Recent Developments in Securities Law

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Cornerstone Research Statistics 2019 Midyear Assessment

- Federal class action securities fraud lawsuits are at near record levels in the first half of 2019.
- There were 198 filings in the first half of 2019.
- This is the 4th highest since the PSLRA was passed.
- Six of the filings were mega filings, which involved maximum dollar losses of at least $10 billion.
- M&A filings fell to 72 from 91 in the first six months of 2018.

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Cornerstone Research Statistics 2019 Midyear Assessment

- The maximum dollar loss so far totals $781 billion.
- The maximum dollar loss in 2018 for the first 6 months was $668 billion.
- 23 percent of all core filings were filed against non-U.S. issuers (companies headquartered outside the U.S.).
  - 11 filings against Asian firms
  - 13 filings against European firms
  - For the first time on record, there are filings against firms in Monaco and Bulgaria.

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Cornerstone Research Statistics 2019 Midyear Assessment

- In the time period 2010-2019, 50 percent of filings were dismissed, with 48+ percent of the remaining having been settled.
- Hot industry sectors in 2019 are as follows:
  - 18.2% in consumer staples
  - 11.6% in industrials
  - 11.1% in telecommunications and information technology
  - 9.7% in healthcare
  - 6.4% were S&P 500 companies

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Cornerstone Research Statistics 2019 Midyear Assessment

- 52 cases were filed in the Second Circuit
- 29 cases were filed in the Ninth Circuit
- 16 cases were filed in the Third Circuit
- 2 cases were filed in the Tenth Circuit

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U.S. Supreme Court

- Lorenzo v. SEC (U.S. March 27, 2019)(6-2 decision)
  - Francis Lorenzo, a director of investment banking at a registered BD, sent along two emails to prospective investors that were false.
  - The Commission found Lorenzo liable for securities fraud.
  - The D.C. Circuit, relying on *Janus Capital v. First Derivative Traders*, held that Lorenzo could not be held liable as a maker, but nevertheless sustained the Commission.
  - The SEC affirmed and held that ***dissemination*** of a false or misleading statement with the intent to defraud can fall within the scope of Rules 10b-5(a) and (c), even if the disseminator did not "make" the statements and consequently falls outside of Rule 10b-5(b).
  - Lorenzo engaged in a device, scheme and artifice to defraud within 10b-5(a) and engaged in a practice or course of business that operated as a fraud or deceit sufficient for 10b-5(c).

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U.S. Supreme Court

- *Lorenzo v. SEC* (U.S. March 27, 2019).
  - The court rejected the argument that the only way to be liable for a false statement is through Rule 10b-5(b) that refers specifically to false statements.
  - The court also rejected the argument that the decision would render *Janus* a dead letter, which applies to Rule 10b-5(b).
  - The court held that *Jan*us still applies were an individual neither *make*s nor *disseminates* false information.
  - *Lorenzo* in short adopts scheme liability, but how far it will reach remains to be seen.

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U.S. Supreme Court

- The U.S. Supreme Court dismissed a writ of certiorari previously granted in January 2019 involving a review of the Ninth Circuit's decision in **Varjaberdian v. Emulex Corp**., which held that plaintiffs bringing claims under Section 14(e) of the Exchange Act need only show that defendants acted negligently, rather than with scienter.
- Section 14(e) prohibits misstatements, omissions or fraudulent conduct in connection with a tender offer.
- There is a split in the circuits between the Ninth Circuit, on the one hand, and the Second, Third, Fifth, Sixth and Eleventh Circuits, which all held that Section 14(e) requires a plaintiff to demonstrate that defendants acted knowingly or with a reckless disregard of the truth – a higher burden than negligence.
- At oral argument, both Emulex and the Solicitor General argued also that there is no private right of action under Section 14(e).
- There was a question of whether the argument had been preserved below.
- The writ of certiorari was dismissed without explanation.
- Perhaps, they will wait for a case where the issue has been preserved.

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U.S. Supreme Court

- The Supreme Court in June 2019 declined a petition for certiorari from the Ninth Circuit's decision in **Mineworkers' Pension Scheme v. First Solar, Inc**. (9th Cir. 2018).
- The decision held that the element of loss causation can be based on an event or disclosure that causes a decline in stock price, even when the event or disclosure does not reveal the underlying fraud.
- The Ninth Circuit permitted plaintiffs to recover based on the drop in the stock's value before the fraud was revealed to the market.
- The Ninth Circuit held that loss causation requires "no more than the familiar test for proximate cause."
- The Solicitor General filed an amicus brief agreeing with the Ninth Circuit.

