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Litigation & Arbitration Group

Client Alert

Securities Class Actions Arising from the COVID-19 Pandemic

April 21, 2020

Contact

Scott A. Edelman, Partner & Chairman
+1 212.530.5149
sedelman@milbank.com

Daniel M. Perry, Partner
+1 212.530.5083
dperry@milbank.com

Jed M. Schwartz, Partner
+1 212.530.5283
jschwartz@milbank.com

William Charles, Partner
+44 20.7615.3076
wcharles@milbank.com

Ryan McKenney, Associate
+1 212.530.5445
rmckenney@milbank.com

Andy Levett, Associate
+44 20.7615.3091
alevett@milbank.com

The ongoing COVID-19 pandemic has caused the sharpest declines in stock market valuations since the 2008 financial crisis and subsequent recession. Financial crises and stock market turbulence often give rise to securities claims by shareholders and other investors in public companies. These claims primarily involve shareholders claiming that companies made material misstatements or omissions in public filings, in essence deceiving shareholders by not giving them adequate information about the risks to which the company was exposed.

In the case of the economic crisis caused by the COVID-19 pandemic, shareholders may claim that a company or its directors made false statements regarding the company and the risks that it faced and/or failed to provide adequate disclosures regarding those risks that have now materialized.

The US is the most developed jurisdiction for these types of claims but, in recent years, there has been an increase in claims along these lines in the UK.

(A) The scope for securities claims in the US

There have already been reports of at least two securities class actions stemming from the COVID-19 crisis being filed in US courts. These claims reportedly concern allegations that: (a) Norwegian Cruise Lines deceived investors by failing to disclose certain assurances made to customers about COVID-19 that proved false; and (b) the CEO of a biotech company, Inovio, made false statements regarding the development of a vaccine for COVID-19, leading to significant volatility in the price of the company's shares.

Unlike the 2008 financial crisis, COVID-19 is a public health emergency that has spurred economic upheaval due to companies having to either close their doors for a prolonged period or having their regular business practices seriously disrupted. The pandemic itself, rather than any alleged systemic fraud, has caused the stock market volatility.

This may make it very difficult for parties to claim that any particular alleged misstatement or omission caused an investor's loss. As a result, prospective plaintiffs may be less willing to bring securities class actions under Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), under which they bear the burden of proving the cause of investment losses, preferring instead to bring securities claims under Section 11 and 12(a)(2) of the Securities Act of 1933 (the "Securities Act"). Although the Securities Act is more limited in scope—for example, it only covers securities actually issued pursuant to the relevant offering materials—plaintiffs asserting those claims do not have the burden of proving that the alleged misstatements or omissions actually caused their claimed loss. These differing burdens, coupled with the ability of plaintiffs to file Securities Act class actions in state courts, may lead to an increase in Securities Act-only claims throughout the country. This underscores the importance of issuers amending their articles of incorporation to make federal court the exclusive venue for Securities Act claims, as discussed in our previous client alert here.

Section 10(b) of the Exchange Act prohibits material misstatements and omissions in connection with the purchase or sale of a security, providing an implied private right of action for actual purchasers and sellers of securities to recover damages. An element of any Section 10(b) claim is loss causation, which requires that a plaintiff establish that the alleged material misstatement or omission at issue caused subsequent economic harm. To satisfy this requirement, a plaintiff must allege and prove that (1) the misstatement or omission artificially inflated the price of the stock or security that the plaintiff purchased; (2) the market learned of the misstatement or omission, resulting in a stock price decline; (3) the decline in stock price was caused by the fraud's revelation and not by other unrelated market factors such as changed economic circumstances or changed investor expectations.[1] Given the numerous other factors that have affected the markets during the recent period, proving that any particular amount of a decline in a security's price was caused by the fraud's revelation will be extremely difficult, if not impossible. Indeed, as the Second Circuit has noted, when the plaintiff bears the burden of proving loss causation, a "*financial crisis may stand as an impediment to proving loss causation because it can be difficult to identify whether a particular misstatement or macroeconomic forces caused a security to lose value in the fog of a coincidental market-wide downturn*."[2]

In contrast to claims brought under Section 10(b) of the Exchange Act, claims under Sections 11 and 12(a)(2) of the Securities Act ***do not*** require the plaintiff to prove that their damages were caused by a misstatement or omission. Rather, each provision contains a statutory scheme for measuring how much a successful plaintiff can recover. Under Sections 11 and 12(a)(2) of the Securities Act, defendants are provided with an affirmative defense allowing them to disprove that a decline in a security's price was caused by an alleged misstatement or omission.[3] This "*negative causation*" defense has been referred to as a "*mirror image*"[4] of loss causation under Section 10(b) of the Exchange Act, and for the same reasons that proving loss causation under Section 10(b) of the Exchange Act may be difficult, disproving damages under Sections 11 and 12(a)(2) of the Securities Act may be just as difficult.

Given the foregoing, there may not be the same flood of Section 10(b) of the Exchange Act cases that was seen in the aftermath of the 2008 financial crisis. However, the sharp economic downturn will likely mean that many companies may need to access the public capital markets over the next few months. If stock prices continue to decline, plaintiffs may choose to file cases under Sections 11 and 12(a)(2) of the Securities Act, putting the heavy burden on defendants to disprove damages rather than plaintiffs taking on that burden themselves under Section 10(b) of the Exchange Act.

