

Trends in Securities and Derivative Litigation: Fewer Merger and Acquisition Filings at the Forefront of Litigation Activity

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Historically, the volume of shareholder litigation increases in periods of market turbulence and significant merger or acquisition activity. During the past two years, there has been a decrease in the number of shareholder complaints filed due to the decrease in merger objection filings. The number of complaints filed may have decreased even more if not for the litigation activity surrounding both special purpose acquisition companies (“SPACs”) and COVID-19. This discussion analyzes this decrease in shareholder claims. This discussion also provides an overview of the types of litigation claims being filed, the impact of SPACs and COVID-19 on shareholder litigation, and the recent trends in shareholder litigation judicial decisions.

INTRODUCTION

As a general matter, investors are more likely to file a lawsuit during periods of economic turbulence rather than during periods of economic prosperity. Shareholders who own investments that are generating healthy returns are less likely to find fault with company directors than investors who are losing money. In addition to unsatisfied investor-related lawsuits, investors often pursue their statutory dissenting shareholder appraisal rights in objection to mergers and acquisitions.

In light of this general trend, it is notable that shareholder complaints decreased from the high levels observed from 2017 through 2019. After the record high period of shareholder lawsuits filed in those years, shareholder litigation activity has returned to more normal levels in terms of the number of cases filed.

This discussion provides observations related to the typical categories of shareholder litigation (including related statistics), particularly with regard to the following considerations:

1. The filing trends over the past two years
2. Special purpose acquisition companies (“SPACs”) and the issue of fiduciary duty
3. The presence of COVID-19 in litigation
4. The recent trends in judicial decisions

GENERAL SHAREHOLDER LITIGATION AND DERIVATIVE LITIGATION

As company owners, shareholders have rights and privileges as a collective group. These rights and privileges include, but are not limited to, the appointment and removal of officers and directors, calling meetings, proxy representation, information, and oversight.

Further, shareholders may be called on to approve dividends, approve the financial statements of the company, approve mergers and acquisitions, or approve a company liquidation.

While the duties of directors can vary by state, all directors have a fiduciary duty. As a result, corporation directors are compelled to act in the best interest of the company and of its shareholders.

However, directors occasionally make decisions that inevitably decrease the value of the shareholders' ownership stake. When the value of the shareholders' ownership stake decreases due to the decisions made by directors, then shareholders may use the judicial system to make their claim.

CLASSIFYING SHAREHOLDER LITIGATION

Federal Securities Litigation

While all claims filed with regard to securities laws fulfill the definition of "securities litigation," the remainder of this discussion concerns federal class action lawsuits. In effect, this discussion discusses new class action lawsuits citing Federal Rule of Civil Procedure 23 ("Rule 23").

Rule 23 enables someone to file a class action lawsuit for a group of people or entities (1) that purchased a company's securities during a specified period of time and (2) that allege that the company and/or its officers and directors violated federal securities laws.¹

Many securities-related class action claims asserted in such Rule 23 cases cite Section 10(b) of the Securities Exchange Act of 1934 and Securities and Exchange Commission Rule 10b-5. Plaintiffs file lawsuits in reference to the above-stated provisions in order to compel liability on persons who were responsible for material misrepresentations or omissions.

Misstatements and omissions can often be found in financial statements or published investment guidance. Plaintiffs may allege such misstatements and omissions adversely cause harm through the decrease in shareholder value.

Rule 23 is not the only course of action for disgruntled shareholders. Shareholders of public companies can file claims citing a breach of the Securities Act of 1933.

Often, shareholders cite Section 11 of that Act. Section 11 imposes liability for material misrepresentations and omissions in a registration statement.²

Shareholder Derivative Litigation

Shareholder derivative suits are another type of representative litigation. While in a securities class

action suit, the plaintiff represents other members of the same class, and the plaintiff in a shareholder derivative action asserts claims on behalf of the corporation itself.

To be considered derivative, a shareholder suit should be focused on actions detrimental to the well-being of the corporation. Any claims for monetary damages should be based on corporate mismanagement.³

Derivative suits can encompass many allegations. Typically these allegations include (1) self-interest by corporate executives, (2) mismanagement or misuse of corporate assets, or (3) shareholder objections to specific corporate transactions.

FILING TRENDS

As previously noted, the number of securities and derivative lawsuits filed in the United States decreased during the past two years. In 2021, the number of cases filed decreased for a second year in a row. There were only 205 new cases filed in 2021, as compared to the 321 new cases filed in 2020. The total number of cases filed had not fallen below 300 since 2016.

The decrease in the number of cases in 2021 outpaced the decrease in the number of cases filed in 2020. New cases decreased by 116 in 2021; while in 2020, there were 99 fewer cases as compared to 2019.⁴

The number of cases previously increased in 2017 and remained at a relatively high level through 2019. However, as the number of cases filed in 2021 decreased to 205, that number was more consistent with the number of cases filed from 2005-2015 time period.

