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Monitoring Corrective Disclosures To Protect Investors

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Event-driven securities class actions are an evolving class action mechanism employed by securities class action counsel to protect all investors that buy and sell publicly traded securities on U.S. exchanges.[1] Sound investor protection in volatile equity markets is important, because stock drops that materialize in response to an alleged corrective disclosure may be masked by notable market corrections.

Company-specific information that corrects alleged misstatements or omissions that are disseminated via U.S. Securities and Exchange Commission filings, press releases and/or social media — such as tweets by directors and officers of publicly traded companies — forms the basis of fraud-on-the-market allegations. In declining equities markets, institutional investors will increase their reliance on portfolio monitoring programs to attain monetary recompense from alleged corrective events that were mispriced as a result of alleged misstatements or omissions by directors and officers of publicly traded companies.

The equities market cycle is at the tail end of the longest running bull market in U.S. history.[2] The current cyclical downturn in the equities market, coupled with a plethora of emerging risks to public companies — such as data breaches, sexual misconduct and GDPR-related securities claims — has pushed key stakeholders in the securities class action arena to adopt technologies that foster data-driven decision-making at the investigatory stages of potential claims.

“One of the reasons why the U.S. securities marketplace is as respected as it is, and one of the reasons why a listing on a U.S. exchange is perceived as a mark of status and reliability, is that our marketplace is viewed as transparent and having integrity,” wrote the D&O Diary’s Kevin LaCroix. An event-driven securities class action

> does not seek damages for harm from the underlying event, which is addressed through other lawsuits. Rather, the securities claim asserts that the company defrauded investors by intentionally or recklessly failing to warn that the adverse event might occur, even though these events are — by definition — unexpected. ... The securities class action complaint will assert that the price drop resulted from the supposed 'correction' of prior false statements of material omissions.[3]

The Securities Exchange Act of 1934 is the basis of all securities laws that apply to public corporations and the sale of publicly traded securities.[4] Empirical evidence, such as statistical analysis of company-specific events that correct an alleged false statement or omission, is required to adequately plead loss causation in a post-Dura world.[5]

Stable equity market conditions may not have necessitated robust statistical analysis at the investigatory stages of a securities class action claim. That is no longer the case. General market and industry-specific indexes are undergoing notable corrections.[6]

At the onset of a potential claim, class action counsel that investigate, initiate and vigorously litigate these claims to attain monetary recompense for defrauded investors need to rely on technological advancements that facilitate data-driven decision-making processes to more effectively evaluate potential classwide damages that may be due to a proposed class of investors. Sound and objective evaluation of the magnitude of the residual stock price decline and potential classwide damages of a securities class action claim is a valuable exercise which will deter the filing of "meritless cases and encourage the filing of cases involving real fraud."[7]

Continuous analytical monitoring of the universe of alleged corrective disclosures that form the basis of event-driven securities class actions alleging violations of the federal securities laws under Section 10(b) and 20(a) of the Securities Exchange Act of 1934 serves two critical functions. First, it provides objective validation of the portion of artificial inflation that dissipated from stock price resulting from an alleged corrective event. Second, it provides a quantum of potential classwide exposure and damages at the onset of a potential securities class action claim that may result from the alleged corrective event.

Applied statistical and quantitative analysis at the investigatory stages of a potential securities class action may seem like a Herculean requirement for entrepreneurial, up-and-coming, innovative plaintiff class action counsel.[8] Nevertheless, data-driven decision making is the modus operandi for respected securities class action counsel. "Data has always been a foundational part of practicing law. … Today, however, data is not only a set of static reference points on which a human can make decisions. It's a dynamic asset they can use to root out previously unseen relationships and conclusions."[9]

Allegations for violations of the federal securities laws under Section 10(b) and 20(a) of the Securities Exchange Act of 1934 are specific, and relate to a series of potential corrective disclosures that may affect a company's market capitalization in a material manner — see, for example, Facebook.[10] Objective and robust statistical analysis in response to stock drops that allegedly correct a prior misstatement or omission is a fundamental component used to determine the magnitude of classwide damages due to investors that purchased publicly traded securities at artificially inflated prices and/or in response to alleged misinformation.

Current equity market dynamics have heightened the level of rigor required to validate whether single-trading-session stock drops — that may appear to be of high magnitude in response to a potential corrective event — surpass the statistical threshold that abides by the heightened pleading standards of loss causation in a post-Dura world. Event-driven securities class actions that plead stock drops that do not surpass robust analytical standards are more likely to be dismissed at the motion-to-dismiss stage.

Continuous analytical monitoring of securities class actions that allege violations of the federal securities laws under Section 10(b) and 20(a) of the Securities Exchange Act of 1934 is a sound mechanism, which fosters a data-driven environment that protects investors in the U.S. capital markets, and deters the filing of meritless claims. "Complex configurations of technologies will require a corresponding need to bring together new kinds of partners."[11]

Data-driven processes to attain objective measures of risk, exposure, damages and liability are a valuable tool which the securities bar as a whole should adopt to curtail repetitive issues that may have already been addressed in the Private Securities Litigation Reform Act of 1995.

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[1] "Turning Events into Securities Suits," The D&O Diary, July 17, 2017.

[2] "Bull Market Hits a Milestone: 3,453 Days. Most Americans Aren't at the Party." The New York Times, Aug. 22, 2018.

[3] "A Rising Threat," U.S. Chamber Institute for Legal Reform, Dec. 17, 2018.

[4] Professional Liability Underwriting Society, 2018.

[5] Allen Ferrell & Atanu Saha, The Loss Causation Requirement for Rule 10B-5 Causes of Action: The Implications of Dura Pharmaceuticals v. Broudo, 63 Bus. Law. 163 (2007).

[6] The S&P 500 Total Return Index and NASDAQ Composite have declined over 10 percent and 12 percent, respectively, since Oct. 3, 2018.

[7] "A Rising Threat," U.S. Chamber Institute for Legal Reform, Dec. 17, 2018.

[8] Devin F. Ryan, Comment, Yet Another Bough on the "Judicial Oak": The Second Circuit Clarifies Inquiry Notice and its Loss Causation Requirement Under the PSLRA in Lentell v. Merrill Lynch.

[9] "How Data Can Make Lawyers More Efficient, Competitive, and Predictive," Thomson Reuters, 2018.

[10] "Facebook Suffers Worst-Ever Drop in Market Value," The Wall Street Journal, July 26, 2018.

[11] "Why Legacy Companies Must Reinvent — or Die," Fortune, Sept. 24, 2018.