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The Bulletin is a quarterly newsletter by Kessler Topaz Meltzer & Check to help institutional investors stay

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HIGHLIGHTS

KTMC LEADS $13 BILLION TRIAL AGAINST ELON MUSK

Lee Rudy, Esquire

For two weeks in July 2021, a team of Kessler Topaz lawyers and their co-counsel sought to convince a Delaware court that Elon Musk, the founder and CEO of Tesla, forced Tesla to bail out his cousins' failing solar installation company. Tesla paid $2.4 billion for SolarCity in 2016; plaintiffs allege that at that time, SolarCity was insolvent and its equity was therefore worthless.

Tesla bought SolarCity using Tesla stock as merger consideration. Musk personally received 12 million Tesla shares in the transaction, in exchange for his 22% stake in SolarCity. Those shares, worth $400 million in 2016, are now worth $13 billion. At trial, plaintiffs sought equitable remedies including cancellation of all of the shares Musk improperly received in the transaction.

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THE STEWARDSHIP PROFESSION — A MANIFESTO

Guest Authors: Dr. Alexander Juschus LL.M. and Mike Lubrano

Stewardship is Fiduciary Duty in Action

"Investor Stewardship" is a comparatively new term in the lexicon of capital markets, but stewardship itself is not a new concept. The word "stewardship" goes back to at least the Middle Ages, with echoes of knights left behind to care for their lords' lands while the latter were off doing silly things, like making war on neighboring kingdoms or fighting far-off crusades. Merriam-Webster defines stewardship to mean "the careful and responsible management of something entrusted to one's care". In the context of capital markets, investor stewardship is fiduciary duty in action — it's what those who manage assets on behalf of others are obligated to do to protect such assets' value, for the benefit of their ultimate owners.

The International Corporate Governance Network first issued

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"CRYPTOCURRENCY TRIAL OF THE CENTURY": *SEC V. RIPPLE LABS, INC.* AND THE FUTURE OF CRYPTO LITIGATION

Eli Greenstein, Esquire

Regulation of cryptocurrencies and digital assets was recently described by the new Chairman of the Securities Exchange Commission as the "Wild West."[1] As of December 2021, the market for cryptocurrencies included nearly 12,000 crypto tokens worth over $2 trillion.[2] Given the "virtual" nature of crypto assets and the complexity of new "blockchain" technologies, cryptocurrency offerings potentially implicate many different legal regimes — securities laws, banking regulations, and commodities laws, to name a few. The meteoric rise in crypto investments since 2017 has forced regulators around the world to move quickly to protect investors and address unique legal and regulatory challenges facing the fast-paced crypto markets.

In November 2021, President Biden's Working Group on Financial Markets, an interagency body chaired by Treasury Secretary Janet Yellen involving the SEC, CFTC, Federal Reserve, FDIC, and the OCC, issued a report recommending legislation that would require issuers of "stablecoins" — cryptocurrencies that are pegged to the U.S. dollar — to effectively be treated more like banks in order to guard against runs in the cryptocurrency market. Secretary Yellen noted that "[c]urrent oversight is inconsistent and fragmented, with some stablecoins effectively falling outside the regulatory perimeter" and the "absence of appropriate oversight presents risks to users and the broader system."[3]

One of the hotly contested legal issues surrounding the crypto market is whether offers and sales of crypto assets are considered "securities" under the federal securities laws and thus subject to myriad registration, disclosure, and anti-fraud requirements. Although the SEC has brought dozens of cases involving crypto assets since 2013, it has largely taken a "facts and circumstances" approach to enforcement, creating substantial uncertainty for issuers and market participants alike.[4] In the absence of bright line regulations, the SEC's enforcement actions provide important guidance regarding the application of its fact-based standards.

One recent high-profile enforcement action, *SEC v. Ripple Labs, Inc.*, No. 20-CV-10832 (S.D.N.Y.) has garnered significant attention and may have far-reaching implications in the crypto space. The litigation has been particularly hard-fought, giving rise to contentious disputes regarding, *inter alia*, the discoverability of the SEC's internal communications and analyses surrounding its policy decisions pertaining to crypto regulation as a whole.[5] The Court presiding over the action has observed that "the nature of the case involves significant policy decisions in our markets" and "the public's interest in resolution of this case is also quite significant."[6] Understanding the facts and legal landscape surrounding the *Ripple* action and the complex nature of crypto-asset technologies is critical to assessing the future of legal and regulatory challenges in the burgeoning crypto market.

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[1] Statement from Chair Gary Gensler, Remarks Before the Aspen Security Forum, SEC (Aug. 3, 2021), https://www.sec.gov/news/public-statement/gensler-aspen-security-forum-2021-08-03.

[2] Akshay Chinchalkar, *Crypto Barrels Toward 2022 After Adding $1.5 Trillion in Value*, Bloomberg (Dec. 19, 2021, 9:01 PM PST), https://www.bloomberg.com/news/articles/2021-12-20/cryptocurrencies-and-bitcoin-btc-2021-year-in-charts.

[3] Press Release, U.S. Treasury Dept., President's Working Group on Financial Markets Releases Report and Recommendations on Stablecoins (Nov. 1, 2021), https://home.treasury.gov/news/press-releases/jy0454.

[4] Statement from Chair Gary Gensler, *supra* note 1.

[5] *See SEC v. Ripple Labs, Inc.*, No. 20-CV-10832 (AT) (SN), 2022 U.S. Dist. LEXIS 6999, at *3-4 (S.D.N.Y. Jan. 13, 2022) (granting discovery).

[6] SEC's Motion to Quash Conference Transcript, *SEC v. Ripple Labs, Inc.*, No. 20-CV-10832 (S.D.N.Y. July 25, 2021), ECF No. 269 at 40:4-8.

KTMC SECURES $124 MILLION TENTATIVE SETTLEMENT WITH CARDINAL HEALTH DIRECTORS, AMIDST BROADER PUSH FOR CORPORATE ACCOUNTABILITY FOR THE NATION'S OPIOID EPIDEMIC

Justin Reliford, Esquire

Since 2017, litigation in connection with America's opioid epidemic has proliferated, as regulators, Attorneys General, and private litigants seek to impose greater corporate accountability for the nationwide crisis. KTMC and its clients are currently prosecuting two derivative actions against the directors and officers of two of the nation's biggest opioid distributors seeking to do just that.

In a shareholder derivative action captioned *In re Cardinal Health, Inc. Derivative Litigation*, Case No. 2:19-cv-2491 (S.D. Ohio), KTMC is prosecuting claims against current and former fiduciaries of Cardinal Health for failing to properly oversee the company's compliance with laws regulating the distribution of controlled substances. The suit, which has been ongoing since 2019, has been in discovery since the court's February 2021 ruling substantially denying defendants' motion to dismiss. As Cardinal Health recently announced in its February 3, 2022, quarterly filing with the SEC, the parties have agreed to a $124 million tentative settlement that would fully resolve the action. The settlement, which remains subject to final documentation and court approval, will be one of the top 12 largest derivative settlements in US history.[1]

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[1] K. LaCroix, "Largest Derivative Lawsuit Settlements," The D&O Diary, available at https://www.dandodiary.com/2014/12/articles/shareholders-derivative-litigation/largest-derivative-lawsuit-settlements/ (last updated Nov. 7, 2021).

BOEING V. BRADWAY — THE LIMITS OF FORUM SELECTION CLAUSES

Kevin Cunningham, Jr., Esquire

I. Introduction

Forum selection clauses are a key tool in protecting the interests of all parties when negotiating a contract or agreement. When used collaboratively, they allow all sides of an agreement to confer and agree upon which forum would be most conducive to settling any disputes that may arise out of the contract. However, such clauses are often used offensively as well — the choice of forum can have a significant impact on leverage, strategy, and expense. Therefore, it is often the case that parties on opposite sides of a negotiation place a premium on having their preferred forum make it into any choice of forum provision, given the clear advantages.

One way choice of forum clauses can be used offensively is to intentionally restrict parties from litigating certain claims in federal court, mandating that all relevant claims be brought in a state court instead. However, if federal courts have exclusive jurisdiction over the claims being brought, applying the choice of forum provision could result in a plaintiff having *no* proper forum to bring her claim. The United States Court of Appeals for the Seventh Circuit addressed this very scenario in *Seafarers Pension Plan on behalf of The Boeing Co. v. Bradway,*[1] and held that Boeing could not use a forum selection clause to prohibit stockholders from bringing exclusively federal claims in a federal court.

II. Factual Background

This matter initially arose as a shareholder derivative lawsuit following the Boeing 737 MAX crashes that

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[1] No. 20-2244, 2022 WL 70841 (7th Cir. Jan. 7, 2022)

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Trial in this matter was originally scheduled for March 16, 2020. As many will recall, mid-March 2020 was when the United States was suddenly forced to confront the growing COVID-19 pandemic. Sectors of the economy shut down one after another as the severity of the pandemic became clearer and clearer. The plaintiffs' trial team spent that week huddled in a conference room (sharing food, sitting shoulder to shoulder, not wearing masks) preparing for trial. The last day before trial was set to commence, Friday the 13th of March, the Court apprised the parties that it would be postponing the trial.

Plaintiffs had originally brought the case against Tesla's full board of directors. Plaintiffs accused the other board members of rolling over to Musk's urging that Tesla buy SolarCity, even though they knew it was not in Tesla's business interests. Shortly before the original March 2020 trial date, the other defendants agreed to settle for $60 million in cash. That left Musk as the only defendant heading to trial.