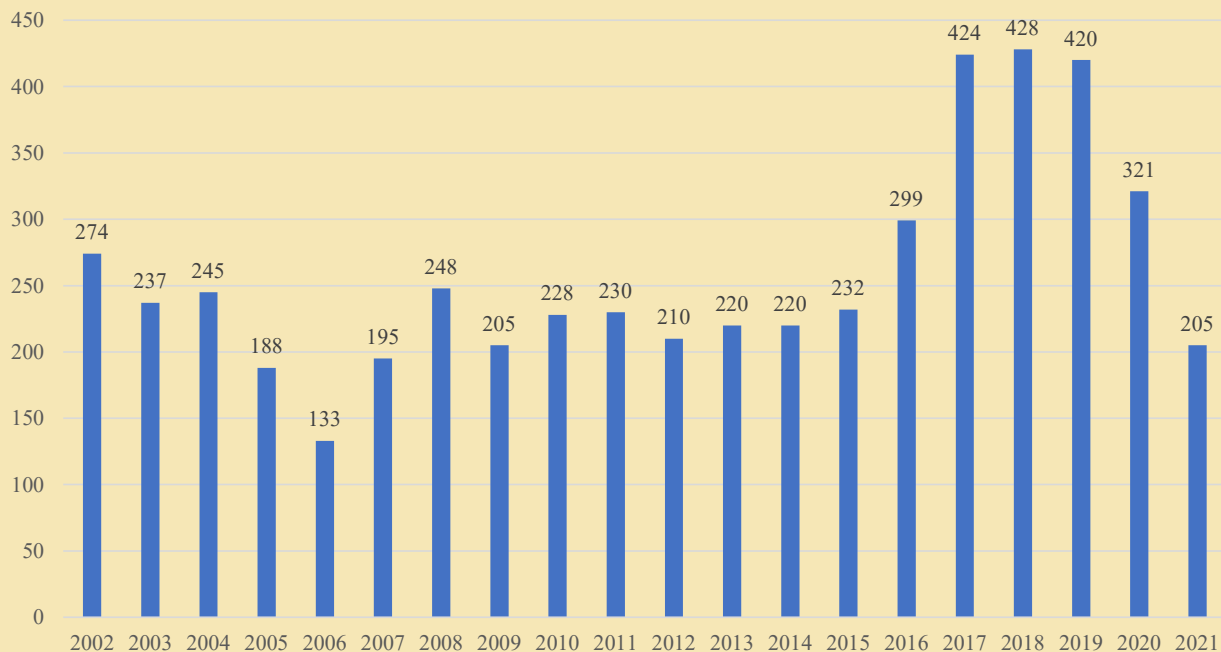
Figure 1 presents the number of new federal securities cases filed during the past 20 years.⁵

What's Driving the Decrease in Filings?

A healthy stock market often lacks material valuation (price) volatility. In times of major market disruption, shareholder and derivative litigation tends to emerge. This fact is fairly intuitive; if shareholders are receiving positive returns, they are much less likely to attribute fault or negligence to company management.

However, the trend in cases filed over the past few years have less to do with market turbulence. Instead, the decrease in the number of new securities cases filed centered around diminishing merger objections.

Figure 1
Federal Securities Filings
By Year during the Past 20 Years
From 2002 to 2021



The increase in the number of cases filed from 2017 through 2019 was due in large part to substantially greater merger objection cases. In 2018, for instance, plaintiffs filed a total of 182 merger objection cases, which accounted for more than 40 percent of total class action lawsuits filed.

After decreasing to 103 cases filed in 2020 from 162 cases filed in 2019, the number of new merger objection cases filed in 2021 decreased to only 14. That number represents more than an 80 percent decrease in merger objection litigation. The decrease may be attributable to increased individual filings.

Figure 2 illustrates the federal securities actions filed by type in over the past 10 years.⁶

In addition to a decrease in merger-related litigation, Rule 10b-5 filings decreased as well. Though the decrease was not as stark as merger objections, Rule 10b-5 filings decreased by more than 15 percent in 2021.⁷

Allegations

Of the cases filed that did not involve merger-related litigation, the most typical allegation in the cases filed in 2021 related to misleading future performance. Approximately 40 percent of the cases filed

in 2021 related to misleading future performance allegations.