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U.S. Supreme Court

- On November 1, 2019, the U.S. Supreme Court granted cert. in Chales Liu and Xin Wang v. S.E.C., Case No. 18-1501.
  - Petitioners are challenging a $27 million disgorgement order from the S.E.C.
  - This was the amount raised from investors.
  - Petitioners are challenging the authority of the S.E.C. to order disgorgement.
  - They argue that disgorgement is a penalty.
  - The S.E.C. left the issue open after *Kokesh v. SEC (2017),* which held that disgorgement is a penalty subject to a 5-year statute of limitations.

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Tenth Circuit

- **S.E.C. v. Charles D. Scoville and Traffic Monsoon, LLC** (10th Cir. Jan. 24, 2019).
  - Scoville allegedly operated a Ponzi scheme through his Utah company, Traffic Monsoon, LLC.
  - Defendants challenged district court orders freezing assets, appointing a receiver, and granting a preliminary injunction.
  - At issue was whether the federal securities laws reached Traffic Monsoon's sales to customers outside of the United States applying the conduct-and-effects test enacted by Dodd-Frank.
  - At issue was whether Traffic Monsoon's Adpacks (bundled internet advertising services) qualified as investment contracts.

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Tenth Circuit

- Traffic Monsoon was operated by Scoville from his Utah apartment with servers located in the U.S.
- Traffic Monsoon represented that it shared revenue with user members for clicking on websites within certain limits.
- Traffic Monsoon members also could earn money by recruiting new members.
- Traffic Monsoon sold $173 million in Adpacks, distributing $88 million to members, and keeping $87.4 million.
- 90% of the Adpacks were purchased by people outside of the U.S.
- At the time of the asset freeze, the receiver froze $50-$60 million in assets, and members were owed $34.2 million, and potentially as much as $278.1 million.

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Tenth Circuit

- Defense counsel argued that the antifraud provisions of the federal securities laws did not apply to members located outside of the U.S. because of Morrison v. National Australia Bank, Ltd.
- Relying on § 929P(b) of the Dodd-Frank Act, the Tenth Circuit held that "Congress undoubtedly intended that the substantive antifraud provisions should apply extraterritorially when the statutory conduct-and-effects test is satisfied."
- The Tenth Circuit also found that the conduct-and-effects test was met because defendants "conduct within the United States . . . constitue[d] significant steps in furtherance of the violation' of Rule 10b-5 and Section 17(a). Mr. Scoville conceived and created Traffic Monsoon in the United States."
- Prior to Dodd-Frank, such transactions may not have been actionable under the Supreme Court's decision in Morrison v. National Australia Bank. Ltd.
- Morrison was decided 3 weeks before Dodd-Frank was effective.
- The court held that because Traffic Monsoon undertook significant conduct in the U.S. to make those sales to persons abroad, it was subject to the federal securities laws.
- The Tenth Circuit also found that the Adpacks were securities because they were investment contracts.

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Tenth Circuit

- Dennis J. Malouf v. S.E.C. (10th Cir. Aug. 13, 2019).
- Mr. Malouf had key roles at two firms:
  - 1. UASNM, Inc., an investment advisor;
  - 2. Branch manager at Raymond James, a broker dealer.

  Malouf saw a conflict between his roles, so he sold off the Raymond James branch for $1.1 million to be paid by the branch.

  After the sale, he steered bond trades made on behalf of UASNM to Raymond James, so they had enough money to pay him. He did not seek competing bids, even though UASNM required him to get 3 bids from 3 BDs before placing a trade.

  He did not disclose the conflict of interest to his clients.

  Mr. Malouf did not disclose the conflict to the Chief Compliance Officer of UASNM either.

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Tenth Circuit

- The S.E.C. filed an enforcement action, and an ALJ found that Mr. Malouf had (i) aided and abetted UASNM's violations of federal securities laws; and (ii) committed violations of his own. In his administrative appeal, the SEC agreed.
- He was barred from the securities industry, and ordered to disgorge $562,000 and pay a civil penalty of $75,000.