The trial was held in the Delaware Court of Chancery in Wilmington, Delaware, before Vice Chancellor Joseph R. Slights III. Vice Chancellor Slights acted as the fact-finder, in lieu of a jury. The trial began with Elon Musk, who spent a day and a half on the witness stand. Among other things, Musk was confronted with the impetus for the merger, namely that SolarCity was struggling and needed either to go back to the equity markets or to be sold. Plaintiffs later presented expert testimony that SolarCity was incapable of raising money from the equity markets because of its precarious financial position. Among other things, SolarCity's financial advisor testified that he canvassed the markets and was unable to find anyone other than Tesla, Musk, or Musk's cousins who was willing to invest in SolarCity.

The court heard from another dozen or so trial witnesses besides Musk. Plaintiffs presented an expert on the solar industry, and a financial expert who valued SolarCity at between $0 per share and $10 per share, as opposed to the merger price of $21 per share. Musk's cousins, Lyndon and Peter Rive, ran SolarCity and admitted that it faced significant liquidity challenges when acquired. SolarCity's CFO, however, testified that the company would have been fine. Musk presented a financial expert who opined that the merger price was fair. Tesla's financial advisor Evercore, while advising the Tesla board that the merger was fair, was forced to admit that Evercore worked closely with Musk while conducting its analyses, even though Tesla stockholders were told that Musk was recused. Tesla's other board members were confronted with their overlapping social and business interests with Musk.

After the last witness testified, the parties spent the next several months exchanging post-trial briefs. The parties exchanged opening, responding, and reply briefs in September, November, and December 2021. The Court then heard post-trial oral argument for three hours on January 18, 2022.

The Court will likely issue its post-trial opinion by May 2022. The first question the Court will need to answer is whether the merger was "entirely fair," in both process and price. If the merger was not entirely fair, then plaintiffs will have won the liability case, and the Court will then determine what the fair price actually was in determining damages.

KTMC was very proud of its team of lawyers and support staff who helped put this trial together. We have our fingers crossed and are hopeful that the Court will find that the merger was not entirely fair to Tesla and its public stockholders, and will order Musk to pay substantial damages. ■

RECENT DEVELOPMENTS IN SECURITIES CLASS CERTIFICATION LAW AFFIRM THAT GENERIC MISSTATEMENTS CAN CAUSE PRICE IMPACT

Karissa J. Sauder, Esquire, and Barbara A. Schwartz, Esquire

The Supreme Court's June 2021 decision in *Goldman Sachs Group, Inc. v. Arkansas Teacher Retirement System*, 141 S. Ct. 1951 (2021), provided updated guidance on rebutting the fraud-on-the-market doctrine's presumption of classwide reliance at the class certification stage. As the Supreme Court previously explained, defendants can try to rebut this presumption of classwide reliance by proving that their alleged misstatements did not impact the price of the company's stock. In *Goldman*, the Supreme Court instructed that courts must consider all evidence relevant to price impact, including whether defendants' statements were so generic that they could not have impacted the company's stock price. However, as subsequent developments in the case have demonstrated, the Supreme Court's opinion confirms that plaintiffs can continue to establish classwide reliance on even generic misrepresentations. The nature of a statement is a factor, not a bright line, under *Goldman*.

The *Basic* Presumption

Plaintiffs seeking to certify a securities fraud case as a class action must show that "questions of law or fact common to class members predominate over any questions affecting any individual members."[1] In *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), the U.S. Supreme Court provided that courts can presume the reliance element under Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act")[2] on a classwide basis if the plaintiffs establish that: (1) the defendants' false statements were publicly known; (2) the relevant shares traded in an efficient market; and (3) the plaintiffs purchased their shares at the market price after the misrepresentations were made but before the truth was revealed.[3] This presumption is based on the fraud-on-the-market theory, which provides that "investors presume that theoretically efficient markets, such as the New York Stock Exchange or NASDAQ, incorporate all public information — including material misstatements — into a share price."[4] In other words, because the price of a security is determined by all available material information regarding the company, misleading statements can defraud the market whether or not any individual investor specifically relied on those misstatements.

The Supreme Court reiterated these principles in *Halliburton Co. v. Erica P. John Fund, Inc.*, 574 U.S. 258 (2014), where defendants argued that, in order to invoke the *Basic* presumption, plaintiffs should be required to prove directly that the defendants' misstatements affected the market price of the relevant securities. The Court rejected this argument, explaining that "[u]nder *Basic*'s fraud-on-the-market theory, market efficiency and the other prerequisites for invoking the presumption constitute an indirect way or showing price impact," and that it is therefore "appropriate to allow plaintiffs to rely on this indirect proxy for price impact, rather than requiring them to prove price impact directly."[5] Nevertheless, defendants may rebut the presumption by proving an absence of price impact — i.e, "that the *entire* price decline on the corrective-disclosure

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1 Fed. R. Civ. P. 23(b)(3).

2 To establish liability under Section 10(b), a plaintiff must show that: (1) the defendant made a material misrepresentation or omission; (2) the misrepresentation or omission was made with an intent to deceive, manipulate or defraud; (3) there is a connection between the misrepresentation or omission and the plaintiff's purchase or sale of a security; (4) the plaintiff relied on the misrepresentation or omission; (5) the plaintiff suffered economic loss; and (6) there is a causal connection between the misrepresentation or omission and the plaintiff's loss. *See Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 341–42 (2005).

3 *Basic*, 485 U.S. at 248-49.

4 *Arkansas Teacher Ret. Sys. v. Goldman Sachs Grp., Inc.*, 955 F.3d 254, 261 (2d Cir. 2020).

5 *Halliburton*, 573 U.S. at 278-81.

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Global Stewardship Principles in 2003, revising them most recently in 2020. The UK's Financial Reporting Council issued the first national Stewardship Code in 2010. Since then, not only standard-setters and regulators but also institutional investors themselves in over twenty other markets have articulated what they believe institutional investors must do effectively to be considered good stewards of the assets they manage. The best of these set expectations around institutional investors' own governance, clear and consistent policies for evaluating and monitoring the environmental, social and governance (ESG) practices of investee companies, investor-company engagement, share voting, and transparency to beneficiaries about stewardship policies, activities and outcomes.

The Tools of the Trade

Legal frameworks, corporate charters and loan agreements accord equity and debt investors alike a variety of powers to impact the behavior of portfolio companies. For shareholders, these powers range from the exercise of voting rights, to the introduction of resolutions and participation in shareholder meetings, all the way to pursuing redress through derivative actions and class action litigation. Holders of debt instruments are accorded specific rights in loan agreements and bond indentures. Like shareholders, they have access to courts to seek protection of the benefits of their bargain with investee companies.

Investors can also influence the direction and behavior of companies through various forms of direct and indirect, one-on-one and collective engagement. Some investor-company engagements are conducted privately. Others take place in the public forum and can also involve non-investor stakeholders with an interest in the company's approach to ESG issues.

Taken together, the "hard power" of legal rights and enforcement actions and the "soft power" of private and public engagement and cajoling, comprise the toolkit of investor stewardship.

Investor Stewardship is a Profession

As the concept of investor stewardship gained greater acceptance over the course of the past couple of decades, institutional investors gradually responded by more explicitly accepting and assigning responsibility for stewardship and ESG integration in their operations. The authors' Outlook contacts are replete with senior managers at large, mid-size and smaller asset owners and fund managers with "stewardship" in their job titles. Others have titles including terms like ESG or sustainability, but whose responsibilities clearly revolve around stewardship. Judging by the number of LinkedIn postings for stewardship, ESG and sustainability positions, this trend is accelerating. Alongside the evident growth of stewardship specialization within institutional investors, service providers and consultants have expanded their stewardship-related services, products and marketing. (Full disclosure: the authors are both affiliated with a consulting firm that includes stewardship in its very name.)

But including a term in the title of a lot of professionals does not by itself make the concept behind that term a profession. Jaded human resource experts will tell you that job titles are sometimes faddish and fanciful. For something to truly amount to a profession, it must involve a common core of acquired knowledge, skills and behaviors, by individuals who regard their activities as a vocation (or even a calling), and that are recognized by others as valued expertise. These three elements of a profession are often reinforced by a fourth — a formal, recognized qualification.

A single individual can profess more than one vocation. A plumber can also be a carpenter. Indeed, it's probably a good idea to seek out a plumber-carpenter when considering putting in new bathroom and kitchen cabinets. Again, perusing through our Outlook and LinkedIn contacts, we see stewardship practitioners with educational and experiential backgrounds in law, accounting, business, finance, environmental science, and a variety of other technical scientific and social science disciplines. This is unsurprising — the broad spectrum of environmental, social and governance topics germane to investors' analysis and engagement with companies militates for bringing into the stewardship fold experts from a range of other disciplines. What they have in common is that they are all working towards the same objective — effectively looking out for the long-term interests of beneficiaries by incorporating ESG in the investment process and engaging with portfolio companies on issues that matter.

