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SECURITIES SIDEBAR

THE LATEST SECURITIES LITIGATION NEWS FROM BLOCK & LEVITON

B&L TURNS 10

Jeff Block

Ten years ago, we set out to start a law firm with a slightly different focus in the plaintiff corporate class action space: be nimble, creative, and focused on achieving great results. We also wanted to build a firm where people wanted to work, rather than approaching it as just another job. Jason Leviton, Whitney Street, and I began our law firm journey ten years ago and looking back, we are well on our way to building the firm we envisioned.

We started in small, temporary office space in Boston and began our quest. We were careful in the cases we brought and the lawyers and staff we hired. We quickly grew from three to ten lawyers within two years. One of our early, and most creative, cases was suing Google when its founders wanted to create a class of non-voting stock to cement their majority voting control over the company for the remainder of their lives. Two days before trial, we resolved the case by negotiating a payment structure which paid then-existing public shareholders over a half billion dollars and put restrictions on the founders' stock. We were also involved in leading the securities class action against BP regarding the massive oil spill in the Gulf of Mexico, another case that is emblematic of our creative approach to securities litigation. BP and its executives vastly understated the amount of oil spilling from the deep sea well damaged when its rig exploded. After securing victory at the Fifth Circuit affirming class certification, we defeated, in part, BP's motion for summary judgment and settled the case for approximately 50% of investors' actual losses.

Since then, we have grown beyond our expectations. Today, we have an office in Delaware anchoring our thriving corporate governance practice, where we are one of the leading firms in the nation holding directors accountable for breaching their fiduciary duties to their shareholders. Our securities class action practice, based in Boston and San Francisco, has grown by leaps and bounds and the number of institutional investors hiring us has also grown exponentially. We also added an office in Washington DC where our partner, Joe Barton, leads our ERISA and USERRA practice protecting the rights of employees and our members of the armed forces who sacrifice for this country and should not be short-changed for their heroic efforts.

What is probably the most gratifying has been the compliments we receive from the bench, our employees, and clients. Not only have judges complimented our work when we win, but also when our arguments do not carry the day—something we believe truly underscores the quality of our work. When our associates thrive at Block & Leviton and report that it is the best job they have ever had, we know our law firm is on the right path. When our clients tell us, unsolicited, that they appreciate our efforts and that we are clearly putting their interests ahead of our own, we know we've created the law firm we set out to achieve.

For us, the last ten years has flown by, and we've seen remarkable growth and success. **We believe we are poised for achieving even greater successes for our clients as we embark on the next decade.**

INSIDE THIS ISSUE

SHINING SUNLIGHT INTO THE BOARDROOM

Since the early twentieth century, reformers have recognized the importance of publicity as "a remedy for social and industrial diseases." "Sunlight," in the famous words of Supreme Court Justice Louis Brandeis, "is said to be the best of disinfectants; electric light the most efficient policeman."

Taking that wisdom to heart, activist organizations routinely use the Freedom of Information Act and analogous state-level public records statutes in an effort to expose all forms of corruption, negligence, or other forms of mismanagement. This is important and valuable work. However, these statutes are limited to obtaining information from government entities. These statutes do not extend to private corporations, which perform vital roles in our society, from guarding our prisoners to treating our sick and teaching our children.

If real change is the goal, then cleansing sunlight must extend beyond the halls of government. They must also pry open the shutters of corporate Boardrooms. Historically, this has been a nearly impossible task. But in a handful of recent opinions, the courts of Delaware have created tools that can do just that.

Most publicly traded companies are incorporated in Delaware. That means that they are subject to Section 220 of the Delaware General Corporation Law, which provides that stockholders have the right to demand inspection of a corporation's "books and records." While such an inspection demand must be narrowly targeted, it is not limited to formal Board materials such as Board minutes or presentations. If they can show a "proper purpose" for doing so, investors are able to obtain any documents held by the corporation that are necessary to the stockholders' investigation, including executives' emails and text messages.

This right belongs to any investor who currently holds at least one share of a Delaware corporation. But until recently, there were two key limitations on this

right that made Section 220 demands an unappealing tool for exposing and reforming corporate misconduct.
First, Delaware courts have tended to interpret "proper purpose" narrowly. In a number of cases, the Court of Chancery refused to find that stockholders had a "proper purpose" to investigate misconduct unless they could show that they had standing to bring a potential derivative breach of fiduciary duty claim. As a result, even in cases of egregious wrongdoing, the only shareholders who could seek inspection were investors who had owned stock in the company at the time of the alleged misconduct and held those shares continuously through the time of the inspection demand.