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Tenth Circuit

- On appeal, Malouf argued that the ALJ had been appointed in violation of the appointments clause, the SEC misinterpreted the securities laws, there was no evidence to support the findings, and the sanctions should be vacated.
- The 10th Circuit held that Malouf waived his appointments clause argument because he did not argue it below.
- The 10th Circuit also affirmed the SEC's findings that Mr. Malouf had failed to correct material misstatements made by UASNM. It did not matter that Mr. Malouf had not made the false statements. It failed to correct UASNM's false statements, which he knew were false.

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Utah Cases

- *Matthew Kessman v. Myriad Genetics, Inc., et al*. (D. Utah March 25, 2019).
  - Judge Kimball granted defendants' motion to dismiss.
  - Judge Kimball ruled that plaintiffs did not plead sufficient facts to establish that Myriad's statements about billing were false and illegal.
  - Judge Kimball ruled that plaintiffs did not plead sufficient facts to establish a strong inference of fraudulent intent.
  - Judge Kimball ruled that plaintiffs did not plead loss causation.

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Utah Cases

- *Matthew Kessman v. Myriad Genetics, Inc*., et al. (D. Utah March 25, 2019).
  - Myriad had publicly disclosed that it had been served with a subpoena from HHS.
  - Judge Kimball held that mere receipt of a subpoena was insufficient, particularly given Myriad's disclosure of the many risks associated with reimbursement.
  - "[T]he court finds Defendants' argument – that the disclosure of a single subpoena, without any other type of disclosure, is insufficient to reveal fraud to the market for purposes of showing loss causation – to be more persuasive."

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Utah Cases

- *Benjamin Ha v. Overstock.com* (D. Utah September 27, 2019).
  - The complaint alleged that in connection with Overstock's crypto currency project tZERO, Overstock "had engineered the tZERO offering as revenge upon short sellers and tried to create a short squeeze by offering a digital token dividend that would not be registered and could not be resold for at least 6 months. The lock-up period created by the issuance of an unregistered security effectively results in the inability of short sellers to deliver the security upon the surrender of their shares. Because a short seller is responsible for any dividends issued during the time when that seller has borrowed shares, the inability to obtain the locked-up digital token dividend made it impossible for short sellers to maintain their short positions. This was a significant issue, in part, because during the Class Period, Overstock was a heavily shorted stock."
  - "During the period when defendants were executing this short squeeze, and as shares of Overstock spoked in advance of the expected crypto Dividend date, however, investment banks began to make it know that they would accept cash in lieu of the crypto dividend. This alone had the effect of ending this short squeeze, but not before shares of the Company spoked up from $16 to almost $27.00 per share."
  - "Soon thereafter, on September 18, 2019, Overstock too relented and announced that it would modify the terms of its tZERO Dividend, and register such shares so as to avoid any lock-up. This too had the effect of ending the embargo against short sellers."
  - "The end of the short squeeze caused shares of the Company to immediately deflate. . . . Investors also ultimately learned was the SEC that quietly put a stop to Overstock's attempted market manipulation scheme."

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Utah Cases

- *Benjamin Ha v. Overstock.com* (D. Utah September 27, 2019).
  - "Thus, while failing to disclose the true risks inherent in defendants' plan, or the true plan itself, and the real motive for the tZERO Dividend, which was to punish short sellers for a decade long campaign against them for shorting Overstock and for being a market-check, or thorn in the side of defendant Byrne."
  - "While defendant Byrne had previously, at different times, launched into public tirades over short selling and naked short selling, the iZERO Dividend was his secret plot to finally obtain hegemony over them – and it almost worked."

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Utah Cases

- *Benjamin Ha v. Overstock.com* (D. Utah September 27, 2019).
  - The Complaint alleges that Byrne was selling stock while the SEC was objecting to the locked-up crypto dividends, that there were problems with Overstock's D&O insurance, and that the CFO "had abandoned the Company".
  - The Complaint alleges that the Company lacked an adequate system of internal controls necessary to prevent "Byrne from liquidating 100% of his $102 million worth of Overstock shares during the Class Period, while in possession of material adverse, non-public information about the Company."