Notwithstanding the multi-disciplinary nature of much of the practice of stewardship, we assert that investor stewardship today meets all the requirements to be recognized as a true profession:

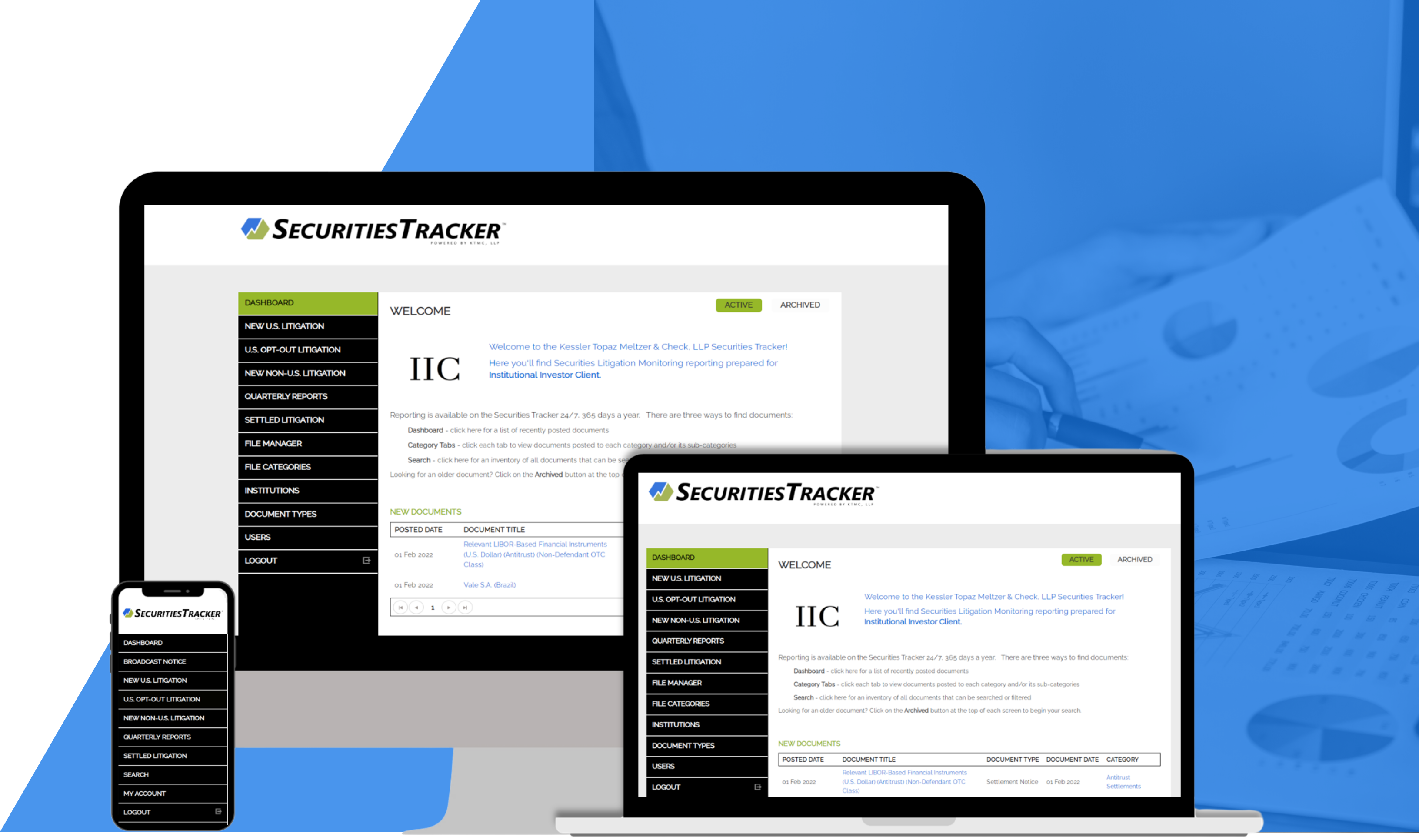
- Its practitioners have (or should have) a core set of knowledge and skills relevant to the central environmental (including climate), social and corporate governance topics around which institutional investors' analysis and engagement with portfolio companies revolve. While no one can be an expert in all these areas, true stewardship professionals possess a workable understanding of issues, standards and reporting frameworks applicable to each of them;
- Those engaged in the vocation of stewardship share a common understanding of the hard power and soft power tools of their trade; and
- Others, especially in the leadership of institutional investors, but also their beneficiaries and the broader set of stakeholders, value the expertise and experience that stewardship professionals bring to the investment process and to the investor-company relationship.

Cultivating the Stewardship Profession: StePs© — the Association of Stewardship Professionals

Just as with other recognized professions, investor stewardship stands to benefit from an institution that brings together practitioners, as well as people outside the profession, to improve the quality of training and education, establish professional qualifications and credentials, and support practitioners in career development. With these objectives in mind, a group of respected stewardship professionals from a variety of institutions came together in 2021 and conceived StePs© — the Association of Stewardship Professionals.

With the support of a set of farsighted and generous donors (including Kessler Topaz Meltzer and Check), StePs' central undertaking is to develop a rigorous internationally-recognized professional credential for stewardship practitioners — the Certified Stewardship Professional (CSP©). The educational requirements for the CSP© are expected to revolve around four core pillars of knowledge and skills related to the stewardship toolkit. The educational requirements for the CSP© will build on curricula already being delivered by respected providers of training on environmental sustainability, socially-responsible investment and good corporate governance (such as the International Corporate Governance Network's signature Governance, Stewardship and Sustainability course). StePs© is to be a global institution, availing itself of blended and distance learning technologies to ensure accessibility in all capital markets. The examinations will be overseen by independent experts, with StePs© ultimately seeking formal ISO certification for the CSP© qualification itself.

In addition to providing stewardship professionals with a platform for trainings, testing and credentialling, as a not-for-profit member association, StePs© will serve as a natural focal point for promoting high ethical standards and broad recognition of the stewardship profession. On its own and in collaboration with partners in related fields, StePs© will conduct surveys and sponsor research in areas of interest to stewardship practitioners. By supporting the profession, StePs© will contribute to achieving the central objective of all stewardship practitioners — accelerating progress toward a more accountable and responsible capital market. ■



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"CRYPTOCURRENCY TRIAL OF THE CENTURY": *SEC V. RIPPLE LABS, INC.* AND THE FUTURE OF CRYPTO LITIGATION

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Understanding Cryptocurrencies

Crypto assets, which are also called "cryptocurrencies," "coins," or "tokens" are decentralized digital commodities that rely on a technology called the "blockchain." A blockchain is a decentralized or "distributed" electronic ledger and peer-to-peer database spread across a network of computers that uses cryptographic techniques to provide secure tracking of ownership and transfer of digital asset transactions in unchangeable, digitally recorded data packages. The blockchain mechanism facilitates the use of crypto assets as secure stores of value and means of exchange that do not rely on centralized government or private control. Blockchains and distributed ledger technologies provide the potential to share information, transfer value, and record transactions in a decentralized digital environment.

Two of the most widely known crypto assets are Bitcoin and Ethereum. Bitcoin is a cryptocurrency that serves primarily as a medium of exchange, while Ethereum serves as both a digital currency (ether) and a blockchain system for hosting various economic transactions such as "smart contracts." A smart contract is a secure digital platform that allows parties to execute and memorialize agreements and transfer consideration with underlying crypto assets that are virtually stored, secured, and authenticated on an immutable electronic ledger. Certain crypto assets have also been labeled "utility tokens" allowing the holder to access or use a specific product or service, or "security tokens" issued by an entity seeking to raise capital to finance a particular endeavor without offering ownership interest in the entity itself.

Are Cryptocurrencies Securities? The *Howey* Test

One threshold legal question surrounding cryptocurrencies and other digital product offerings is whether they are considered "securities" subject to the federal securities laws. This inquiry has far-reaching implications on investors and other market participants, as it subjects the issuer of such products to numerous disclosure and filing requirements, including registration under Section 5 of the Securities Act of 1933.

The Securities Act of 1933 defines the term "security" to encompass stocks, notes, bonds, debentures, and other types of "investment contract[s]."[7] In a 1946 landmark decision, *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298-99 (1946), the Supreme Court articulated a standard for assessing whether a transaction constituted an investment contract — and thus a security — under the federal securities laws. *Howey* involved the unregistered offer and sale of parcels of Florida citrus groves to passive investors who relied on the efforts of the defendants (Florida corporations) to harvest the citruses and generate profits. While the transactions were recorded as real estate sales, they also included a service contract for defendants to cultivate and harvest the crops. The SEC subsequently filed an action against the defendants for failing to register the transactions as securities in violation of Section 5 of the Securities Act of 1933.