In addition, allegations concerning missed earnings guidance accounted for approximately 24 percent of cases filed in 2021. Allegations involving missed earnings guidance accounted for at least 20 percent of the new cases filed since 2018.⁸

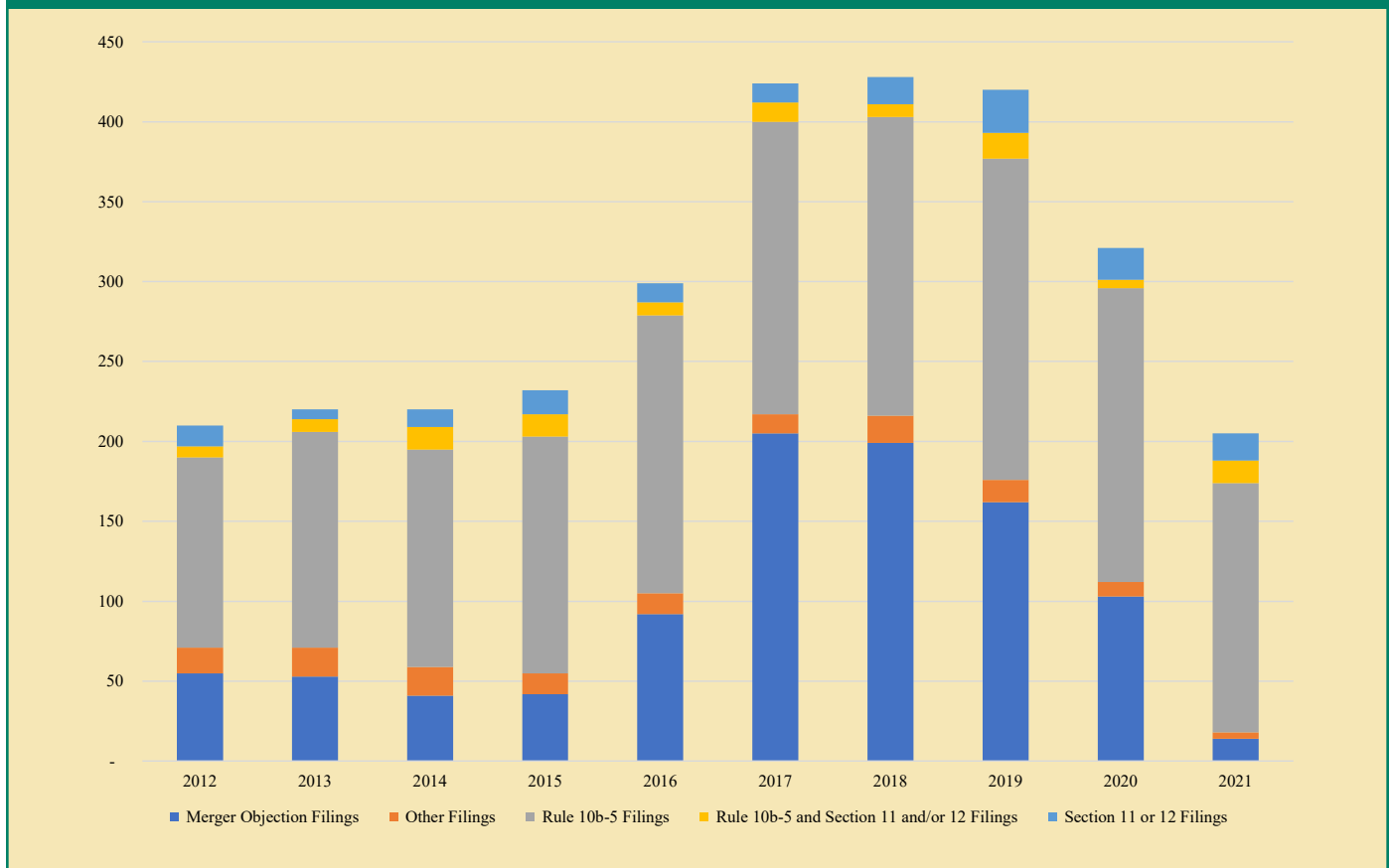
The number of cases related to accounting issues and regulatory issues decreased during the last two years. In 2019, cases filed concerning accounting issues and regulatory issues represented 28 percent and 25 percent of new cases, respectively. In 2021, new cases concerning accounting issues and regulatory issues only represented 16 and 17 percent of cases, respectively.⁹

It should also be noted that the number of cases involving merger integration issues more than tripled in 2021. In 2021, cases with merger integration issues accounted for 17 percent of new cases filed. It appears that the increase in 2021 can be correlated with the increasing popularity of SPAC investments.¹⁰

SPACs

A SPAC is a company formed for the sole purpose of raising capital through an initial public offering

Figure 2
Federal Securities Filings
By Type of Filing
From 2012 to 2021



(“IPO”) with the intent of acquiring or merging with a pre-existing company. While SPACs have existed since the 1990s, they have increased in popularity in recent years. In 2020, for instance, SPACs raised a record \$82 billion.¹¹

However, the increasing popularity may have led to increased litigation.

SPACs can present conflicts between sponsors and the shareholders. From an economic standpoint, SPAC sponsors are often incentivized to complete a merger even if the merger would not create value for the shareholders. Accordingly, shareholders may view such a merger with skepticism.

As fiduciaries, it is necessary for the members of a company’s board of directors to review proposed mergers and to present the proposed merger to the shareholders. However, if the board members’ compensation aligns their interests with the sponsor, the apparent conflict of interest could create concerns about the board of directors’ fiduciary duties to the company’s shareholders.

