fredrick Dunbar, "Materiality and Magnitude: Event Studies in the Courtroom (April 1999)." NERA Working Paper No.
34. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=166408.

[23] "SAR Securities Class Action (SCA) Rule 10b-5 Exposure Report – 1Q 2020," April 10, 2020, SAR.https://bit.ly/SAR_1Q_2020_Exposure_Report.

[24] Id.

[25] In Linenweber v. Southwest Airlines Co. et al., plaintiff alleges four corrective disclosures affecting participants in the market on April 17, 2018, April 19, 2018, June 22, 2018, and June 26, 2019. The t-statistic of Southwest's stock price residual return on each of these dates using a 95% confidence standard does not surpass -1.96 based on a company-specific event study analysis.

[26] In re Chicago Bridge & Iron Company N.V. Securities Litigation, Case No. 1:17-cv-01580, Opinion and Order, March 23, 2020.

[27] "Non-U.S. Issuers Targeted in Securities Class Action Lawsuits Filed in the United States," David H. Kistenbroker, Joni S. Jacobsen and Angela M. Liu, Harvard Law School on Corporate Governance, March 29, 2020. https://corpgov.law.harvard.edu/2020/03/29/non-u-s-issuers-targeted-in-securities-class-action-lawsuits-filed-in-the-united-states/.

[28] Automotive Industries Pension Trust Fund, et al. v. Toshiba Corporation, Case No. 2:15-cv-04194.

[29] "U.S. Securities Suit of Toshiba's Unsponsored ADR Investors to Proceed — Including Even Their Japanese Law Claims," The D&O Diary, Kevin LaCroix, Feb. 3,
2020. https://www.dandodiary.com/2020/02/articles/securities-litigation/u-s-securities-suit-of-toshibas-unsponsored-adr-investors-to-proceed-including-even-their-japanese-law-claims/.

[30] "SAR Securities Class Action (SCA) Rule 10b-5 Exposure Report – 1Q 2020," April 10, 2020, SAR. SAR.https://bit.ly/SAR_1Q_2020_Exposure_Report.

[31] Id.

[32] Id.

[33] Id.