The Supreme Court held that the sales of citrus parcels were investment contracts and thus securities subject to federal securities law. As a threshold matter, the Court defined an investment contract as a "contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party."[8] The Court also stressed that "[f]orm [is] disregarded for substance and emphasis [is] placed upon economic reality."[9] The Court held that the sales of citrus grove interests "clearly involve investment contracts as so defined" as a "common enterprise managed by respondents or third parties with adequate personnel and equipment is [] essential if the investors are to achieve their paramount aim of a return on their investments."[10] Importantly, the Court emphasized that its test "embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits."[11] The Court also rejected the argument that a transaction cannot involve an investment contract if the interest sold has "intrinsic value" independent of the success of the enterprise as a whole: "[t]he test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others. If that test be satisfied, it is immaterial whether the enterprise is speculative or non-speculative or whether there is a sale of property with or without intrinsic value."[12] This standard — (i) investment of money; (ii) common enterprise; and (iii) expectation of profit derived from the efforts of others — is commonly referred to as the "*Howey* test" and has been applied to numerous investment transactions involving everything from oranges and whiskey casks to chinchillas and rare coins.[13]

Application of *Howey* to Cryptocurrencies

On July 25, 2017, the SEC issued a report grounded in the principles of *Howey*, advising "those who would use . . . distributed ledger or blockchain-enabled means for capital raising[] to take appropriate steps to ensure compliance with the U.S. federal securities laws," and finding that the digital asset offerings at issue were investment contracts and, therefore, securities under *Howey*.[14] Nearly two years later, the SEC followed up its report with a formal Framework for Investment Contract Analysis of Digital Assets (the "Framework"), providing additional guidance in applying the *Howey* principles to digital assets.[15] The Framework set forth more specific guidance regarding each of the *Howey* factors and noted that typically the "main issue" in the *Howey* analysis is the last factor — whether "a purchaser has a reasonable expectation of profits (or other financial returns) derived from the efforts of others." The Framework explained that "[w]hen a promoter, sponsor, or other third party . . . provides essential managerial efforts that affect the success of the enterprise, and investors reasonably expect to derive profit from those efforts, then this prong of the test is met."[16] It also noted that "[r]elevant to this inquiry is the 'economic reality' of the transaction and 'what character

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7 15 U.S.C. § 77b(a)(1).

8 *Howey*, 328 U.S. at 298-99.

9 Id. at 298.

10 *Id.* at 299-300.

11 *Id.* at 299; *see also United Housing Found., Inc. v. Forman*, 421 U.S. 837, 848-49 (1975) (the "emphasis should be on . . . economic realities underlying a transaction, and not on the name appended thereto") (citation omitted).

12 *Howey*, 328 U.S. at 301.

13 *See, e.g.*, *Glen-Arden Commodities, Inc. v. Costantino*, 493 F.2d 1027, 1034-35 (2d Cir. 1974) (whiskey casks); *Miller v. Cent. Chinchilla Grp., Inc.*, 494 F.2d 414, 415-16 (8th Cir. 1974) (chinchillas); *SEC v. Brigadoon Scotch Distribs.*, 388 F. Supp. 1288, 1290-91 (S.D.N.Y. 1975) (rare coins).

14 Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, 117 S.E.C. Docket 745, 2017 WL7184670, at *1, *8 (July 25, 2017).

15 Framework for "Investment Contract" Analysis of Digital Assets, SEC (last updated Apr. 3, 2019), https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets#_edn9.

16 Framework, *supra* note 14.

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the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect.'"[17] Thus, the inquiry is "an objective one, focused on the transaction itself and the manner in which the digital asset is offered and sold."[18]

Consistent with this guidance, numerous federal courts have found that various cryptocurrencies and digital assets are securities under *Howey*[19] and have certified private securities class actions based on unregistered offerings of crypto assets.[20] The SEC's "facts and circumstances" approach and the lack of a bright-line rule, however, continues to create substantial uncertainty. Most notably, the SEC has implicitly endorsed the position that the two most popular cryptocurrencies — Bitcoin and Ethereum — are not securities because their decentralized nature fails to implicate the critical element of the *Howey* test: the expectation of profits "from the efforts of [a] promoter or a third party."[21]

Given the SEC's seemingly hands-off approach to Bitcoin and Ethereum, the agency's decision in December 2020 to file an enforcement action against Ripple concerning one of the most high-profile cryptocurrencies in the U.S. — the "XRP" token — came as a surprise to some observers, as XRP had been trading since 2013 without regulatory action. Following the SEC's lawsuit, the price of XRP plummeted by 25 percent, and most XRP trading was halted. Given its sweeping ramifications, the Ripple case has been called the "crypto trial of the century"[22] and will likely be a bellwether for future actions and provide a legal blueprint for issuers of new cryptocurrencies.

The Ripple Allegations

Ripple is a San Francisco company and issuer of the XRP token, currently the ninth largest cryptocurrency in the world as measured by market capitalization.[23] The Company operates the RippleNet and the XRP payment protocol to execute international digital transactions across more than 50 countries. Ripple is widely considered one of the titans of the crypto market in the U.S. and a competitor to Bitcoin for digital payment transactions over electronic ledgers.

The SEC's complaint alleges that beginning in 2013, Ripple and two senior executives, Bradley Garlinghouse (current CEO) and Christian A. Larsen (former CEO and current executive Chairman of the Board) marketed and sold over 14.6 billion units of XRP for

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17 *Id.*

18 *Id.*

19 *See, e.g.*, *SEC v. Kik Interactive Inc.*, 492 F. Supp. 3d 169, 177 (S.D.N.Y. 2020); *Beranger v. Harris*, No. 1:18-CV-05054-CAP, 2019 U.S. Dist. LEXIS 195107, at *6 (N.D. Ga. Apr. 24, 2019); *SEC v. NAC Found., LLC*, 512 F. Supp. 3d 988, 997 (N.D. Cal. 2021); *SEC v. Telegram Grp. Inc.*, 448 F. Supp. 3d 352, 371 (S.D.N.Y. 2020); *Rensel v. Centra Tech, Inc.*, No. 17-24500-CIV-King/Simonton, 2018 U.S. Dist. LEXIS 106642, at *15 (S.D. Fla. June 25, 2018); *Solis v. Latium Network, Inc.*, No. 18-10255 (SDW) (SCM), 2018 U.S. Dist. LEXIS 207781, at *8-9 (D.N.J. Dec. 10, 2018); *SEC v. Blockvest*, LLC, No. 18CV2287-GPB(BLM), 2019 U.S. Dist. LEXIS 24446, at *24-25 (S.D. Cal. Feb. 14, 2019).

20 *See, e.g.*, *Balestra v. Cloud With Me Ltd.*, No. 2:18-CV-00804, 2020 U.S. Dist. LEXIS 117663, at *6-9, *14 (W.D. Pa. July 2, 2020), *class cert. granted in* 2020 U.S. Dist. LEXIS 134869 (W.D. Pa. July 30, 2020); *Davy v. Paragon Coin, Inc.*, No. 18-CV-671, 2020 U.S. Dist. LEXIS 151486, at *16, *20-21 (N.D. Cal. June 24, 2020); *Williams v. Kucoin*, No. 20-CV-2806 (GBD) (RWL), 2021 U.S. Dist. LEXIS 204334, at *29-30, *44 (S.D.N.Y. Oct. 21, 2021).

21 *Howey*, 328 U.S. at 299; *see also, e.g.*, William Hinman, Dir. Div. of Corp. Fin., SEC, Remarks at the Yahoo Finance All Markets Summit: Crypto, Digital Asset Transactions: When Howey Met Gary (Plastic), (June 14, 2018), https://www.sec.gov/news/speech/speech-hinman-061418 ("[W]hen I look at Bitcoin today, I do not see a central third party whose efforts are a key determining factor in the enterprise.").

22 Roslyn Layton, *SEC v. Ripple: The Cryptocurrency Trial of the Century*, FORBES (Dec. 29, 2020, 12:00 PM EST), https://www.forbes.com/sites/roslynlayton/2021/12/29/sec-v-ripple-the-cryptocurrency-trial-of-the-century/?sh=7701d47e5417.

23 *See* https://finance.yahoo.com/u/yahoo-finance/watchlists/crypto-top-market-cap/

$1.38 billion without registering the offerings in violation of Section 5 of the Securities Act of 1933.[24] The complaint also alleges that Garlinghouse and Larsen violated Section 15(b) of the Securities Act by "aiding and abetting" Ripple's violations while collectively selling 1.7 billion XRP tokens to public investors for $600 million in proceeds.[25] More specifically, the complaint claims that the defendants promoted XRP as an investment into a common enterprise that would increase in value based on Ripple's efforts, including taking steps to control the supply and price of XRP and creating an active trading market for XRP tokens.[26] The SEC further alleges that Ripple offered and sold XRP to raise the capital necessary to fund its operations and that from 2013 to 2020 nearly all of Ripple's revenues came from public sales of XRP to investors, without any registration or disclosures required by federal securities laws.[27]

Defendants' Answer and the Motions to Dismiss

In April 2021, Ripple answered the complaint and the individual defendants each moved to dismiss the action in its entirety, calling the case "regulatory overreach, plain and simple."[28] As a threshold issue, the individual defendants asserted that the SEC failed to demonstrate that their transactions in XRP constituted an "investment contract" under *Howey* and thus were not securities.[29] More specifically, the individual defendants argued that there was no "common enterprise" with XRP purchasers that was dependent upon the defendants' managerial efforts to generate profit. Rather, the individual defendants claimed that their XRP sales involved "no contract of any kind" with the buyers, there was no pooling of proceeds, and the sales were done anonymously over an exchange.[30] Further, the individual defendants claimed that XRP's value "historically has not been correlated with Ripple's actions, results, or public announcements, but instead with changes in the value of other digital assets, such as [B]itcoin and [E]ther, that the SEC has publicly declared are not securities."[31] The individual defendants also noted that in 2015 and 2020, the Department of Justice and the Department of Treasury's Financial Crimes Enforcement Network found XRP to be a "convertible virtual currency," requiring Ripple to implement anti-money laundering controls generally not applicable to securities transactions.[32] Thus, the individual defendants argued that XRP transactions were not securities under the *Howey* test.

