First COVID-19 Stock-Drop Litigation Filed

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The COVID-19 outbreak has put many aspects of everyday life, and wide swaths of the U.S. economy, on hold. It may, however, have precisely the opposite effect on stock-drop securities class action litigation. Securities fraud lawsuits stemming from COVID-19 have already begun to be filed and more are sure to come. Below, we briefly review recent developments, touch on a few ways in which the pandemic may fuel event-driven stock-drop litigation in the near future and bullet point some of the defenses that issuers and executives may be able to raise in, and prophylactic measures they can take in order to mitigate the risk posed by, such suits.

The First-Filed COVID-19 Securities Fraud Class Actions

On March 12, 2020, what we believe to be the first two federal securities fraud class actions arising out of COVID-19-related events were filed. These cases—one against Norwegian Cruise Lines and the other against Inovio Pharmaceuticals, Inc.—targeted companies in two industries that are, for different reasons, on the front lines of the outbreak and reflect two categories of allegations that may well come to characterize the first wave of COVID-19 securities class actions.

The first of these cases—predictably zeroing in on the cruise line industry—alleges that the company, in effect, misrepresented and/or failed to disclose the severity of the impact the virus was likely to have on its business. The second—against a pharmaceutical company—is based on claims that the company overstated its potential to capitalize on the outbreak.

- In *Douglas v. Norwegian Cruise Lines*, plaintiffs allege that Norwegian's February 20, 2020 Form 8-K and press release provided a misleadingly positive outlook for the company despite the COVID-19 outbreak and that its 10-K, filed seven days later, failed to disclose that the company was employing fraudulent sales tactics, including false statements by its sales force about the virus and its impact on the cruise industry, to induce customers to continue booking (or refrain from canceling) cruises. According to plaintiffs, the truth only came out on March 11, 2020, when a *Miami New Times* article leaked emails from a Norwegian employee concerning the company's sales practices. The company's shares fell 26.7% that day and another 35.8% the next. Of course, given the unfolding global impact of the virus (and its widely reported impact on the cruise line industry in particular), Norwegian's stock price was already precipitously declining during the period between the alleged

misrepresentations/omissions and the "corrective disclosure"—dropping from $48.51 on February 20 to $20.50 on March 10.

- In *McDermid v. Inovio Pharmaceuticals*, the plaintiffs claim that Inovio capitalized on COVID-19 fears when, on February 14, 2020, it announced that the company had developed a COVID-19 vaccine and planned to start human testing early this summer, statements that were reiterated on March 2. The company's stock price allegedly "more than quadrupled from $4.28 per share on February 28, 2020, and continued to increase in the following weeks, reaching an intra-day high of $19.36 on March 9, 2020." Then, on March 9, an activist short-seller called for an SEC investigation into what it called the company's "ludicrous and dangerous claim," following which the stock price tumbled back down to $5.70.

Looking Forward

The *Norwegian* case appears to prove out what many expected: that certain key industries hardest hit by the pandemic (*e.g.*, travel, hospitality) would be at the leading edge of the inevitable wave of securities class actions. *Inovio*, on the other hand, points up a perhaps less intuitive but potentially equal risk in the opposite direction: overly optimistic statements by companies in industries best-positioned to benefit from the crisis (pharma, medical devices, etc.).

Public companies in these industries (and their senior executives, many of whom will find themselves in front of the cameras or otherwise addressing the media on short notice, often in emergent situations) are now clearly on notice that their public statements may in hindsight provide fodder for the securities class action plaintiffs' bar and should take appropriate steps to guard against that possibility. Those in industries a step or two further removed from the epicenter of the crisis should also be acting—right now—to ensure that their SEC disclosures and other public statements do not unnecessarily expose them to such suits. (As but one example, there is speculation that COVID-19 may rapidly accelerate an already existing trend toward businesses working remotely, which could have long-term negative impacts on the commercial real estate industry.)

