Law360

5 Securities Litigation Issues To Watch In 2024

By **Todd Cosenza, Charles Cording and Madeleine Tayer** (January 9, 2024)

Todd Cosenza

Charles Cording

Madeleine Tayer

2023 was an eventful year for securities litigation, and 2024 promises to start with, as sports commentator Mike Breen would say, a bang.

In January, the U.S. Supreme Court is slated to hear argument in a case presenting a key question in securities class action litigation that has eluded review for the last eight years. Later in the year, we can expect to see important — if not landmark — decisions that will shape the scope of liability for issuers and underwriters going forward.

Securities law practitioners and public companies should also keep an eye on lawsuits related to hot topics like ESG, cybersecurity and meme stocks, which are dominating the conversation around securities law today.

This article highlights the key cases and trends in securities litigation that will matter most in 2024.

1. Supreme Court to Resolve Whether Item 303 Gives Rise to Private Claim

Questions arising out of cases primarily alleging omissions, as opposed to misrepresentations, will be front and center in 2024.

On Jan. 16, the Supreme Court will hear argument in Macquarie Infrastructure v. Moab Partners LP[1] to resolve a circuit split regarding whether alleged failures to make disclosures required by Item 303 of Regulation S-K can alone — i.e., without an affirmative misstatement — serve as the basis for private securities litigation under Section 10(b) of the Securities Exchange Act of 1934.

Item 303 requires a company's management to disclose "any known trends or uncertainties that have had or that are reasonably likely to have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations." Because Item 303 imposes an affirmative disclosure obligation on public companies, it can be a way for plaintiffs to plead securities law claims even when defendants are silent on a topic.[2]

The plaintiffs allege that Macquarie, a company that invests in infrastructure businesses, violated Item 303 by failing to disclose the fact that the revenues of one of its subsidiaries relied on a freighter fuel that was subject to potential elimination by international regulators. The U.S. Court of Appeals for the Second Circuit held that a failure to disclose information required by Item 303 is sufficient to plead a Section 10(b) claim and reversed the district court's dismissal of the complaint.

In 2016, the Second Circuit similarly held that an Item 303 violation is sufficient to plead a Section 10(b) claim in Leidos v. Indiana Public Retirement System.[3] However, other circuits have reached the opposite conclusion, holding that Item 303 does not give rise to

an independent duty to disclose for purposes of finding a Section 10(b) violation.

For example, in a 2000 opinion authored by then-U.S. Circuit Judge Samuel Alito in Oran v. Stafford,[4] the U.S. Court of Appeals for the Third Circuit held that a Section 10(b) claim cannot be based solely on the alleged failure to make a disclosure required under Item 303. The U.S. Court of Appeals for the Ninth Circuit reached the same conclusion in 2014 in In re: NVIDIA Corp. Securities Litigation.[5]

Though the Supreme Court granted certiorari in Leidos in 2017 to resolve this circuit split, the case settled before the Supreme Court could weigh in on this important issue.

The long-awaited resolution of these issues by the Supreme Court will be of significant practical importance to securities law practitioners. Securities class action complaints in "duty to disclose" cases are often premised on Item 303. Hence, a reversal of the Second Circuit decision will practically narrow the scope of Section 10(b) liability for public companies.

Several amicus briefs have been filed ahead of oral argument, including one by the U.S. Department of Justice and the U.S. Securities and Exchange Commission in support of Moab Partners, arguing that an Item 303 omission can give rise to a Section 10(b) violation, and one by the Securities Industry and Financial Markets Association in support of Macquarie, taking the opposite position.

2. The Presumption of Reliance in Cases Alleging Half-Truths

Reliance is an essential element of a securities fraud claim under Section 10(b). To facilitate modern securities class action litigation, the Supreme Court has crafted two rebuttable presumptions of reliance: (1) the Basic presumption, established in the 1988 Basic Inc. v. Levinson[6] decision, which governs cases alleging misrepresentations; and (2) the Affiliated Ute presumption, established in the 1972 Affiliated Ute Citizens of Utah v. United States[7] decision, which governs cases based on pure omission, i.e., a failure to disclose notwithstanding a legal duty to speak.

