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Securities Litigation To Watch In 2020

By **Reenat Sinay**

Law360 (January 1, 2020, 12:04 PM EST) -- In 2020, securities attorneys will be following a U.S. Supreme Court case that will decide the scope of the U.S. Securities and Exchange Commission's disgorgement powers and an appeal before the Second Circuit concerning price maintenance theory.

Attorneys are also eyeing whether federal courts will begin to more aggressively curb mootness fees in litigation stemming from mergers and are watching a Fifth Circuit case over the constitutionality of removing the SEC's administrative law judges from their posts in a follow-up to the Lucia ruling.

Here, Law360 looks at four key securities cases for the coming year.

Taking on the SEC's Disgorgement Powers

The most hotly anticipated ruling of 2020 will be in Liu v. SEC before the Supreme Court, which will decide whether the regulator can keep its powers of disgorgement in enforcement actions.

Charles Liu and Xin Wang, a couple who had been accused of scamming Chinese immigrant investors out of millions, argue that the high court's 2017 ruling in Kokesh v. SEC stripped the SEC of its ability to seek disgorgement as a form of "equitable relief."

The Kokesh ruling said the SEC's collection of disgorgement should be subject to the five-year statute of limitations on civil penalties, since the remedy is often intended to prevent future wrongdoing rather than to compensate victims.

Although five of the justices questioned the SEC's authority to seek disgorgement during oral arguments in the Kokesh case, the court didn't formally take a position on it. Liu and Wang are now pursuing that question, with oral arguments scheduled for March 3.

The SEC has argued that whenever the issue has come up, the circuit courts have unanimously deemed disgorgement to be an acceptable remedy in its enforcement actions. But some attorneys believe that the Supreme Court's unusual willingness to take up the case without a split ruling in the circuit courts indicates that the SEC isn't likely to retain its powers of disgorgement.

Robert Long of Alston & Bird LLP says that Kokesh was just the starting point for this conversation, and that the justices' apparent eagerness to review Liu signals that the high court wants to further clarify its position on disgorgement.

"The reality is disgorgement would be pretty painful for some of these defendants, so the SEC is able to wield that in an effort to settle," he said. "If it's ruled a penalty and the SEC is not able to pursue it in enforcement actions in court, that's a pretty significant piece of leverage" the regulator would be losing.

Long noted that disgorgement historically makes up "a big chunk of [the SEC's] collection." In fiscal year 2019, the agency reaped $3.2 billion in disgorgement compared to just over $1 billion in civil monetary penalties, according to its most recent annual enforcement report. Those statistics include both enforcement actions and administrative proceedings, the latter of which would not be affected by the Liu decision.

Brendan Quigley of Baker Botts LLP agrees that the Supreme Court likely intends to strip the SEC of its disgorgement powers, and that the outcome could put a dent in ongoing enforcement actions.

"The fact that they reached for the case doesn't sound promising for disgorgement for the SEC," Quigley said. "It can create some short-term uncertainty for people who are in settlement negotiations or defendants in cases right now."

Harry Sandick of Patterson Belknap Webb & Tyler LLP says that while Kokesh effectively defined disgorgement as a penalty and not as equitable relief, that case was about statute of limitations and didn't directly deal with the definition of disgorgement.

"This issue is one that they have talked about in the past as something worthy of consideration, but now they're going to take it head on," he said.

Sandick adds that disgorgement isn't even one of the powers explicitly assigned to the SEC by Congress, and if the Supreme Court rules against the SEC, it would be up to lawmakers to decide down the road whether the regulator should be able to seek disgorgement in enforcement proceedings.

"[The SEC] would have to restrict themselves to what Congress allowed them to have, or Congress would have to amend the law to permit this," he said.

According to Quigley, a legislative fix is "at least likely" in the long term.

The case is Charles C. Liu et al. v. U.S. Securities and Exchange Commission, case number 18-1501, in the Supreme Court of the United States.

Challenging the SEC's Administrative Law Justices

In the latest battle over the constitutionality of the regulator's in-house administrative law judges, who preside over the SEC's administrative proceedings, the Fifth Circuit will rule on a challenge to their removal protections.

Accountant Michelle Cochran has argued before the appellate court that the ALJs are unconstitutionally protected from being fired even after the SEC's efforts to address the issue following the Supreme Court's 2018 Lucia v. SEC decision.

In that opinion, the justices said the ALJs are not federal employees but are "inferior officers" subject to the appointments clause of the Constitution and who must be appointed by the president or head of an agency. Cochran now argues that protections preventing the judges' removal are unconstitutional as well.

According to Sandick, the case could follow Lucia and another similar case, Free Enterprise Fund v. Public Company Accounting Oversight Board, all the way to the Supreme Court.

"The SEC administrative judges have effectively a type of tenure — they can't just be fired," he said. "Their removal can't be for any reason — it has to be for cause, but if they are officers of the U.S. as opposed to just employees, then the way in which these judges are hired or subject to removal cannot involve this type of job protection."

Like Lucia and Free Enterprise before it, Sandick believes the Cochran case will find its way to the high court due to its constitutional relevance.