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[1] *Dura Pharms, Inc. v. Broudo*, 544 US 336, 345-46 (2005).
[2] *Fed. Hous. Fin. Agency for Fed. Nat'l Mortg. Assoc. v. Nomura Holding Am., Inc.*, 873 F.3d 85, 155 (2d Cir. 2017).
[3] 15 U.S.C. § 77/(b); *Iowa Public Employees' Ret. Sys. v. MF Global Ltd.*, 620 F.3d 137, 145 (2d. Cir. 2010).
[4] *In re Barclays Bank PLC Sec. Litig.*, No. 09 CIV. 1989 (PAC), 2017 WL 4082305, at *20 n.29 (S.D.N.Y. Sept. 13, 2017), *aff'd*, 756 F. App'x 41 (2d Cir. 2018), *as amended* (Nov. 20, 2018)

(B) The scope for securities claims in the UK

The shareholder claims and securities litigation landscape in the UK is in a relatively early stage of development. Despite an increase in such claims since the 2008 financial crisis, there is currently only one securities class action which has reached trial and judgment.[5] However, the principal causes of action – under the Financial Services and Markets Act 2000 ("FSMA") – bear some similarities with the statutory regime in the US (as well as some important differences).[6]

Section 90 FSMA provides a remedy for investors who acquire securities (or who contract to acquire securities or any interest in them), and suffer losses consequent on false or misleading statements in, or the omission of required information from, a prospectus or listing particulars (original or supplementary) concerning those securities. The claims can be brought against any person responsible for the relevant document, including the issuer itself and any others stated as having responsibility for the contents of the document, such as (potentially) the issuer's directors and sponsors. Among other statutory defences, a person will not incur liability under s.90 FSMA for loss caused by a statement if he or she reasonably believed that the statement was true and not misleading.[7] Importantly, there is no express requirement in s.90 FSMA for claimants to demonstrate that they relied on the false or misleading statement, or the omission, in acquiring the securities. Although authority on such claims is very limited, it is notable that the claimant shareholders in the *RBS Rights Issue Litigation* advanced their claims against both RBS and the bank's former directors under s.90 FSMA, alleging that the prospectus that accompanied the £12 billion RBS rights issue in April 2008 contained misleading information on the financial condition of RBS in the context of the global financial crisis. The case settled in 2017, shortly before trial.

Section 90A FSMA provides a remedy for buyers, sellers or holders of securities who suffer losses resulting from untrue or misleading statements in, or omissions from, company announcements (not limited to a prospectus or listing particulars), where a "*person discharging managerial responsibilities*" (principally, the issuer's directors) knew that, or was reckless as to whether, the statement in question was untrue or misleading, or dishonestly omitted any required information. Unlike the s.90 FSMA regime, claims under s.90A FSMA may only be brought against issuers; and, importantly, claimants must establish that they relied on the statement or omission in connection with buying, selling or holding the securities in question. Again, authority on such claims is very limited. However, we note that institutional investors are currently pursuing claims against Tesco Plc under s.90A FSMA, alleging that they sustained losses as a result of knowingly false statements and dishonest omissions by Tesco in its 2014 financial reporting which, on the investors' case, were intended to conceal substantial declines in Tesco's business.[8] The trial is currently listed to take place in October 2020.

It appears that claims under both s.90 and s.90A FSMA require claimants to establish that their losses were ***caused*** by the misleading statement or omission (although there is currently only very limited authority on this). If correct, this is an important difference from claims under Sections 11 and 12(a)(2) of the Securities Act in the US, and may reduce the attractiveness under English law for claims in the context of the market turmoil caused by the COVID-19 pandemic.

(C) Conclusions

Crises which disrupt stock market valuations have been shown to create fertile territory for securities litigation. Even though this trend is much more prevalent in the US, it is important that companies do not ignore the increasing number of such claims in the UK. Although the COVID-19 pandemic is understandably

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[5] *Sharp v Blank* [2019] EWHC 3078 (Ch) (the *Lloyds/HBOS Litigation*).
[6] English law also recognizes causes of action at common law (for example, in negligent misstatement and deceit) but the primary causes of action are the statutory claims under FSMA.
[7] See Schedule 10 FSMA 2000.
[8] *The SL Claimants & Ors v Tesco PLC* [2019] EWHC 2858 (Ch).

apt to focus attention on other issues, companies should be assiduous in taking steps to minimise the risks of private securities claims (and/or regulatory investigations). Accordingly, companies must be careful to ensure that their market disclosures relating to COVID-19 are accurate, particularly in the context of accessing public capital markets. This includes examining whether previous disclosures which are forward-looking remain accurate. Moreover, company directors should take the utmost care in documenting their response to the COVID-19 pandemic and evaluating its effects on the business.

Companies must also be aware of the moratoria and other temporary measures instituted by US and UK regulatory authorities in respect of financial reporting and other disclosures.[9]

[9] In relation to UK measures, please refer to our separate client alert on these issues. Moreover, it is important to note that none of these measures affects existing obligations under the Market Abuse Regulation (MAR) to announce inside information to the market as soon as possible, unless there is a valid reason to delay disclosure. For information on US measures, please refer to our client alert on SEC Guidance on COVID-19 related disclosure considerations.

Key Contacts

New York	55 Hudson Yards, New York, NY 10001-2163	
Scott A. Edelman	sedelman@milbank.com	+1 212.530.5149
Daniel M. Perry	dperry@milbank.com	+1 212.530.5083
Jed M. Schwartz	jschwartz@milbank.com	+1 212.530.5283
Ryan McKenney	rmckenney@milbank.com	+1 212.530.5445

London	10 Gresham Street, London EC2V 7JD	
William Charles	wcharles@milbank.com	+44 20.7615.3076
Andy Levett	alevett@milbank.com	+44 20.7615.3091

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