Second, the individual defendants argued that the SEC failed to establish their "scienter" or fraudulent intent for aiding and abetting claims under Section 15(b) of the Securities Act — i.e., that they knew or "recklessly disregarded" that they were engaged in improper conduct (failing to register XRP as a security) and "substantially assisted" Ripple in committing that violation.[33] The individual defendants asserted that, at best, their alleged knowledge of a "risk" that XRP transactions "might" be classified as a security, was not sufficient to establish that their "state of mind ever crossed over from general awareness of the risk inherent in the digital currency space that a digital asset could be classified as a security if certain criteria were met, to knowledge or recklessness that Defendants' transactions in XRP specifically were or are investment contracts or that Ripple was somehow doing something wrong."[34]

Third, the individual defendants argued that even if their XRP transactions were deemed investment contracts under the *Howey* test, the SEC failed to adequately allege that their individual sales of XRP took place in the U.S. and thus are not subject to the federal securities laws under *Morrison v. Nat'l Austl. Bank Ltd.*, 561 U.S. 247, 267-69 (2010) (establishing a presumption that federal securities laws do not apply extraterritorially).[35] The individual defendants asserted that the decentralized nature of the transactions rendered them "predominantly foreign" and thus beyond reach of the federal securities laws.[36]

Finally, Ripple argued it was denied due process and "lacked fair notice that its conduct was prohibited" both "due to the lack of clarity and fair notice regarding Defendants' obligations under law" and "regarding [the SEC's] interpretation of the law," and due to the "countless market participants for years transact[ing]

(continued on page 14)

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[24] First Amended Complaint, *SEC v. Ripple Labs, Inc.*, No. 20-CV-10832 (S.D.N.Y. Feb. 18, 2021), ECF No. 46, ¶¶ 1-9, 17-18.

[25] *Id.*, ¶¶ 86, 440.

[26] *Id.*, ¶¶ 231-89.

[27] *Id.*, ¶¶ 81, 394-95.

[28] Garlinghouse' Pre-Motion to Dismiss Letter, *Ripple*, ECF No. 49 at 1-2; *see also* Larsen's Motion to Dismiss Brief, *Ripple*, ECF No. 107.

[29] *Ripple*, ECF No. 49 at 1-2.

[30] *Ripple*, ECF No. 49 at 1; *see also* Ripple Response to Pre-Motion to Strike Letter, *Ripple*, ECF No. 70 at 3-4.

[31] *Ripple*, ECF No. 49 at 1-2.

[32] *Ripple*, ECF No. 70 at 3.

[33] *Ripple*, ECF No. 107 at 1-2, 15; *see* 15 U.S.C. §77o(b) (requiring that a defendant "knowingly or recklessly provide[d] substantial assistance to another person in violation of [Section 5]").

[34] *Ripple*, ECF No. 49 at 3-4.

[35] *Ripple*, ECF No. 49 at 4.

[36] *Ripple*, ECF No. 107 at 28.

"CRYPTOCURRENCY TRIAL OF THE CENTURY": *SEC V. RIPPLE LABS, INC.* AND THE FUTURE OF CRYPTO LITIGATION

(continued from page 13)

in XRP believing it was not an investment contract.[37] Ripple also asserted that its lack of fair notice was compounded by the SEC's lack of action or notice to Ripple after several developments, including (i) the 2015 Settlement with the DOJ that described XRP as a "virtual currency," (ii) a 2018 SEC speech by the then-director of the Division of Corporation Finance stating that he "did not consider the virtual currencies [B]itcoin or [E]ther to be securities," and (iii) the listing of XRP for trading on an electronic trading platform after meeting with the SEC.[38] Thus, Ripple argued that it reasonably believed that XRP was not a security and was not given fair notice that it was violating the law, in contravention of its due process rights.

The SEC's Response

In response to the motions to dismiss and Ripple's answer, the SEC asserted that the complaint adequately alleged facts satisfying the *Howey* test — payments of money in a common enterprise with expectations of future profits derived from the efforts of Ripple and the individual defendants.[39] Likewise, the SEC argued that the complaint alleged defendants' scienter based on evidence showing they were repeatedly informed that the marketing, offers, and sales of XRP could be deemed "investment contracts" under *Howey*.[40] The SEC alleged, among other things, that Ripple's chief compliance officer told Garlinghouse that XRP had "'securities-type' traits"; Ripple's public relations firm communicated the concern that XRP could be "considered a security"; one of the defendants "admitted to Ripple investors that he could 'not guarantee' that the SEC would not conclude XRP was a security"; and at least one digital asset trading platform refused to list XRP out of concerns that it was a security.[41] Thus, the SEC countered that the defendants either knew or recklessly disregarded that their unregistered offers and sales of XRP were securities transactions that violated the law.[42] The SEC also argued that the individual defendants had a "powerful financial motive" to recklessly ignore Ripple's securities violations because they stood to pocket hundreds of millions of dollars from unregistered sales of XRP and understood that if Ripple could not sell XRP to fund its operations, the Company would collapse.[43]

In response to the defendants' *Morrison* argument that their sales of XRP were foreign transactions beyond the reach of U.S. securities laws, the SEC countered that the defendants offered and sold XRP from within the U.S., while engaged in directed selling and marketing campaigns into the U.S., and specifically offered and sold XRP to individuals in the U.S.[44] Thus, according to the SEC, the sales of XRP are within the territorial reach of Section 5 of the Securities Act.

Finally, the SEC moved to strike Ripple's affirmative defense that it was not given "fair notice" of the law consistent with due process. As a threshold matter, the SEC asserted that unlike aiding and abetting claims under Section 15(b), "Section 5 is a strict liability statute requiring no showing of scienter or negligence" and thus "Ripple's alleged confusion about its legal obligations cannot be the basis for a defense against a violation of Section 5."[45] The SEC also argued that the securities law definition of "investment contract" is not unconstitutionally vague in any event and that numerous courts have rejected similar challenges, including in the

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[37] Ripple's Answer, *Ripple*, ECF No. 51 at 97; *see also* Opposition to Motion to Strike, *Ripple*, ECF No. 171.

[38] *Ripple*, ECF No. 51 at 97-99; *see also Ripple*, ECF No. 70 at 3.

[39] SEC's Response to Garlinghouse's Pre-Motion to Dismiss Letter, *Ripple*, ECF No. 55 at 1-2; *see also* SEC Opposition to Motions to Dismiss, *Ripple*, ECF No. 182 at 27-28, 30-31.

[40] *Ripple*, ECF No. 55 at 2; *Ripple*, ECF No. 182 at 27-28, 30-31.

[41] *Id.*

[42] *Id.*

[43] *Ripple*, ECF No. 55 at 2; *see also Ripple,* ECF No. 182 at 26-27.

[44] *Ripple*, ECF No. 55 at 3.

[45] SEC Pre-Motion to Strike Letter, *Ripple*, ECF 54 at 3 (citation omitted)

context of applying *Howey* to digital assets.[46] Finally, the SEC noted "the law does not require the Government to reach out and warn all potential violators on an individual or industry level."[47]

Looking Ahead

As of this writing, the Court has yet to rule on the individual defendants' motions to dismiss and the SEC's motion to strike Ripple's "fair notice" defense. The parties have completed fact discovery and are in the midst of expert discovery and final depositions. Accordingly, unlike most cryptocurrency litigations, the Court will have the benefit of a full evidentiary record and testimony from numerous expert witnesses prior to issuing its much-anticipated decision.

Whether the case against Ripple turns out to be the "crypto trial of the century" or just another passing cryptocurrency litigation based on the unique "facts and circumstances" of the case remains to be seen. Regardless of which side prevails, however, the outcome of the litigation will provide much-needed precedent for issuers, investors, attorneys, and other market participants in the multi-trillion-dollar crypto market. ■

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[46] *Ripple*, ECF 54 at 2-3 (citing *SEC v. Kik Interactive, Inc.*, No. 19 Civ. 5244, 2020 WL 5819770, at *9 (S.D.N.Y. Sept. 30, 2020) (rejecting statutory vagueness argument because "*Howey* provides a clearly expressed test for determining what constitutes an investment contract, and an extensive body of case law provides guidance on how to apply that test to a variety of factual scenarios"); *United States v. Zaslavskiy*, No. 17 Cr. 647 (RJD), 2018 WL 4346339, at *8 (E.D.N.Y. Sept. 11, 2018) (rejecting argument that "the United States securities laws are unconstitutionally vague ('void for vagueness') as applied to cryptocurrencies")).

[47] *Ripple*, ECF 54 at 1 n.1 (quoting *Kik*, 2020 WL 5819770, at *10).