For decades, federal courts have grappled with the issue of where so-called half-truths fit into this framework. Historically, half-truths — that is, incomplete affirmative statements that are alleged to have been misleading by virtue of the information omitted by the speaker — have been treated as a form of misrepresentation under the federal securities laws. Nearly all courts of appeal that have addressed the issue have concluded that the Affiliated Ute presumption applies only to claims based on omissions, not to claims based on half-truths.

This year, the U.S. Court of Appeals for the Sixth Circuit will be the next federal appeals court to address the issue.

In In re: FirstEnergy Corp. Securities Litigation,[8] the plaintiffs filed a putative class action lawsuit in the U.S. District Court for the Southern District of Ohio against FirstEnergy Corp., an Ohio-based electrical utility company, alleging that FirstEnergy violated Section 10(b) by making numerous statements that were false or misleading because they failed to disclose FirstEnergy executives' alleged bribery of Ohio public officials in connection with H.B. 6. In other words, the plaintiffs' claims were based on half-truths rather than pure omissions.

On March 30, 2023, the district court certified the class.[9] Treating the alleged half-truths as omissions, the district court held that individual issues of investor reliance did not

predominate because the Affiliated Ute presumption applied.

The district court reasoned that the Affiliated Ute presumption "appears appropriate" because the defendants made omissions of material fact. Moreover, with no binding Sixth Circuit case law addressing the treatment of half-truths, the court was persuaded that the Affiliated Ute presumption could apply to the alleged misrepresentations too.

The court also held, in the alternative, that the Basic presumption would apply. Thereafter, FirstEnergy filed a Rule 23(f) petition, with one of the questions presented being whether the district court erred in extending the Affiliated Ute presumption of reliance to cover claims based on half-truths.

At the end of 2023, the Sixth Circuit granted FirstEnergy's Rule 23(f) petition. If the Sixth Circuit affirms the district court's ruling, it could have significant consequences for future securities fraud class actions and give rise to a notable circuit split. For example, plaintiffs need not prove market efficiency under the Affiliated Ute presumption, and, as a result, defendants facing securities fraud class actions may have more of an uphill battle when trying to defeat class certification.

3. Market Efficiency in Meme-Stock Lawsuits

In recent years, meme stocks have become a new phenomenon. "Meme stocks" refer to shares of a company that have a significant increase in trading volume due to attention on social media. In other words, the increase in trading is based on internet hype and enthusiasm rather than the company's performance or new, value-relevant information. Meme stocks are often like roller coasters — the stock price will go higher and higher until there's suddenly a quick drop, which can lead to lawsuits from investors.

One recent example of this is Shupe v. Rocket Companies Inc.,[10] a securities class action filed in the U.S. District Court for the Eastern District of Michigan against Rocket Companies Inc., an online mortgage lender. The plaintiffs primarily allege that Rocket violated federal securities laws by making false and misleading statements about key financial metrics related to Rocket's mortgage business.

The case arises out of a Reddit frenzy that occurred in March 2021, in which nearly 400 million Rocket shares traded in a single day, and the company ended the day with a share price increase of 71.2%. However, the next day, the share price plunged by over 31%.

The case is currently at the class certification stage, where the parties are battling over whether the plaintiffs can invoke the Basic presumption of reliance, which rests on the theory that the price of stock traded in an efficient market reflecting all public, material information. Rocket's argument is that the plaintiffs cannot invoke the Basic presumption because Rocket's stock did not trade in an efficient market given the fact that the stock was targeted on Reddit as a meme stock, which caused an irrational trading frenzy by non-professional retail investors.[11]

The court has yet to rule on the plaintiffs' motion to certify the class, but we can expect to see a decision sometime this year. Given the fact that your typical run-of-the-mill securities class actions face very few hurdles in proving market efficiency, it will be interesting to see how the court reacts to the fact that Rocket was a meme stock.