Second, even if a stockholder could show a "proper purpose," Delaware courts routinely allowed corporations to condition the production of documents upon stockholders agreeing to draconian confidentiality provisions that would prevent them from disclosing what they learned (outside of sealed filings made in litigation). Both of these limitations have been substantially undermined by recent decisions.

In its recent AmerisourceBergen decision, the Delaware Supreme Court rejected a narrow reading of "proper purpose." The Court made clear that if a stockholder can show a "credible basis" that misconduct or wrongdoing may have occurred, that is enough to show a proper purpose. Even an investor who purchased after the misconduct—and would, thus, lack standing to bring a derivative fiduciary duty claim—

> "may use information about corporate mismanagement in other ways... They may seek an audience with the Board to discuss proposed reforms or, failing in that, they may prepare a stockholder resolution for the next annual meeting, or mount a proxy fight to elect new directors."

In Tiger v. Boast Apparel, the Delaware Supreme Court held that Section 220 "inspections are not subject to a presumption of confidentiality." While "the Court of Chancery may ... condition Section 220 inspections on the entry of a reasonable confidentiality order," in doing so, it must "weigh the stockholder's legitimate interests in free communication against the corporation's legitimate interests in confidentiality."

The Court of Chancery has taken this message to heart. Earlier this year, in litigation arising from the high-profile Boeing 737 MAX air crash disasters, the Court of Chancery rejected Boeing's attempt to maintain confidential treatment for, among other things, emails

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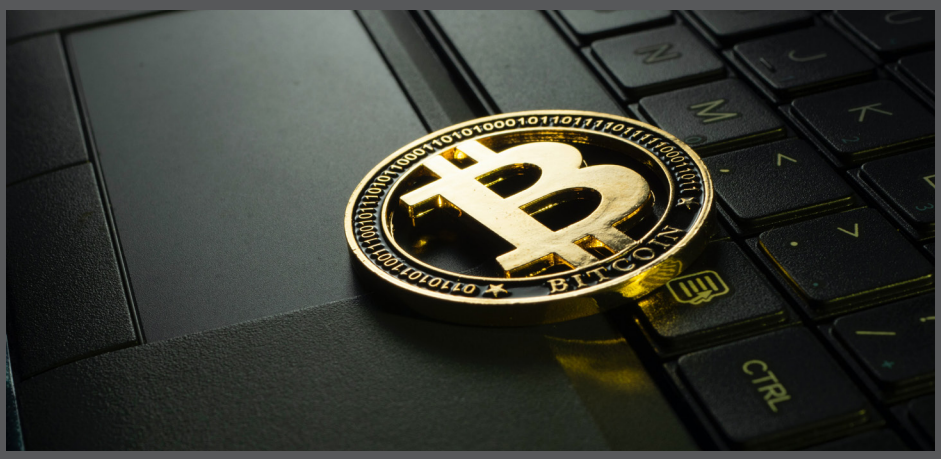
amongst directors and senior executives that had been filed under seal. The Court held that these "communications … [were] essential to the public's understanding of this litigation, which centers on what the Board knew about the 737 MAX and the crashes, when the Board knew it, and how the Board reacted to that information." The procedural context there—a media organization's objection to continued sealing—was different. But the logic is the same and the Court's reasoning in Boeing should apply with equal force when evaluating confidentiality restrictions on Section 220 demands.

In combination, these decisions have drawn a roadmap that gives investors a path to obtaining internal corporate documents to shed light on serious wrongdoing. Investors can make an inspection demand, then refuse to agree to confidentiality provisions, so that they can use the documents obtained to communicate, publicly, with other shareholders for the purpose of **encouraging corporate governance reforms.**

This will not be an easy road. Corporations will resist. Investors will have to litigate to enforce their rights. But they can do so with confidence that the Delaware courts will vindicate them.

LAWMAKERS AND REGULATORS ZEROING IN ON CRYPTO SECTOR



For all the hype surrounding the crypto sector, not many institutional investors have waded in. Early adopters include the Fairfax County Retirement Systems, which first gained exposure to the sector in 2018 through its investment in the Morgan Creek Blockchain Opportunities Fund. To the extent pension funds have ventured into this space, their investments have been focused in digital asset technology and the surrounding infrastructure, rather than in cryptocurrencies themselves. This is true for the Fairfax County Retirement Systems, whose Executive Director Jeffrey Weiler clarified that "No more than 15% of the funds [invested in Morgan Creek Blockchain Opportunities Fund] will be invested in actual cryptocurrencies and, to-date, the Fund has no exposure to any cryptocurrencies." CalPERS CEO Marcia Frost similarly stated in a recent interview that she did not foresee CalPERS investing in cryptocurrency in the near future, although CalPERS has invested in digital asset technology in the past.