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Utah Cases

- *Dale and Kareen Springer, et al. v. Zions Bancorporation* (January 15, 2019).
  - Plaintiffs filed a Complaint against Zions Bank alleging that Zions breached its fiduciary duties by letting fiduciary funds be diverted and used in a Ponzi scheme perpetrated by Gaylen Rust, his family, and Rust Rare Coin, Inc.
  - The SEC sued Rust and RRC on November 15, 2018.

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Other Utah Class Actions

- *Jarrett Patton v. Domo, Inc.*, (D. Utah October 17, 2019).
  - The complaint alleges that Domo's Form S-1 and prospectus in connection with the IPO was negligently prepared and contained untrue statements of material facts concerning the state of Domo's business.
  - The complaint alleges that the decline in Domo's revenues was later disclosed to the market.

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Other Utah Cases

- *Silverman v. Myriad* (September 27, 2019)
  - The Complaint alleges that the Myriad revealed that "the FDA requested changes to the GeneSight test offering."
  - The Complaint alleges that "Defendants disclosed that the FDA had questioned whether the validity of GeneSight's purported benefits had been established."
  - The Complaint alleges that these disclosures allegedly caused the stock to drop 42.76%.

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Other Utah-related cases

- On November 1, 2019, Pomerantz announced a securities class action against Vivint Solar, Inc.
- The case is filed in the Eastern District of New York.
- The complaint alleges that defendants made false and/or misleading statements and/or failed to disclose that: (i) the Company engaged in fraudulent practices, including forging customer contracts; (ii) as a result, the Company's reported sales and megawatts installed were overstated; (iii) these practices were reasonably likely to lead to regulatory scrutiny; (iv) as a result, the Company's earnings would be materially and adversely impacted; and (v) as a result of the foregoing, Defendants' positive statements about the Company's business, operations, and prospects were materially misleading and/or lacked a reasonable basis.

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Utah Supreme Court

- *Raser Technologies v. Morgan Stanley & Co, LLC* (Utah August 13, 2019).
  - Plaintiffs alleged that defendants devised and perpetrated a naked short selling stock manipulation scheme that targeted and intentionally destroyed Raser Technologies.
  - The question before the Utah Supreme Court was not whether the claims were valid, but whether a conspiracy theory of personal jurisdiction was valid and would be accepted in Utah.

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Utah Supreme Court

- *Raser Technologies v. Morgan Stanley & Co, LLC* (Utah August 13, 2019).
- The Court held: "After analyzing recent United States Supreme Court jurisprudence, we conclude that there is an articulation of the conspiracy theory of jurisdiction that comports with the due process principles of the Fourteenth Amendment."
- "And we hold that the Utah Nonresident Jurisdiction Act compels us to adopt the conspiracy theory of jurisdiction

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Utah Supreme Court

- *Raser Technologies v. Morgan Stanley & Co, LLC* (Utah August 13, 2019).
- Discussing *Walden v. Fiore* (U.S. 2014) and *Bristol-Myers Squibb Co. v. Superior Court* (U.S. 2017), the Supreme Court held that the focus is "on the defendant and the litigation-related contacts she makes with the forum."
- "Walden therefore makes clear that a defendant's knowledge of a plaintiff's connections to the forum state coupled with the plaintiff's suffering a foreseeable harm, cannot, by themselves, satisfy the minimum contacts analysis."
- "Plaintiffs' allegations that Defendants 'knew that Raser's headquarters was in Utah, and, accordingly, that a large number of insiders were located in Utah,' and that 'the scheme was intended to drive [Raser] into bankruptcy,' which resulted in injuries suffered in Utah, without more, is insufficient."

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Utah Supreme Court

- *Raser Technologies v. Morgan Stanley & Co, LLC* (Utah August 13, 2019).
- The Court, however, after supplemental briefing, went on to consider conspiracy jurisdiction.
- "We conclude that a conspiracy theory of jurisdiction can satisfy due process concerns."
- "*Walden* and *Calder* therefore indicate that the acts of a third-party – such as an agent – can, in some circumstances, provide a basis to exercise jurisdiction over an out-of-state defendant. And because a conspiracy is a type of agency relationship, an act taken during the course of a conspiracy relationship may lead to specific personal jurisdiction over a defendant."
- "The practical application of this is that if Plaintiffs can establish specific jurisdiction over a single defendant, they might be able to demonstrate that the defendant was acting as an agent of some of the other defendants. For example, if jurisdiction can be properly exercised over Merrill, Walden permits plaintiffs to attempt to show that Merrill acted as an agent for Merrill Pro, Merrill International, and Goldman Sachs, and that those defendants expressly aimed their conduct towards Utah through Merrill"