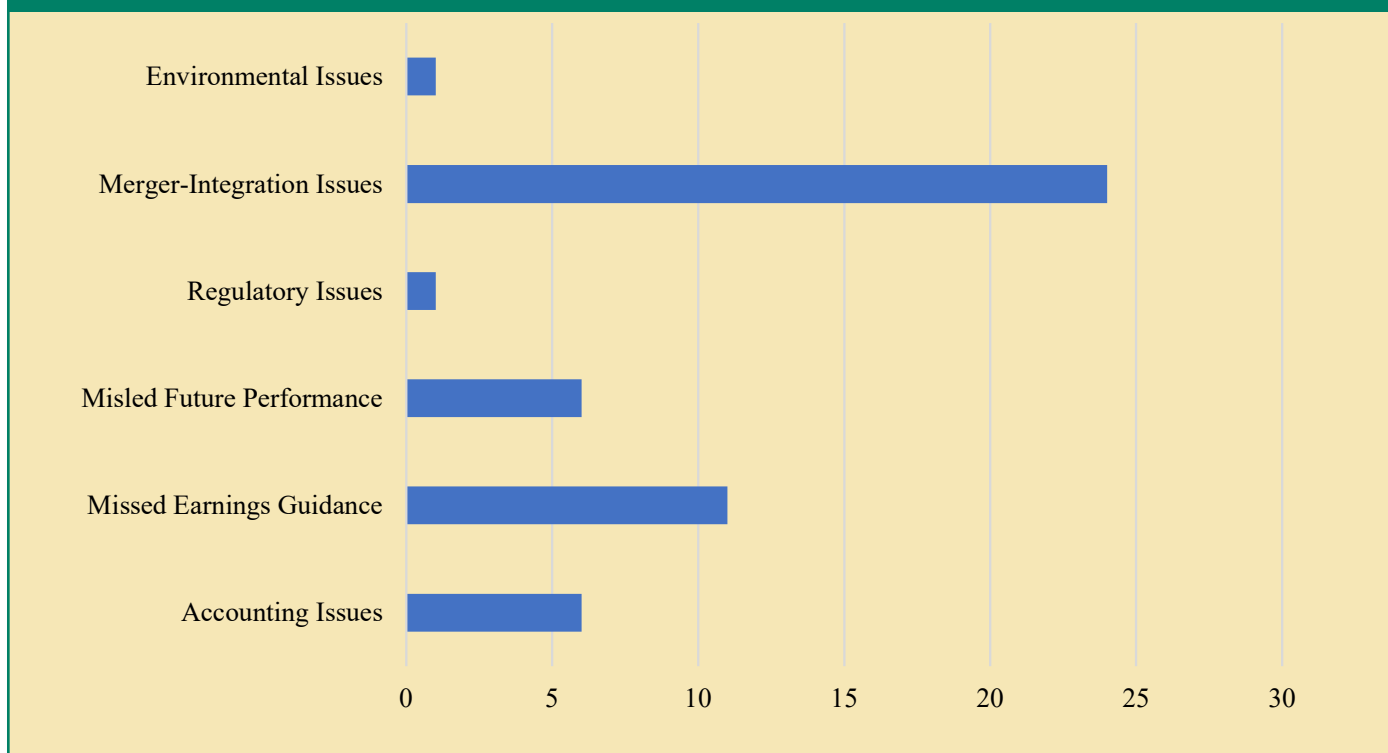
In 2021, merger integration issues were central to most SPAC-related court filings. There was a total of 24 such cases filed in 2021, or almost half of all cases. Other SPAC-related filings most typically involved missed earnings guidance and misled future performance—with 11 and 6 cases, respectively.

Figure 3 presents the composition of SPAC-related filings over the past year.¹²

The *In re Multiplan Stockholders Litigation* (“*Multiplan*”) decision provides an example of this merger integration conflict. In *Multiplan*, Churchill Capital Corp. III (“Churchill”) was formed as a SPAC in October 2019 and completed its \$1.1 billion IPO in February 2020. The IPO was sponsored by M. Klein and Company, a financial services firm led by Michael Klein.

On July 13, 2020, Churchill and Multiplan Corp. announced the two had agreed to merge in a deal worth \$11 billion. The deal was later approved by Multiplan Corp. and by the Churchill shareholders in October 2020.

Figure 3
SPAC-Related Federal Lawsuit Filings
By Type of Allegation in 2021



Soon after approval, a short seller published a research report painting Multiplan Corp. in a negative light, and soon after that, a lawsuit was filed in Delaware Court of Chancery. The lawsuit alleged that Michael Klein and the Churchill directors' ownership interests provided significant financial incentives to seek and to approve any deal.

The lawsuit claimed that even a bad deal for the SPAC public investors would provide a strong financial benefit to the directors' shares.

The board, as alleged, ignored advice from their standard third-party financial adviser, and instead retained Michael Klein's own vehicle and transferred an advisory fee of \$30.5 million in addition to his founder shares.¹³

Claims for breach of fiduciary duty were made against the directors, and against Michael Klein and his related entities. This is one of the first instances in which a court had to consider the unique structure of SPACs in conjunction with a board's obligation to comply with fiduciary duty laws.