A few examples of potentially available defenses for companies faced with COVID-19-based securities class actions—and some concrete prophylactic steps that companies across all industries should consider to best avail themselves of those defenses when and if they face such suits—include:

- Risk Disclosures: For many companies, the effect of the COVID-19 pandemic may represent the materialization of a risk that was already sufficiently described in the company's existing risk factor disclosures, which would provide a defense. And public companies across the board should be revisiting their risk factor disclosures to determine whether they need updating or supplementation in light of the outbreak.
- Safe Harbor for "Forward-Looking" Statements: The Private Securities Litigation Reform Act provides a statutory "safe harbor" from liability for securities fraud for statements that are forward-looking in nature and accompanied by meaningful cautionary language. Many statements regarding the potential risk or impact of COVID-19, or a company's future prospects in light of the pandemic, that plaintiffs may allege were false or misleading will qualify as forward-looking and may have been qualified by appropriate cautionary language. Once again, public companies should ensure, going forward, that all such statements (including call scripts, statements made in interviews with senior executives, etc.) are appropriately qualified so as to preserve the potential availability of the statutory safe harbor defense.
- Loss Causation/Damages: Plaintiffs in securities fraud class actions must plead and prove so-called "loss causation" (*e.*, that the plaintiff's loss was caused by the defendant's fraudulent conduct) and provide a methodology sufficient to establish damages on a class-wide basis. Showing that the decline in the stock price of any given company affected by COVID-19 was attributable to alleged misstatements or omissions by the defendants, as opposed to the extensive market- and industry-wide effects of the pandemic itself, will be no mean feat. Indeed, in the best of times, determining the price impact of alleged misstatements or omissions, controlling for market- and industry-wide (as opposed to company-specific) factors and "confounding news" and related issues require expert economic analysis and testimony that is frequently subject to dispute. In the context of the COVID-19 outbreak, such factors as the unprecedented market volatility over the past two weeks (with plus or

minus 5% swings on an almost daily basis), the profound market- and industry-wide impacts of the virus, the exacerbating effect of leverage, etc., will require plaintiffs' experts to revise their models, subjecting them to fresh challenges.

While there is, of course, still enormous uncertainty around the COVID-19 pandemic, it is vitally important for public companies to consider and constantly revisit whether they have provided and are providing appropriate disclosure regarding the effects the virus has had, and is expected to have, on their business.

Characterizing a risk as "potential" when it has in fact already been realized, downplaying the expected negative (or overstating the potential positive) impacts of the virus on the company's business or simply remaining silent could all expose a company and its senior executives to significant liability. Silence, which might otherwise seem prudent in the face of such uncertainty, could actually pose a particularly pronounced risk. Consider, for example, Item 303 of Regulation S-K, which requires disclosure in the company's MD&A of trends or uncertainties that are known to management and reasonably expected to have a material impact on net sales or revenue. While the magnitude of COVID-19's potential impact may have gone from unknown to murky to fairly clear over an extraordinarily short period of time, plaintiffs in securities fraud class actions are virtually certain to argue that the existence of the trend and its likely impact were known—and disregarded—before appropriate disclosure was made. At present, whether a violation of Item 303 can give rise to liability in a private securities fraud class action brought under SEC Rule 10b-5 remains unsettled. But the U.S. Court of Appeals for the Second Circuit, for one, has held that it can and the plaintiffs' bar could latch onto the COVID-19 pandemic as the vehicle to press the issue in courts across the country.

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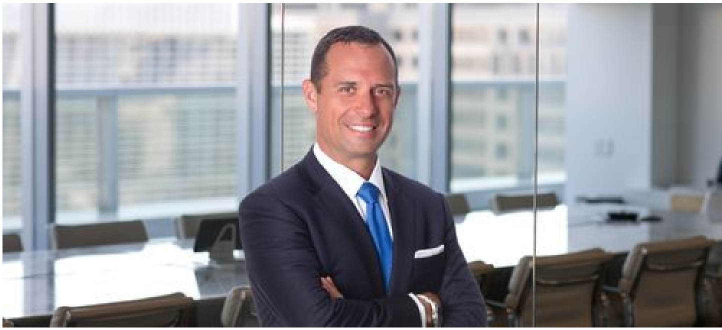

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