BOEING V. BRADWAY — THE LIMITS OF FORUM SELECTION CLAUSES

(continued from page 3)

took place near Indonesia on October 29, 2018 and in Ethiopia on March 10, 2019.[2] In addition to the tragic loss of 346 lives resulting from the crashes, the United States Federal Aviation Administration grounded all Boeing 737 MAX aircraft until November 18, 2020, ultimately costing Boeing billions of dollars.[3] Plaintiff in this matter, Seafarers Pension Plan, filed a derivative suit on behalf of Boeing under Section 14(a) of the Securities Exchange Act (the "Exchange Act"), which prohibits making an untrue statement or omission in a proxy statement.[4] Plaintiff argued that Boeing board members made false statements about the development and operation of the Boeing 737 MAX in Boeing's 2017, 2018, and 2019 proxy materials.[5] Specifically, plaintiff argued that false and misleading proxy statements resulted in the improper re-election of Boeing directors who had allowed poor oversight of safety standards, regulatory compliance, and risk management during the development of the 737 MAX, ultimately resulting in the two crashes that cost Boeing billions, and 346 people their lives.[6] Plaintiff further argued that misleading communications caused shareholders to vote down a proposal calling for the bifurcation of the CEO and chairman roles.[7]

One of Boeing's bylaws gave the company the ability to force any derivative litigation to take place in the Delaware Court of Chancery, not in the U.S. District Court for the Northern District of Illinois, where Boeing is headquartered. It read, in relevant part:

> With respect to any action arising out of any act or omission occurring after the adoption of this By-Law, unless the Corporation consents in writing to the selection of an alternative forum, the Court of Chancery of the State of Delaware shall be the sole and exclusive forum for . . . any derivative action or proceeding brought on behalf of the Corporation . . .[8]

At the crux of this issue is whether federal courts have exclusive jurisdiction over claims arising under the Exchange Act,[9] thereby mandating that plaintiff's Section 14 claims against Boeing could not be tried in the Delaware Court of Chancery. If that were correct, and the District Court chose to enforce the forum selection provision, plaintiff would be barred from asserting a Section 14 claim altogether, as plaintiff could not bring the claim in federal court under the terms of the forum selection clause, nor could the claim proceed in state court.

Defendants acknowledged that enforcement of the forum bylaw would bar plaintiff's federal claim, but argued that Delaware state law allows for sufficient substitutions for the Exchange Act claims. The District Court agreed with defendants and, citing Boeing's bylaw, dismissed the suit without reaching the merits.[10] Plaintiffs appealed the District Court's decision to the Seventh Circuit.

III. The Seventh Circuit's Analysis

A. Boeing's Choice of Forum Provision Is Barred by the Exchange Act

The Seventh Circuit declined to enforce the forum selection clause, noting that doing so would be "checkmate for defendants," as it would prevent plaintiff from bringing its only claim in the federal district in which Boeing was located and would force the claim to be litigated in a court not authorized to entertain it.[11] The Seventh Circuit further found that such a result would be "difficult to reconcile" with Section 29(a) of the Exchange Act, which voids any contractual provision that waives compliance with any portion of the Exchange Act.[12] Essentially, the Seventh Circuit found as a threshold matter that no contract can contain a provision absolving any party of their obligation to be governed by the Exchange Act.

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2 *Id.*

3 *Id.*

4 15 U.S.C.A. § 78n.

5 *Boeing* No. 20-2244, 2022 WL 70841 at *1.

6 *Id.* at *3.

7 *Id.*

8 *Id.*

9 *Id.* at *3

10 *Id.*

11 *Id.* at *4.

12 *Id.*

B. Delaware Law Also Prohibits Boeing's Choice of Forum Clause as Applied

The Court also determined that the most straightforward solution to the question of whether to apply Boeing's choice of forum provision already existed under Delaware law. Specifically, the Court analyzed Section 115 of the Delaware General Corporation Law, which provides, in relevant part, that:

> bylaws may require, consistent with applicable jurisdictional requirements, that any or all internal corporate claims shall be brought solely and exclusively in any or all of the courts in this State.[13]

The Seventh Circuit focused on two clauses of Section 115 — "consistent with applicable jurisdictional requirements" and "the courts *in* this State."

First, concerning the "applicable jurisdictional requirements" language, the Seventh Circuit found that the Delaware General Assembly had already contemplated the exact issue presented. In the synopsis accompanying the 2015 Amendment to the Delaware General Corporation Law, the General Assembly noted specifically that the new Section 115 was not drafted to authorize any provision that purports to strip federal courts of federal question jurisdiction, nor was it meant to limit or expand the powers of the Delaware Chancery Court or Superior Court.[14]

Second, through an analysis of several other cases wherein other courts examined the function of the preposition "in" in statutory construction, the Seventh Circuit found that the phrase "courts *in* this state," rather than "courts *of* this State," encompassed federal courts located in Delaware, and was not limited to Delaware state courts.[15] Therefore, the Seventh Circuit reasoned that Boeing's bylaws were unenforceable insofar as they purported to limit the forum to Delaware state courts.

Defendants argued that Section 109(b) of the Delaware General Corporation Law overrides Section 115. Section 109(b) provides:

> bylaws may contain any provision, not inconsistent with law or with the certificate of incorporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees.[16]

The Seventh Circuit rejected defendants' argument, finding that the more targeted Section 115 takes precedence over the more general Section 109.[17] Defendants cited one case, *Salzberg v. Sciabacucchi,*[18] which they claimed justified giving Section 109 precedence over Section 115, but the Seventh Circuit found the case distinguishable, and declined to apply its holding.[19]

Defendants also cited *Boilermakers Local 154 Retirement Fund v. Chevron Corp.,*[20] claiming that prior Delaware courts have permitted forum selection clauses like the one in question under highly similar circumstances.[21] The Seventh Circuit, however, both distinguished *Boilermakers* and opined on the types of bylaws that would fall into an impermissible category, *e.g.*, those that would foreclose a plaintiff from bringing an Exchange Act claim in any forum.

Finally, the Seventh Circuit distinguished the last two of Defendants' cited cases, both concerning forum selection clauses in international agreements, and reversed the decision of the trial court.[22,23]

Generally speaking, investors are not at the table with companies when these types of forum selection clauses are being discussed, and are often at the mercy of pre-existing clauses whenever a dispute arises. Decisions like *Boeing* are important to reinforce the idea that unilaterally dictated choice of forum clauses in a company's bylaws cannot be wielded to completely immunize corporate defendants from certain causes of action. Likewise, by limiting the breadth of choice of forum clauses, the courtroom doors aren't closed to seeking judicial remedies to their disputes with a corporate defendants. Finally, this decision is important for parties drafting choice of forum clauses as well — it is imperative that the language in the clause is carefully considered from the perspective of whether it bars claims that a potential plaintiff would otherwise have a right to make. Even if there was no intent to bar a plaintiff from asserting certain un-waivable claims, failure to make sure could result in costly litigation for the company. ■

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13 8 Del. C. § 115

14 S.B. 75, 148th Gen. Assemb., Reg. Sess. (Del. 2015) (synopsis)

15 *Id.* at *5.

16 8 Del. C. § 109(b)

17 *Boeing*, No. 20-2244, 2022 WL 70841 at *5.

18 227 A.3d 102 (Del. 2020)

19 *Boeing*, No. 20-2244, 2022 WL 70841 at *5-6

20 73 A.3d 934 (Del. Ch. 2013)

21 *Boeing*, No. 20-2244, 2022 WL 70841 at *6

22 *Boeing*, No. 20-2244, 2022 WL 70841 at *10.

23 Judge Easterbrook penned a thoughtful dissent in this matter, and though the discussion of the dissent exceeds the scope of this article, those interested in this topic are encouraged to read it for an alternate view of the scope of federal jurisdiction over Section 14 claims, and the state courts' ability to hear derivative claims arising from Section 14.

KTMC SECURES $124 MILLION TENTATIVE SETTLEMENT WITH CARDINAL HEALTH DIRECTORS, AMIDST BROADER PUSH FOR CORPORATE ACCOUNTABILITY FOR THE NATION'S OPIOID EPIDEMIC

(continued from page 3)

On December 30, 2021, KTMC also filed a shareholder derivative action in the Delaware Court of Chancery against certain directors and officers of AmerisourceBergen, captioned *Lebanon County Employees' Retirement Fund, et al. v. Collins, et al.*, No. 2021-1118 (Del. Ch.). The litigation followed KTMC's review of over a decade of the company's corporate records. As with the Cardinal Health matter, the suit generally alleges that the directors of AmerisourceBergen prioritized profits over legal compliance, even as red flags of the company's potentially unlawful conduct mounted. Defendants will respond to that complaint on or before March 29, 2022.

While distributors like Cardinal Health and AmerisourceBergen do not make pain pills and do not fill prescriptions, the distributors' role in the pharmaceutical supply chain gives them a unique ability to prevent suspicious opioid orders before pills are diverted to the illegal market. Distributors purchase prescription medications from manufacturers to store in warehouses and distribution centers across the nation. Pharmacies, hospitals, and healthcare providers order medications from the distributors, which can process and deliver orders on a daily basis. This permits drug makers to focus on their own core competencies of developing and manufacturing products, while distributors ensure the proper and fluid functioning of the prescription medication supply chain.

Given their central role in the supply chain, federal and state laws require opioid distributors to maintain suspicious order monitoring programs that identify, stop, and report potentially suspicious opioid orders from pharmacy customers. The numerous lawsuits against distributors, whether based on public nuisance, negligence, or other tort theories, principally center on the distributors' alleged failure to comply with these legal requirements.

Much of the recent opioid litigation news has focused on three distributors in particular—Cardinal Health, AmerisourceBergen, and McKesson Corporation. Often referred to as the "Big Three," these distributors held over 90% of the nationwide market share for distributing prescription opioids. In suits frequently naming all three as co-defendants, state and local governments have alleged that the Big Three independently failed to maintain sufficient suspicious order monitoring programs. More specifically, lawsuits have claimed, among other things, that the distributors maintained artificially high thresholds for reporting suspicious orders, repeatedly increased those thresholds to fill potentially suspicious orders, and worked with their pharmacy customers to avoid being reported to the DEA. In total, the allegations against opioid distributors paint a picture of an industry-wide breakdown in compliance that persisted for over a decade, as the nation's epidemic grew beyond control.