On January 3, 2022, the Delaware Court of Chancery denied the defendants' motion to dismiss, and the court addressed claims against the sponsor and other insiders of the SPAC for breach of fiduciary duties in connection with a de-SPAC merger.

While it appears that more time is needed for the court to examine the relationship of SPACs and fiduciary duties, the court's Vice Chancellor concluded that the entire fairness standard applied in *Multiplan* and not the business judgment rule. This is significant because the fairness standard is Delaware's most onerous standard of review.

The Vice Chancellor also noted that it is rare for the court to dismiss a fiduciary duty claim under the fairness standard.

The *Multiplan* matter may have a significant impact on securities and derivatives litigation as it could likely serve as precedent for future claims of breached fiduciary duty in SPAC-related litigation. However, if the court sides with Churchill and Klein, then it stands to reason that SPAC sponsors and directors may use the *Multiplan* decision as a reason to structure similar financial incentives that more heavily favor their own financial interests.

COVID-19 and the Courtroom

Since March 2020, there have been a total of 53 class action lawsuits with COVID-19-specific allegations. In 2021, there were a total of 20 lawsuits filed with COVID-19-related claims, as compared to the 33 claims filed in the previous year.

According to NERA Economic Consulting, filings related to COVID-19 were approximately 10 percent of total securities-related filings in 2020.¹⁴

In the first year of COVID-19, the types of allegations within the new cases filed appeared to vary.

Figure 4 presents the various groupings of allegations related to COVID-19 litigation matters filed in 2020. Regulatory issues were the most typical causes of new lawsuits filed, while missed earnings guidance and misleading future performance followed closely behind with 28 percent and 25 percent of new cases filed, respectively.

The reasons for COVID-19-related litigation shifted in 2021. Claims primarily centered around misleading future performance and missed earnings guidance with 43 percent and 38 percent of new cases filed, respectively. Meanwhile, cases alleging regulatory issues became a relative afterthought.

Figure 5 provides an analysis of the claimed allegations for 2021.¹⁵

Litigation matters involving certain alleged misstatements related to company safety procedures and risk disclosures are still being filed in the courts. It is possible that if any additional COVID-19 variants arise, COVID-19-related litigation will continue into 2022.

Other Industries and Trends

While the number of new case filings was led by COVID-19 and SPACs issues, there were noteworthy trends across several industries.

Excluding all merger objection lawsuits, new cases filed against companies in the electronic technology and technology services sector increased in 2021. In 2021, lawsuits against companies in the electronic technology and technology services sector represented 31 percent of all new securities-related cases filed, as compared to 22 percent filed in 2020.

Securities-related lawsuits against companies in the health technology and services sector increased to 26 percent of all 2021 similar lawsuits, as compared to 22 percent in 2020.

Finally, lawsuits against companies in the finance sector decreased to 11 percent of all new cases filed in 2021, versus 17 percent filed in 2020.¹⁶

In 2021, class action lawsuits stemming from cybersecurity breaches increased from that of prior years. For example, there were only three of these types of lawsuits filed in both 2019 and 2020. In 2021, the number of filed class action lawsuits related to cybersecurity increased to five.

According to law firm Gibson Dunn, increased 2021 class action lawsuits stemming from cybersecurity breaches activity has been linked to ransomware attacks.¹⁷

The number of new filings in the cannabis industry decreased from six cases filed in 2020 to just one case filed in 2021. In 2020, filings revolved around accounting issues, misleading statements about projected performance, and missed earnings guidance. As an emerging industry, it would not be surprising

Figure 4
Percentage of COVID-19-Related Federal Securities Filings
Categorized by Type of Allegation in 2020

- Accounting Issues
- Missed Earnings Guidance
- Misleading Future Performance
- Regulatory Issues
- Merger-Integration Issues