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Utah Supreme Court

- *Raser Technologies v. Morgan Stanley & Co, LLC* (Utah August 13, 2019).
- "While Utah courts have apparently not yet opined that conspirators are considered agents for jurisdictional purposes, other jurisdictions have already reached this conclusion."
- "[T]he 'relationship between co-conspirators required by the conspiracy theory' ensures that if a co-conspirator is subjected to personal jurisdiction of a forum state, that a co-conspirator 'has fair warning that he or she could be subjected to suit in the forum state sufficient to satisfy the due process concerns about fair warning of the possibility of suit."
- "By the terms of the conspiracy theory, a co-conspirator to whom the acts of another co-conspirator are attributed must have agreed to participate in a conspiracy that he or she could reasonably have expected at the time of agreement to involve the forum-related actions attributed to him or her. The acts attributed are not simply unilateral acts of the co-coconspirator who literally performed them, but are also the acts of the other co-conspira

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Utah Supreme Court

- Here is the test from *Raser Technologies v. Morgan Stanley & Co, LLC* (Utah August 13, 2019).
- "We therefore adopt a conspiracy theory of jurisdiction that focuses on whether the defendant could have reasonably anticipated being subject to jurisdiction in the forum state because of her participation in the conspiracy. To assert specific personal jurisdiction, the plaintiff must plead with particularity that (1) the defendant is a member of a conspiracy, (2) the acts of the defendant's co-conspirators create minimum contacts with the forum, and (3) the defendant could have reasonably anticipated that her co-conspirator's actions would connect the conspiracy to the forum state in a meaningful way, such that she could expect to defend herself in that forum."
- "[A] plaintiff who seeks to establish jurisdiction over a defendant based on a co-conspirator's contacts must plead, at a minimum, that the defendant knew his co-conspirator was carrying out acts in furtherance of the conspiracy."

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Utah Court of Appeals

- *State of Utah v. Tonia Schnae Brown* (Ut. Ct. App. July 18, 2019).
  - Brown was convicted of securities fraud.
  - She claimed that she had $50 million in a bank in Saint Vincent and the Grenadines, as well as $300,000 in the Bank of China in Hong Kong.
  - She represented she owed $59,500 in VAT taxes to Hong Kong.
  - She told victims that she would give them $1 million if they would wire the VAT tax.
  - The first victim did so. The second victim wired $80,500 for VAT. The third victim wired $140,000.
  - Bryan Allen was the securities expert for the prosecution.
  - After her conviction, Brown said that Allen offered inappropriate expert testimony, in terms of legal opinions.
  - The Court of Appeals discussed both State v. Tenney (Utah Ct. App. 1996) and State v. Larsen (Utah 1993) to establish whether the testimony was proper.
  - The Court of Appeals that Allen's testimony was find "[b]ecause rule 704 permits expert testimony 'regarding the ultimate resolution of that disputed issue as long as that testimony is otherwise admissible under the ru of evidence."

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Utah Court of Appeals

- *State of Utah v. Tonia Schnae Brown* (Ut. Ct. App. July 18, 2019).
  - Allen's testimony was fine because he testified how fraud was defined in the securities industry.
  - Allen testified what would be material to an investor.
  - He did not give opinions of law.
  - He tied his opinions to the securities industry.

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A Decision of Local Interest

- *S.E.C. v. Alpine Secs. Corp*. (2nd Cir. May 28, 2019).
  - Affirmed the decision of Judge Denise Cote granting the SEC's motion to enjoin Alpine from prosecuting a separate action in the District of Utah against the SEC, which had sought to challenge the SEC's statutory authority to sue Alpine.
  - The District Court held that the Utah case was a "transparent attempt to relitigate rulings in this action unfavorable to Alpine."

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Other Notable Decisions

- *Singh v. Cigna Corp*. (2nd Cir. 2019).
  - Second Circuit held that plaintiffs failed to identify a materially false statement as a matter of law when they alleged that Cigna's statements about its commitment to regulatory compliance procedures were materially misleading in light of an undisclosed history of non-compliance with Medicare regulations.
  - The statement as deemed "puffery."

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