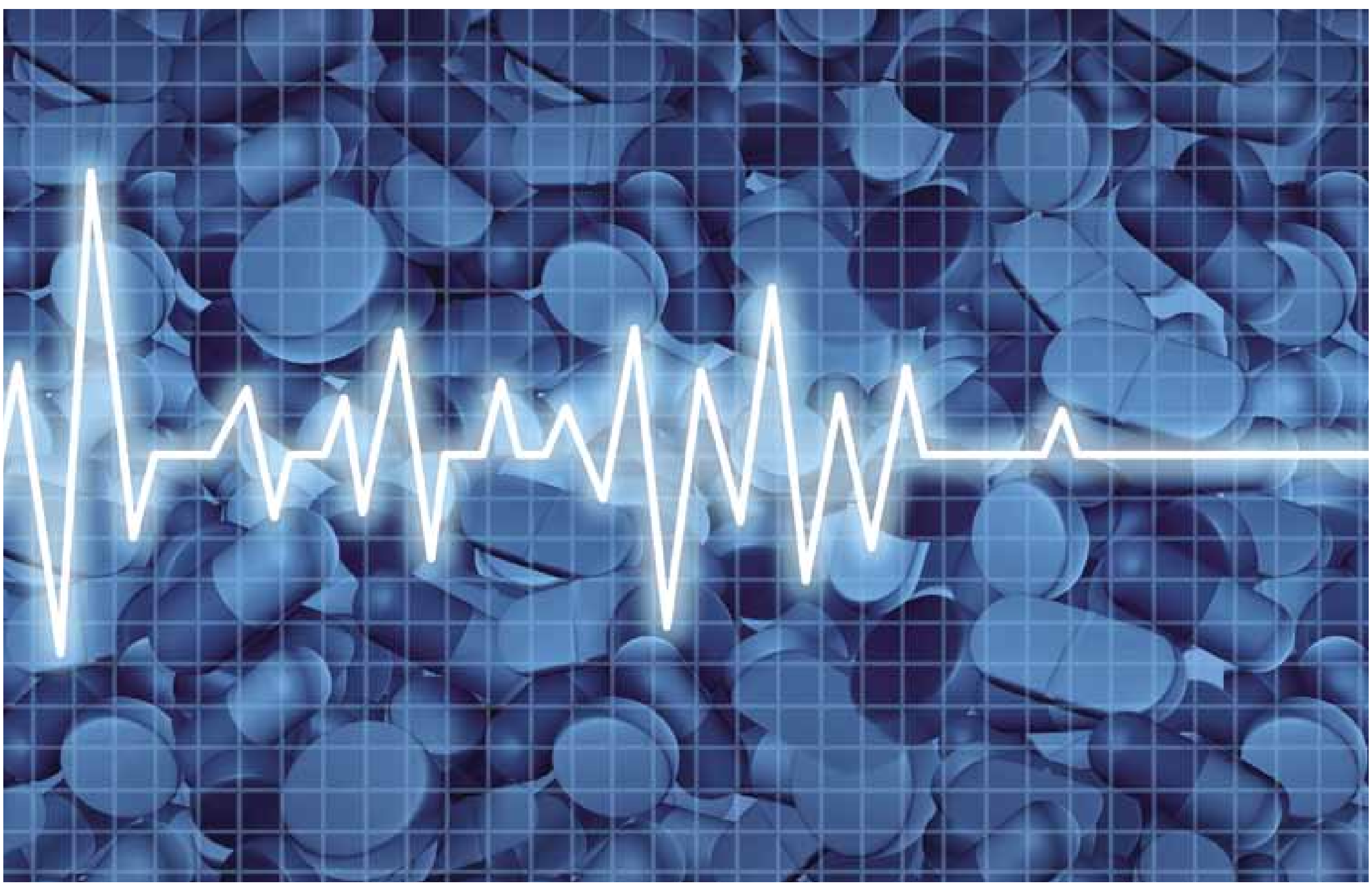
Each of the Big Three has denied liability. The distributors point to others involved in the supply chain as being more culpable, including drug makers and prescribers. The distributors have likewise claimed that the DEA, the primary federal industry regulator, failed to provide clear or consistent guidance on distribution practices. At bottom, the distributors maintain that they did all that they needed to do to comply with the law.

Nevertheless, on July 21, 2021, the Big Three offered to pay up to $21 billion over the next 18 years to resolve claims raised in thousands of opioid-related lawsuits by various states and local municipalities. The settlement offer is part of a larger deal involving Johnson & Johnson, which would pay an additional $5 billion over the same period. The final amount of the settlement will depend on the number of state and local governments that agree to participate in it. To receive the full $26 billion payment, participating states must convince their "political subdivisions" — i.e., cities, towns, other large municipalities — to terminate all litigation against the opioid distributors and to agree to a bar on future claims.

Accordingly, the Big Three settlement called for two separate opt-in periods. In the first period, state governments determined whether they would join the settlement. By the September 4, 2021, deadline, 42 states agreed to participate in the settlement with the Big Three, with several additional states opting-in after the original deadline. By January 26, 2022, approximately 90% of the local governments nationwide that were eligible to participate in the settlement had elected to do so. The Big Three now have until February 26, 2022, to determine whether that is sufficient to move forward with the settlement.

Although the settlement will resolve the bulk of claims pending against the distributors, the Big Three still face billions of dollars of exposure in litigation by non-participating states and municipalities. Most notably, the distributors are awaiting a ruling from a three-month bench trial that took place in West Virginia federal court in 2021. In that case, two West Virginia political subdivisions that were hit hard by the opioid epidemic, Cabell County and the city of Huntington, are seeking $2.5 billion in damages to help fund opioid abuse prevention, treatment, and education in those areas. Likewise, in November 2021, the state of Washington began a lengthy bench trial against the Big Three that remains ongoing. Washington is asking for roughly $95 billion in relief, including $38.2 billion to fund treatment and other programs, with billions more in penalties and forfeited profits.

Meanwhile, through the derivative actions filed on behalf of long-term Cardinal Health and AmerisourceBergen shareholders, KTMC is seeking to hold the top executives and officers of these companies accountable for the role they played in contributing to the nationwide opioid epidemic. After all, corporations, on their own, do not prioritize profits over legal compliance. Rather, individual executive officers and directors make those decisions. Where those decisions result in significant fines that hurt the bottom line, the individuals responsible for making them should account to their shareholders. ■



RECENT DEVELOPMENTS IN SECURITIES CLASS CERTIFICATION LAW AFFIRM THAT GENERIC MISSTATEMENTS CAN CAUSE PRICE IMPACT

(continued from page 5)

dates was due to something other than [their] alleged misstatements."[6]

The *Goldman* Allegations

Goldman centers on alleged misrepresentations concerning Goldman Sachs Group, Inc.'s ("Goldman" or the "Company") commitment to avoiding conflicts of interest in its business operations. Specifically, Plaintiffs allege that although Defendants — Goldman and certain of its executive officers — had represented, among other things, that Goldman maintains "extensive procedures and controls that are designed to identify and address conflicts of interest," and that Goldman's "clients' interests always come first," Defendants had failed to disclose that Goldman had substantial conflicts of interest with respect to at least four collateralized debt obligation ("CDO") transactions involving subprime mortgages.[7] Most notably, in a transaction involving the Abacus 2007 AC-1 ("Abacus") CDO, Goldman secretly allowed a hedge fund — Paulson & Co. ("Paulson") — to dictate the composition of the mortgages within the Abacus CDO while also taking a short position against the CDO. As a result, Paulson received a significant profit when Abacus collapsed in the midst of the 2008 financial crisis. Goldman later paid a record $550 million to settle claims brought by the U.S. Securities and Exchange Commission for its role in the Abacus CDO. In other instances, Goldman represented to investors that its interests were aligned with theirs, while Goldman was in fact short selling against its' clients positions.[8]

The plaintiffs in *Goldman* are Goldman shareholders alleging securities fraud claims under Sections 10(b) and 20(a) of the Exchange Act. The Southern District of New York first certified a class of Goldman shareholders in 2015, finding that Plaintiffs had satisfied the *Basic* presumption's requirements and Defendants had failed to "demonstrate a complete absence of price impact."[9] Defendants appealed, and the Second Circuit remanded with instructions for the district court to reconsider Defendants' evidence against class certification because intervening Second Circuit law had had made it "clear that defendants seeking to rebut the *Basic* presumption of reliance must do so by a preponderance of the evidence" — a standard the district court had not applied.[10] On remand, the district court once again certified a class of Goldman shareholders, holding that Defendants had not rebutted the *Basic* presumption by a preponderance of the evidence.[11] Defendants appealed again.

In 2020, the Second Circuit again affirmed the district court's class certification decision, holding that the district court did not abuse its discretion by concluding that Defendants had filed to rebut the *Basic* presumption.[12] Specifically, the Second Circuit held that general statements about business principles, like those challenged in *Goldman*, can impact the price of a company's securities, and reiterated that securities defendants bear the burden of persuasion in rebutting the *Basic* presumption.[13] Defendants then appealed to the Supreme Court.