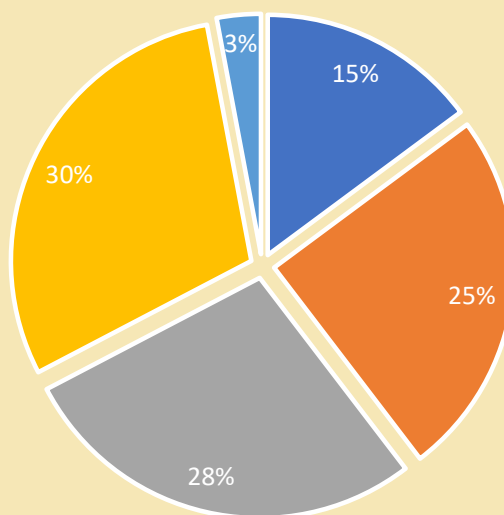
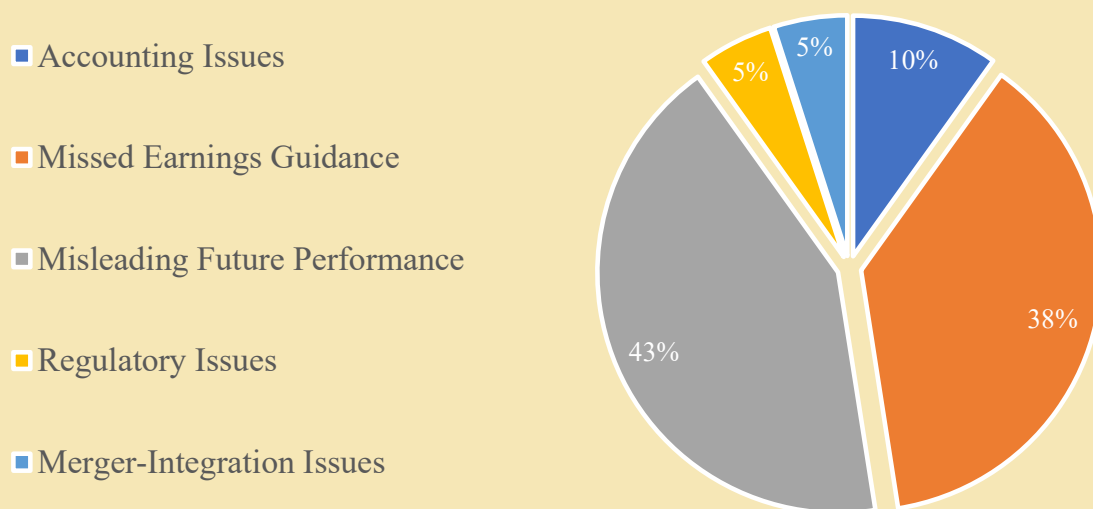


Figure 5
Percentage of COVID-19-Related Federal Securities Filings
Categorized by Type of Allegation in 2021



to see more cannabis-related litigation emerge in 2022 and beyond.¹⁸

RESOLUTION TRENDS

While many of the class action lawsuits go to trial, there are also many cases that are resolved. Cases may be dismissed by a judge or may be settled between the parties involved. A judge may dismiss a lawsuit for any number of reasons. Likewise, there are many factors involved in settling a lawsuit.

The number of cases that are either dismissed or settled typically varies by year. Often, more cases are resolved in periods of increased litigation activity and vice versa. In 2021, this observation proved to be true.

As the number of new cases filed decreased, the number of resolutions decreased to its lowest level since 2015. A total of 239 cases were resolved, with 153 of those cases being dismissed, while the remaining 86 were settled.

Figure 6 provides a summary of the trends in resolved cases from 2012 through 2021.¹⁹

There is not one trend that explains resolution activities. As presented in Figure 6, the number of nonmerger dismissals reached a 10-year period high in 2021. The relatively high number of nonmerger dismissals is noteworthy. However, the dismissal of merger objections decreased by nearly 100 cases in 2021. This trend is consistent with the decreased merger-related cases filed in 2021.

According to NERA Economic Consulting, in each filing year since 2015, more cases have been resolved in favor of the defendant than have been settled. In some cases, a litigation matter can last for several years. Typically, during the life of a lawsuit, newer cases are more likely to be dismissed while older cases are more likely to be settled.

Figure 7 presents trends in non-merger-securities-related case matter resolutions since 2012.

The relatively high percentage of pending cases from 2020 and 2021 is not surprising. However, the volume of pending cases from 2018 and 2019 is starkly different from pre-2018 levels.