Overall, institutional investors appear to be taking a cautious approach regarding investments in the crypto sector, which may be due not only to a lack of regulation in the sector, but a lack of clarity on whether various assets are even subject to regulation, and if so, by which agency. In recent remarks, S.E.C. Chair Gary Gensler suggested that the issue was clear cut: under the long-standing Howey test, an "investment contract" exists (and is therefore a "security" subject to S.E.C. regulation) when "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." Bitcoin and Ethereum (the two largest cryptocurrencies) are understood to fall outside this definition because they are neither a "common enterprise" nor do they entail "a reasonable expectation of profit derived from the entrepreneurial or managerial efforts of others." Yet, **in late 2020, the S.E.C. filed an enforcement action against Ripple charging that its product, XRP, is a security, not a currency.** Ripple has aggressively defended the suit and repeatedly decried the lack of regulatory clarity. Senator Elizabeth Warren has also expressed uncertainty about the parameters of the S.E.C.'s authority, writing to Chair Gensler in late July 2021 "to request information regarding the [SEC's] authority to properly regulate cryptocurrency exchanges and to determine if Congress needs to act to ensure that

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the SEC has the proper authority to close existing gaps in regulation that leave investors and consumers vulnerable to dangers in this highly opaque and volatile market."

Although much of the recent focus has been on the S.E.C.'s scope of authority, it is not the only agency that may have jurisdiction over the complicated crypto sector. At the recent Assets Derivative Management Forum, CFTC Commissioner Dan Berkovitz singled out Decentralized Finance (or "DeFi") as a potential CFTC enforcement target. DeFi is a catchall term referring to financial services that operate entirely on blockchain networks, dispensing with banks and other financial intermediaries. DeFi can be used for basic borrowing and lending, i.e., a market participant can lend its cryptocurrency and earn interest rates that typically exceed the interest rates offered by typical banks. The transactions can also involve more complex arrangements, including the ability to speculate on the change in price of assets using derivatives. In his comments to the ADM Forum, Commission Berkovitz explained that the Commodities Exchange Act requires futures contracts to be traded on designated markets that are licensed and regulated by the CFTC. He went on to state in stark terms: "Not only do I think that unlicensed DeFi markets for derivative instruments are a bad idea, I also do not see how they are legal under the CEA." The comments are noteworthy, in part due to the size and growth rate of the DeFi market. As of January 2021, over $20 billion in cryptocurrency was traded using DeFi, representing a twenty-fold year-over-year increase.

Against this backdrop, regulators and lawmakers appear poised to introduce a clear, consistent framework – as Chair Gensler phrased it, "guardrails" – to regulate this market sector to protect investors while supporting innovation. "We are at a pivotal point with respect to shaping policies that will significantly impact the digital asset ecosystem," explained Representatives McHenry and Thompson in a recent letter to Chair Gensler. This area should prove to be an extremely interesting one for institutional investors to watch in the coming months.

DELAWARE LAW PROVIDES WIDENING PATH FOR HOLDING PHARMACEUTICAL AND HEALTH CARE EXECUTIVES ACCOUNTABLE

Directors and officers of Delaware corporations generally enjoy broad protections from liability under the business judgment rule. Executives' actions that, in hindsight, seem to have been completely boneheaded are often still insulated from breach of fiduciary duty lawsuits as long as the directors and officers were pursuing lawful business activity, were not obviously acting just to line their own pockets, and there's a rational basis to presume that they believed their actions were in the best interest of the company and its stockholders. Historically, that's meant that, while "corporate traumas" have been the subject of government prosecution, the courthouse doors have generally been closed to stockholders trying to hold directors and officers personally liable for breaches of fiduciary duty in connection with those traumas. But that may be changing. In a potentially big way.

First, let's start with the legal standard: When a Board fails to establish a system to oversee a key area of corporate operations or establishes such a system but consciously fails to monitor it, its members can be found personally liable for related corporate wrongdoing. These claims are called "Caremark claims" and, historically, have been notoriously difficult for plaintiffs to win. This is in part because the magnitude of the corporate wrongdoing and the actual failure of the Board to detect or correct it are, at least technically, irrelevant to the Caremark analysis. If the Board made a good faith effort to establish and implement a reasonable oversight system, the claim has historically been dismissed even if the Board in fact failed to prevent or even detect the problem at all.

Although the difficulty of prevailing on a Caremark claim has become a cliché, there have been recent signs of hope for plaintiffs in the Delaware courts. This is particularly true in suits involving companies in the healthcare sector, where the courts seem to have been more open to claims that Boards were asleep at the wheel during periods of serious corporate misconduct.