The Supreme Court Provides New Guidance as to Price Impact

The Supreme Court granted certiorari to review the Second Circuit's 2020 decision. The Court considered two questions: (1) whether generic statements about business principles are relevant to the price impact inquiry at class certification; and (2) whether defendants in

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6 *Goldman*, 955 F.3d at 270 (emphasis added).

7 *Arkansas Teachers Ret. Sys. v. Goldman Sachs Grp., Inc.*, 955 F.3d 254, 258-59 (2d Cir. 2020).

8 *See id.*

9 *In re Goldman Sachs Grp., Inc. Sec. Litig.*, 2015 WL 5613150, at *7 (S.D.N.Y. Sept. 24, 2015).

10 *Arkansas Teachers Ret. Sys. v. Goldman Sachs. Grp., Inc.*, 879 F.3d 474, 485 (2d Cir. 2018).

11 *In re Goldman Sachs Grp., Inc. Sec. Litig.*, 2018 WL 3854757, at *2 (S.D.N.Y. Aug. 14, 2018).

12 *Goldman*, 955 F.3d at 270-72.

13 *Id.*

securities class actions bear the burden of proving a lack of price impact.

First, Defendants argued that the Second Circuit erred by concluding that the generic nature of their alleged misrepresentations regarding conflicts of interests is irrelevant to the question of whether Defendants' statements impacted the price of the Company's securities. While this point was initially disputed before the Second Circuit, Plaintiffs conceded to the Supreme Court that "the generic nature of an alleged misrepresentation often will be important evidence of price impact because, as a rule of thumb, a more-general statement will affect a security's price less than a more-specific statement on the same question."[14]

The Supreme Court agreed, holding that district courts determining whether defendants have rebutted the *Basic* presumption should consider whether a misrepresentation was so generic and nonspecific that it did not affect the price of the securities at issue. Specifically, the Supreme Court stated that "[i]n assessing price impact at class certification, courts should be open to *all* probative evidence on that question — qualitative as well as quantitative — aided by a good dose of common sense."[15] The Court further noted that "[t]he generic nature of a misrepresentation often will be important evidence of a lack of price impact, particularly in cases proceeding under the inflation-maintenance theory"[16] — where plaintiffs argue that defendants' misleading statements maintained the existing inflation of the company's stock price, rather than introducing new price inflation. The Supreme Court remanded this issue, instructing the Second Circuit to "take into account *all* record evidence relevant to price impact, regardless whether that evidence overlaps with materiality or any other merits issue" — which are usually not addressed at the class certification stage.[17]

Defendants also argued that the Second Circuit had erred by placing the burden of persuasion on Defendants to prove a lack of price impact in order to rebut the *Basic* presumption. Specifically, Defendants argued that under Federal Rule of Evidence 301, the *Basic* presumption shifts only the burden of *production* to securities defendants, and that plaintiffs retain the burden of *persuasion* to show price impact.

The Supreme Court rejected this argument, reiterating its prior holding that Rule 301 "in no way restricts the authority of a court . . . to change the customary burdens of persuasion" pursuant to a federal statute, and stating that *Basic* properly exercised the Court's authority to assign the burden of persuasion to securities defendants.[18] The Court further explained that "the allocation of the burden is unlikely to make much difference on the ground," as the "district court's task is simply to assess all the evidence of price impact — direct and indirect — and determine whether it is more likely than not that the alleged misrepresentations had a price impact."[19]

The Supreme Court's opinion in *Goldman* does not meaningfully impact existing law governing securities class action litigation. As to the first holding, the parties agreed that the generic nature of a misrepresentation could be relevant to the question of price impact, and the Court remanded only because the Second Circuit's opinion left "sufficient doubt" that it had, in fact, considered the generic nature of Goldman's statements when it assessed Defendants' effort to show a lack of price impact.[20] Further, the Court's holding on the burden of persuasion was merely an affirmation of existing precedent, and the Court itself noted the limited impact of the ruling, explaining that "[a]lthough the defendant bears the burden of persuasion, the allocation of the burden is unlikely to make much difference on the ground."[21] Accordingly, the battle for class certification in future securities litigation is likely to proceed along the same lines as before the Court's *Goldman* ruling.

The District Court Applies the Supreme Court's New Guidance

Subsequent developments in *Goldman* support this conclusion. On remand, the Second Circuit, consistent with the Supreme Court's commentary, vacated the district court's class certification decision, stating that "it is unclear whether the district court considered the generic nature of Goldman's alleged misrepresentations," and remanded for the district court to reconsider class certification in light of the Supreme Court's decision.[22]

On December 8, 2021, the district court again granted Plaintiffs' motion for class certification. The

(continued on page 22)

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[14] *Goldman Sachs Grp., Inc. v. Arkansas Teacher Ret. Sys.*, 141 S. Ct. 1951, 1960 (2021).

[15] *Id.*

[16] *Id.* at 1961.

[17] *Id.*

[18] *Goldman*, 141 S. Ct. at 270 (quoting *NLRB v. Transp. Mgmt. Corp.*, 462 U.S. 393, 404 n.7 (1983).

[19] *Id.* at 1963.

[20] *Id.*

[21] *Id.*

[22] *Arkansas Teacher Ret. Sys. v. Goldman Sachs Grp., Inc.*, 11 4th. 138, 143-44 (2d Cir. 2021).

RECENT DEVELOPMENTS IN SECURITIES CLASS CERTIFICATION LAW AFFIRM THAT GENERIC MISSTATEMENTS CAN CAUSE PRICE IMPACT

(continued from page 21)

district court concluded that Defendants failed to rebut the presumption of reliance.[23] Specifically, the district court held that Plaintiffs' expert had effectively linked the declines in Goldman's stock price to pre-disclosure inflation, that Defendants' experts did not persuasively rebut these findings, and that Defendants' "alleged misstatements were not so generic as to diminish their power to maintain pre-existing price inflation."[24] As the district court concluded, certain of Defendants' statements (such as those claiming that "[w]e have extensive procedures and controls that are designed to identify and address conflicts of interest") were reasonably specific, and "even the more generic statements," when read in context and in conjunction with more specific statements, "may reinforce misconceptions about Goldman's business practices, and thereby serve to sustain an already-inflated stock price."[25] Additionally, the court noted that "Defendants' burden is not merely to prove that the alleged misstatements were one of several sources of price impact, nor even that other sources loomed larger," but to show "that the alleged misstatements had *no* price impact whatsoever." The district court concluded that "[e]ven applying the Supreme Court's updated guidance as to genericness, Defendants have not carried this burden."[26]

The district court also rejected Defendants' argument that "the practice of issuing statements of [the kind alleged in *Goldman*] is itself so generic as to nullify any price impact," holding that "[i]nflation-maintenance claims do not hinge on whether such statements were consciously relied upon, in the moment, by investors evaluating Goldman," but on "whether Goldman's alleged misstatements *reinforced*" investors' existing misconceptions about Goldman's business.[27] Indeed, the court stated that it "is hard-pressed to understand why the statements such as those at issue here would have achieved such ubiquity in the first place were they incapable of influencing (including by maintaining) a company's stock price."[28]

In conclusion, while the Supreme Court's opinion provides updated guidance for courts to consider when assessing price impact, it does not mark a sea change in securities class action litigation, and plaintiffs can continue to successfully assert a fraud-on-the-market theory of reliance, even as to generic misstatements. ■

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[23] *In re Goldman Sachs Grp., Inc. Sec. Litig.*, 2021 WL 5826285, at *11 (S.D.N.Y. Dec. 8, 2021).

[24] *Id.*

[25] *Id.*

[26] *Id.* at *12.

[27] *Id.*

[28] *Id.* at *13.

WHAT'S TO COME

MARCH 2022

Council of Institutional Investors (CII)
2022 Spring Conference

March 7 – 9

Washington, DC ■ Mandarin Oriental Hotel

APRIL 2022

Texas Association of Public Employee Retirement Systems (TEXPERS)
2022 Annual Conference

April 3 – 6

Fort Worth, TX ■ The Worthington Renaissance Fort Worth Hotel

MAY 2022

Pennsylvania State Association of Country Controllers (PSACC)
2022 Spring Conference

May 4 – 6

State College, PA ■ Hyatt Place State College

State Association of County Retirement Systems (SACRS)
2022 Spring Conference

May 10 – 13

Rancho Mirage, CA ■ Omni Rancho Las Palmas Resort & Spa

JUNE 2022

National Association of Public Pension Attorneys (NAPPA) Legal Education Conference

June 21 – 24

Louisville, KY ■ Omni Louisville Hotel

Florida Public Pensions Trustees Association (FPPTA) 38th Annual Conference

June 26 – 29

Orlando, FL ■ Hilton Bonnet Creek

AUGUST 2022

County Commissioners Association of Pennsylvania (CCAP)
Annual Conference & Trade Show

August 7 – 10

Lancaster, PA ■ Lancaster County Convention Center and Lancaster Marriott at Penn Square

Texas Association of Public Employee Retirement Systems (TEXPERS)
Summer Forum

August 21 – 23

El Paso, TX ■ Paso Del Norte Hotel

SEPTEMBER 2022

Council of Institutional Investors (CII)
2022 Fall Conference

September 9 – 22

Boston, MA ■ The Westin Copley Place

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