"It will have securities law impact, but I think it's as much a constitutional law question as anything else — a question about the separation of powers," he said.

The case is Cochran v. SEC et al., case number 19-10396, in the U.S. Court of Appeals for the Fifth Circuit.

Goldman Sachs and Price Maintenance Theory

Attorneys are closely watching the unfolding fight between Goldman Sachs and its investors before the Second Circuit over the breadth of the price maintenance theory — the idea that a company's misstatements can fraudulently keep an artificially boosted stock price from declining.

The class of shareholders, who say Goldman lied about its conflicts of interest in underwriting the Abacus CDO transaction before losing $1 billion in securities known as collateralized debt obligations, was recertified in August 2018 based on what the investment bank says is an overly broad definition of the price maintenance theory.

This is Goldman's second attempt to overturn class certification in this case. A New York federal judge certified the class in 2015, finding that the bank hadn't proved that its alleged misstatements had not affected its stock, but the Second Circuit reversed that decision in January 2018, saying that the judge had held Goldman to too high a standard.

Goldman is challenging the recertification of the investor class, arguing that the lower court improperly expanded the scope of the price maintenance theory and overlooked evidence the Second Circuit panel specifically told it to consider on remand.

At oral arguments in June, a three-judge panel was skeptical of Goldman's argument, but reserved judgment. A decision is expected any day now.

Gayle Klein of McKool Smith says the question presented by the case is whether certain statements amount to "fraud on the market" — the theory that defendants can be held liable for statements that are alleged to have affected share price because investors are presumed to have relied upon those statements — and when a defendant can present evidence to challenge that presumption.

"Some courts have said you actually do have to take it into consideration before class certification, but the question presented is how and to what extent it should be considered," she said. "That's very important because it will either increase or limit the class actions available based on the presumption of fraud on the market."

While Long doesn't expect the Second Circuit to overrule the recertification since so many courts have ruled that price maintenance is an acceptable theory, he expects that the circuit judges may clarify the reach of price maintenance and when it can be used.

"Price maintenance right now is in effect a trump card for any argument relating to fraud on the market or any rebuttal to the presumption of fraud on the market," he said. "If they're going to do anything, they're going to address the defendants' argument that the scope of what can show price maintenance is more narrow than just anything."

Quigley noted the appellate panel's hesitance in oral arguments to entertain Goldman's assertions at the class certification stage of litigation.

"In some ways it highlights the importance of the motion to dismiss in a private securities fraud case because once you get past that it becomes harder to litigate the sufficiency of the allegations or whether certain statements as a matter of law cannot be cognizable in their price maintenance theory," he said.

The case is Arkansas Teacher Retirement System et al. v. Goldman Sachs Group Inc., case number 18-3667, in the U.S. Court of Appeals for the Second Circuit.

Mootness Fees Fight Reaches 7th Circ.

In an apparent first, a federal appellate court will rule on the controversial practice of "mootness fees," in which plaintiffs attorneys file objections to company mergers that result in a few extra disclosures for investors and privately negotiated fees for the lawyers.

Shareholders represented by Monteverde & Associates and Geyser PC appealed to the Seventh Circuit to challenge an Illinois federal judge's June order revoking $322,500 in attorney fees they had won after securing additional disclosures about pharmaceutical company Akorn Inc.'s planned merger with Fresenius Kabi AG.

In reaching his decision, U.S. District Judge Thomas M. Durkin examined whether the information sought by the investors was sufficient according to the standard set by the Delaware Chancery Court's 2016 Trulia ruling, which determined that disclosures must be "plainly material" and not just potentially significant.

The Trulia standard was endorsed by the Seventh Circuit in In re Walgreen Co. Stockholder Litigation that same year, in which Circuit Judge Richard Posner called for an end to the "racket" of insufficient disclosure-only settlements and said that such cases that offer no benefit to the class members should be "dismissed out of hand."

But the plaintiffs told the Seventh Circuit in October that the Trulia standard applies only to settlements that give defendants a broad release of additional claims stemming from the merger, which their resolution did not. They maintained that the lower court had no jurisdiction to take away attorney fees when claims are voluntarily dismissed.

In theory, the defendants' disclosures "moot" the investors' allegations, and the plaintiffs then voluntarily dismiss their claims and negotiate fees with the defendants without the need for a judge's approval.

But critics say that mootness fees, like those at issue in the Akorn dispute, ensure that everyone but the lawyers filing the complaint loses, because courts become more skeptical of legitimate allegations and defendants have to address frivolous lawsuits.

According to Long, the Akorn case is "something we're certainly all focused on," and could pave the way for increased scrutiny of such settlements.

"The disclosures are usually such financial arcana that the court has no way to put those in context and judge whether or not they actually brought value to the shareholders," he said. "But some courts are starting to look at this, and are finding out that in fact these disclosures are not giving any value."

"In Illinois they said give the money back," he added. "If that starts happening more frequently, and I think you'll find that the plaintiffs [attorneys] will curb that behavior."

The case is House v. Akorn Inc. et al., case number 18-3307 in the U.S. Court of Appeals for the Seventh Circuit.

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