For example, in 2020, Vice Chancellor Glasscock of the Delaware Court of Chancery issued an opinion refusing to dismiss Caremark claims brought against the Board of drug wholesaler AmerisourceBergen.* The stockholder-plaintiffs in this case alleged that a subsidiary of the company had improperly pooled doses of oncology drugs in unsanitary conditions to

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maximize the number of total doses they could package and sell. The court upheld plaintiffs' claims that the Board had failed to establish any system to supervise the subsidiary or to monitor drug safety and compliance generally. Compounding this lapse was the Board's failure to respond to several red flags that its compliance program was inadequate. These red flags included reports from an internal auditor, a whistleblower executive, and a subpoena from federal prosecutors. The Board's failure to respond to these red flags with a reasonable monitoring program was sufficient to trigger liability under Caremark.

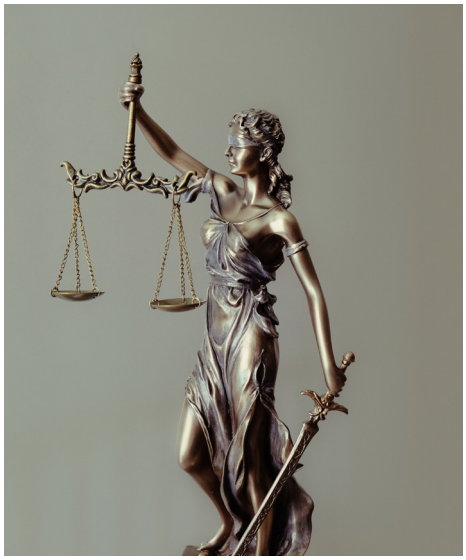
In another pharmaceutical case, this one involving pharmaceutical research company Clovis Oncology, Inc., Vice Chancellor Slights similarly found that the stockholder-plaintiffs had adequately pled Caremark claims. The plaintiffs alleged that the company had trumpeted unconfirmed data for the efficacy of its main drug candidate, even though it had been directly told by the FDA that it could only use confirmed data. Although the Board allegedly knew that the company was using this impermissible data in its public statements, it did not act. This inaction constituted a bad faith failure by the Board to actually implement its compliance system and correct the misconduct.

Finally, in a case that Block & Leviton litigated with others, a U.S. District Court in northern California found that the stockholder-plaintiffs had adequately pled a Caremark claim against the Board of McKesson Corporation, a pharmaceutical distributor. The court found that the Board had failed to implement and maintain a controlled substances monitoring program, resulting in large numbers of suspicious opioid sales and significant sanctions from the DEA. Because an early DOJ settlement required the company to establish a monitoring plan, failure to do so combined with multiple red flags that suspicious sales were still occurring demonstrated bad faith and triggered Caremark liability. In a similar case, a federal judge in New York found that the plaintiffs sufficiently alleged that Pfizer's Board failed to monitor promotion of off-label prescription use despite red flags and settlements requiring it to do so, triggering Caremark liability. Both of these decisions based their Caremark findings in significant part on the Board's failure to properly implement a monitoring system demanded by earlier settlement agreements.
These successful Caremark claims, all of which concern companies in the healthcare sector, share two characteristics common to that sector that help explain their outcomes.

First, because healthcare is a highly regulated sector, companies in the sector are likely to receive explicit regulatory guidance that functions as a relatively clear red flag to directors and officers. In these recent plaintiff-friendly decisions, such red flags have included subpoenas, settlement agreements, and FDA guidance. Ignoring such warnings is a straightforward way for a Board to demonstrate bad faith and run afoul of Caremark.

Second, the decisions seem to take into account the fact that the misconduct put human lives at risk—a fact pattern that is unfortunately all too common in instances of healthcare sector misconduct.

These decisions seem to indicate that Delaware fiduciary duty law is increasingly open to stockholders holding directors and officers of Delaware corporations personally liable for serious corporate misconduct. This is a welcome development in Delaware law.



ANTITRUST ENFORCEMENT UNDER BIDEN

President Biden's July 9, 2021 Executive Order on Promoting Competition in the American Economy made clear his intent to crack down on Big Tech, asserting that while the U.S. information technology sector has historically fueled innovation and growth, **"today a small number of dominant Internet platforms use their power to exclude market entrants, to extract monopoly profits, and to gather intimate personal information that they can exploit for their own advantage."** A sea change is coming to competition enforcement in the U.S., and three appointees will determine its course.