If the court denies the plaintiffs' motion, it may help stave off future securities class actions involving meme stocks.

4. ESG Issues

Environmental, social and governance-related litigation has been on the rise and will continue to be prominent in 2024.

In March 2023, 21 Republican state attorneys general issued an open letter to 53 asset managers, suggesting that their approach to ESG is inconsistent with their clients' financial interests and may violate their fiduciary duties.[12] The letter states that the attorneys general will "continue to evaluate activity in this area in line with our ongoing investigations into potential unlawful coordination and other violations that may stem from the commitments you and others have made" related to ESG initiatives.

Given that, it would not be surprising to see many lawsuits filed against asset managers in 2024.

5. Cybersecurity

Given the proliferation of cyberattacks and data breaches in 2023, it's no surprise that cybersecurity issues will be important to watch in 2024.

On Dec. 18, a new U.S. Securities and Exchange Commission rule went into effect that requires publicly traded companies to disclose material cybersecurity incidents through a Form 8-K filing, detailing the material aspects of the nature, scope and timing of the incident on the registrant. The rule is meant to improve the consistency of cybersecurity disclosure practices, and make it easier for investors to evaluate the registrants' exposure to material cybersecurity risks and incidents, as well as their management of those risks.

This rule comes on the heels of the SEC's lawsuit, filed on Oct. 30, 2023, in the U.S. District Court for the Southern District of New York, against information technology firm SolarWinds and its chief information security officer for allegedly failing to disclose gaps in the company's cybersecurity defenses and ignoring red flags about cyber risks, which culminated in a breach by Russian hackers in 2020.[13]

Notably, the SEC alleges that the defendants knowingly or recklessly made materially false statements, which goes beyond prior cybersecurity enforcement actions that alleged mere negligence.

Whether the SEC brings more suits of this kind in 2024 — especially against chief information security officers — could signal how the SEC plans to approach cybersecurity-related enforcement actions going forward.

Conclusion

In light of these cases and trends, 2024 promises to be yet another exciting and notable year for securities litigation. Securities law practitioners and public companies should continue to closely monitor cases currently pending in the federal and certain state courts, especially those highlighted in this article.

Todd G. Cosenza and Charles Cording are partners, and Madeleine Tayer is an associate, at Willkie Farr & Gallagher LLP.

Willkie associate Amanda M. Payne contributed to this article.

Disclosure: Willkie represents a group of former SEC officials and law professors who filed an amicus brief in support of FirstEnergy's petition for a Rule 23(f) appeal.

[1] No. 22-1165 (2023).

[2] Item 303 is not the only Regulation S-K provision that is often cited in securities complaints. For example, plaintiffs often allege violations of Item 105, which requires disclosure of material risk factors.

[3] 818 F.3d 85 (2d Cir. 2016).

[4] 226 F.3d 275, 288 (3d Cir. 2000).

[5] 768 F.3d 1046, 1054, 1056 (9th Cir. 2014).

[6] 485 U.S. 224 (1988).

[7] 406 U.S. 128 (1972).

[8] 2:20-cv-3785 (S.D. Oh. 2020).

[9] Id., Slip Op. at 1 (ECF No. 435).

[10] Case No. 1:21-cv-11528-TLL-APP (E.D. Mich.).

[11] Defendants' Memorandum of Law in Opposition to Plaintiffs' Motion for Class Certification at 12-17, Shupe v. Rocket Companies, Inc., Case No. 1:21-cv-11528-TLL-APP (E.D. Mich.).

[12] https://ago.mo.gov/wp-content/uploads/2023-03-30-asset-manager-letter-press-final.pdf.

[13] S.E.C. v. SolarWinds Corp., No. 23-cv-9518 (S.D.N.Y. 2023).