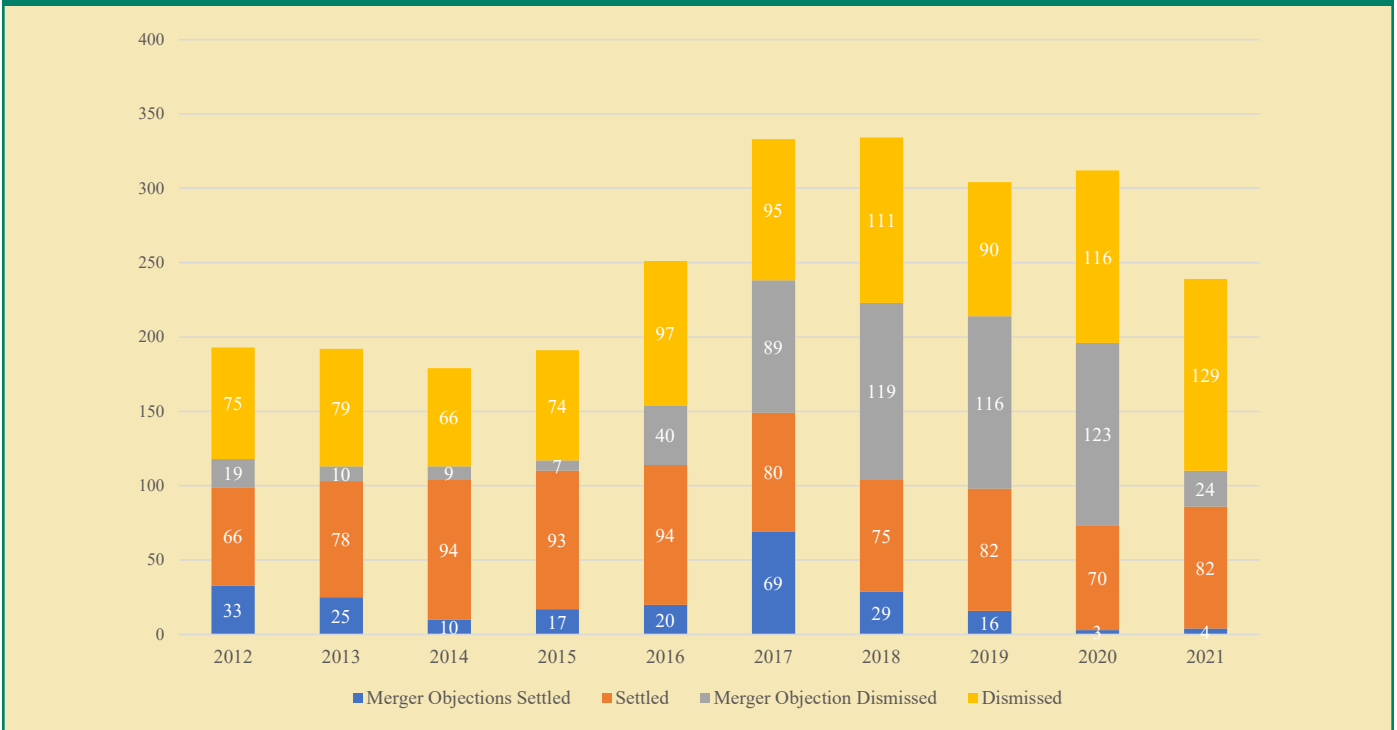
According to NERA Economic Consulting, of the cases filed from January 2003 through December 2017, only 17 percent have a life of more than four years.²⁰

The increase in the number of pending cases in recent years suggests there is a significant backlog in the courts—which would be expected due to the current pandemic.

Settlements

According to NERA Economic Consulting, “In 2021, aggregate settlements amounted to \$1.8 billion. This amount is \$400 million lower than the inflation-adjusted \$2.2 billion aggregate settlement amount in 2019, and considerably lower than the inflation-adjusted amounts of \$3.1 billion and \$5.2 billion in 2020 and 2018, respectively.”²¹

Figure 6
Number of Class Action Lawsuits Resolved
Number of Cases by Year from 2012 to 2021



The median annual settlement amount for 2021 was approximately \$8 million. This amount is a decrease from 2018, 2019, and 2020. Previously the median settlements, adjusted for inflation, were \$14 million, \$13 million, and \$13 million, respectively.

Settlements in 2021 revolved around the technology services sector along with the health services and health technology sectors. Notable companies included within the top 10 securities class action settlements included Snap, Inc.; DaVita Inc.; Allergan plc; and Tableau Software, Inc.²²

SUMMARY AND CONCLUSION

From 2017 through 2019, securities filings represented significantly more legal filings than in more recent years. However, in the past two years, the number of securities and derivative lawsuits decreased to more normal longer-term levels.

While the decrease in securities litigation has been attributed to a decrease in merger and acquisition filings, recent litigation activity has been bolstered by both:

1. increasing litigation related to SPACs and
2. issues tied to the COVID-19 pandemic.