Recently appointed Federal Trade Commission ("FTC") Chair Lina Khan comes to the position armed with a blueprint for replacing the current paradigm governing monopoly analysis. Her 2017 article, "Amazon's Antitrust Paradox" published in the Yale Law Journal, challenges the current antitrust framework's focus on "consumer welfare," which focuses narrowly on price effects in the short term. Ms. Khan advances two critiques of the "consumer welfare" approach. First, it does not sufficiently account for the threat of predatory pricing, which current antitrust doctrine dismisses as irrational. She argues that, for an online platform, predatory pricing is arguably rational, as the platform is incentivized to prioritize growth over immediate profits. Second, online platforms control the

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infrastructure on which their rivals depend, allowing them access to information that can in turn be used to the online platform's competitive advantage. "In order to capture these anticompetitive concerns," Khan argues, "we should replace the consumer welfare framework with an approach oriented around preserving a competitive process and market structure." Early tests of Ms. Khan's vision will include the FTC's challenge to Facebook's acquisition of Instagram and WhatsApp (Ms. Khan oversaw the filing of an amended complaint in August 2021) and the agency's investigation of Amazon's proposed acquisition of MGM.

Many of Ms. Khan's views are echoed by Tim Wu, who has been named a Special Assistant to President Biden for Technology and Competition Policy. In his 2018 book, "The Curse of Bigness: Antitrust in the New Gilded Age," Mr. Wu singles out Facebook, Amazon, Google, and Apple as illustrating the centralization of once competitive technology industries. Mr. Wu calls for a return to the vigor that defined the antitrust laws of the "Gilded Age," which laws Mr. Wu posits have been "enfeebled" by a "consumer welfare" approach that focuses too narrowly on only one type of harm – higher prices. As with Ms. Khan, Mr. Wu's criticism calls for a change in the paradigm governing the analysis of monopolies.

The most recent of President Biden's trio of antitrust appointments, Jonathan Kanter, has been tapped to lead the Antitrust Division at the Department of Justice. Although not yet confirmed by the Senate, there appears to be bipartisan support for his appointment. In private practice, Mr. Kanter represented companies in litigation against Google and – as with Ms. Khan and Mr. Wu – has made known his views (including during a 2018 FTC panel) that the existing antitrust framework must be overhauled to adequately address "how markets actually function in today's economy."

As these enforcers grapple with Big Tech, it appears certain that they will forge a new approach to monopoly analysis under the antitrust laws, with far reaching implications.

SEC LIKELY TO "FRESHEN UP" RULES GOVERNING INSIDER TRADING PLANS

In early June 2021, SEC Chair Gary Gensler announced that he had asked his staff to recommend changes to one of the main regulations governing share sales by corporate insiders: SEC Rule 10b5-1. Rule 10b5-1 allows corporate insiders – executives, directors, and senior officers – to commit to sell a predetermined number of shares at a predetermined time and price. For example, a CEO might enter into a plan to sell 1,000 shares one year after the adoption of the plan at the market price. The plans can also be much more complicated, with complicated formulas determining the price, timing, and size of a sale. If a so-called 10b5-1 plan is adopted in good faith and before the insider becomes aware of material nonpublic information, the plan functions as an affirmative defense to allegations of improper insider trading.

These plans are important, as they allow insiders to safely liquidate some of their shares to pay for major expenses, but they are also ripe for abuse. Insiders with material nonpublic information can adopt a plan that lets them sell stock in a month rather than a year, or cancel or amend a plan when they learn something that makes the sale undesirable. Although these maneuvers might sometimes run afoul of the letter or spirit of Rule 10b5-1, because there are no mandatory disclosure requirements for these plans, such violations are difficult to police. Some preliminary data suggest that insiders do use 10b5-1 plans to take advantage of their access to material nonpublic information. **A recent Financial Times study found that large sales made under 10b5-1 plans were disproportionally followed by company underperformance, suggesting that the plans were used by insiders to sell ahead of unfavorable results.** Nonetheless, some courts in private securities fraud litigation have (inappropriately, in our view) considered stock sales pursuant to a 10b5-1 plan as exculpatory when considering whether Plaintiffs have adequately pleaded scienter.

The SEC's investigation of potential changes to 10b5-1 plans is still in its early stages. Some of the changes Chair Gensler suggested include mandatory cooling-off periods between the adoption of a plan and the first sale of stock and restrictions on when insiders can cancel sale plans. Block & Leviton will continue to monitor the SEC's efforts in this area. Later in the process, the Commission will likely invite public comment on any proposed changes to the rule. Block & Leviton will consider commenting on the impact of 10b5-1 plans on securities fraud litigation, and looks forward to further discussing this issue with its clients in the months to come.