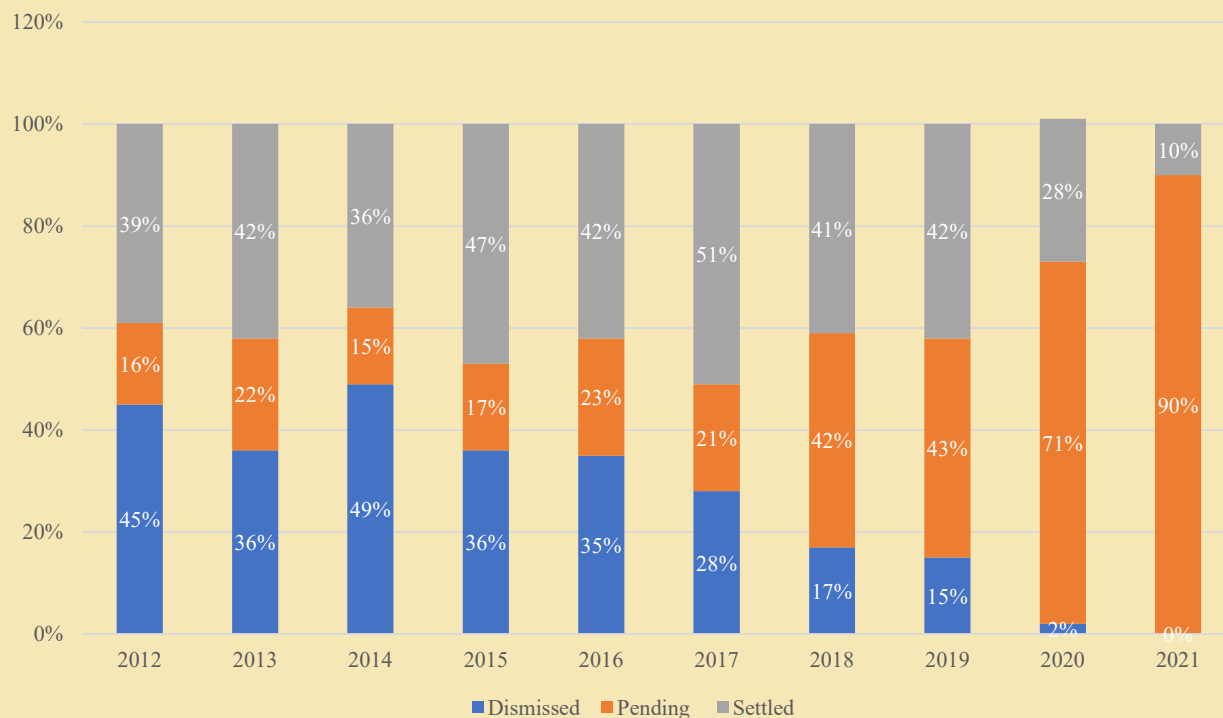
Both issues represent new developments in the courts.

On one hand, the SPAC lawsuits involve boards of directors that are conflicted with fiduciary duty laws. On the other hand, COVID-19-related lawsuits continue to persist with the pandemic. Both developments suggest an increase in securities litigation activity for 2022.

Notes:

1. Federal Rules of Civil Procedure, Rule 23, Class Actions (2019, December 26), Legal Information Institute (accessed January 22, 2022, from https://www.law.cornell.edu/rules/frcp/rule_23).
2. Shayne Clinton, “Section 11 Liability under the 1933 Securities Act for Misstatements and/or Omissions in a Registration Statement,” Georgia State University College of Law Reading Room (May 1, 2004), https://readingroom.law.gsu.edu/cgi/viewcontent.cgi?referer=&httpsredir=1&article=1044&context=lib_student.
3. Ann M. Scarlett, “Shareholder Derivative Litigation’s Historical and Normative Foundations,” 61 *Buffalo Law Review* (2013), 837, 841.
4. James McIntosh and Svetlana Starykh, “Recent Trends in Securities Class Action Litigation: 2021 Full-Year Review,” NERA Economic Consulting

Figure 7
Status of Nonmerger Securities Cases as a Percentage of Federal Securities Filings
From 2012 to 2021



https://www.nera.com/content/dam/nera/publications/2022/PUB_2021_Full-Year_Trends_01222.pdf (January 25, 2022): 1.

5. *Ibid.*: 2.

6. “Cornerstone Research: Accounting-Related Securities Suit Filings and Settlements Increased in 2018,” <https://www.dandodiary.com/2019/04/articles/securities-litigation/cornerstone-research-accounting-related-securities-suit-filings-and-settlements-increased-in-2018/>.

7. McIntosh and Starykh, “Recent Trends in Securities Class Action Litigation: 2021 Full-Year Review,” 3.

8. *Ibid.*: 6.

9. *Ibid.*

10. *Ibid.*

11. Amrith Ramkumar and Maureen Farrell, “When SPACs Attack! A New Force Is Invading Wall Street,” *The Wall Street Journal* (January 23, 2021).

12. McIntosh and Starykh, “Recent Trends in Securities Class Action Litigation: 2021 Full-Year Review,” 9.

13. Kevin LaCroix, “Del. Court Dismissal Denial Has Important SPAC-Related Litigation Implications,” *The D&O Diary* (January 5, 2022), <https://www.dandodiary.com/2022/01/articles/director-and-officer-liability/del-court-dismissal-denial-has-important-spac-related-litigation-implications/>.

officer-liability/del-court-dismissal-denial-has-important-spac-related-litigation-implications/.

14. McIntosh and Starykh, “Recent Trends in Securities Class Action Litigation: 2021 Full-Year Review,” 8.

15. *Ibid.*: 10.

16. *Ibid.*: 4.

17. Gibson Dunn, *2021 Mid-Year Securities Litigation Update* (August 30, 2021), <https://www.gibsondunn.com/wp-content/uploads/2021/08/2021-mid-year-securities-litigation-update.pdf>.

18. McIntosh and Starykh, “Recent Trends in Securities Class Action Litigation: 2021 Full-Year Review,” 10.

19. *Ibid.*: 11.

20. *Ibid.*: 12. From the time of the first complaint filing to resolution, only 17 percent of cases filed last longer than four years.

21. *Ibid.*: 17.

22. *Ibid.*: 19.

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