The Financial Impact of COVID-19
Securities Litigation Precipitated by the COVID-19 Crash
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My Work at Crowninshield Financial Research, Inc.

• Provide expert research, analysis, and testimony.

• Crowninshield’s experts have delivered expert analysis and testimony in numerous high-profile cases:
  ➢ Petrobras Securities Litigation
  ➢ American Realty Capital Properties, Inc. Securities Litigation
  ➢ AIG Securities Litigation
  ➢ Valeant Pharmaceuticals Securities Litigation
  ➢ Mop-Up after 2007-2008
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Class Action Securities Litigation

• When a company makes misrepresentations or omissions that cause investor losses, investors can pursue legal action to recover damages.

• Investors are protected by:
  • The 1933 Securities Act,
  • The 1934 Exchange Act,
  • SEC rules promulgated thereunder,
  • Subsequent legislation (PSLRA 1995),
  • Case law.

• The role of the finance expert.

SEC Rule 10b-5
It shall be unlawful … to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make statements made not misleading.
Class Action Securities Cases

- 428 class action securities cases were filed in 2019.
- 268 of these were securities fraud cases alleging misstatements and omissions.

Valuable Functions of Securities Law and Enforcement

**Classical Agency Problem**
- Corporations are owned by investors, but run by agents
- Rules protect investors

**Operational Efficiency**
- No one wants to play a rigged game
- Mobilizing capital requires fairness

**Prosperity**
- System of laws protecting private property
- Entrepreneurship
Typical Securities Fraud Fact Pattern

- A company makes material misrepresentations or omissions to investors.
- Security price is artificially inflated. New investors overpay.
- Later corrective disclosures dissipate inflation. Stock price declines.
- Investors sustain losses.
- Claim/litigation allows investors to recover losses sustained due to misrepresentations and omissions.

Company discloses “intentional errors” in previous financial statements.
Tenet Example

Third party discloses that the Company is committing Medicare fraud.
The COVID Crash

- **S&P 500**
  - Declined 22% since the beginning of this year.

- **Russell 2000**
  - Declined 35% since the beginning of this year.

- **MSCI World Index**
  - Declined 24% since the beginning of this year.
The Great Recession vs. COVID Crash

S&P 500 Index

The Great Recession

COVID Crash

Source: Thomson Eikon
The Great Recession vs. COVID Crash
Russell 2000 Index
The Great Recession vs. COVID Crash
MSCI International World Price Index
The Great Recession vs. COVID Crash
S&P US Aggregate Bond Index
After a crash … a surge in litigation

- Crash Case Taxonomy – 3 types
  - Blame or direct involvement with cause of crash
  - Concealed or misrepresented exposure to the downturn
  - Fraud is uncovered or revealed by downturn

“It's only when the tide goes out that you learn who's been swimming naked.”
Warren Buffett, Letter To Shareholders, 1992
Example of Great Recession *Blame* Case
Countrywide Financial Corporation

Countrywide ... assured that they employed strict and selective loan underwriting and origination practices. ... Defendants' statements were materially false and misleading.
Example of Great Recession *Exposure* Case
American International Group, Inc.

Defendants repeatedly reassured investors that AIG's superior risk management and diversification had successfully *insulated* the Company from the turmoil that roiled the credit markets ... In truth, AIG hid or recklessly ignored ... mounting losses ... tied to the residential mortgage market.
Example of Great Recession *Reveal* Case

Las Vegas Sands

Statements concerning Las Vegas Sands' business and operations were false and misleading because: (i) **increasing competition in Macau** was steadily eroding the Company's foothold in the region, … (ii) the Company was facing a significant **liquidity crisis as a result of its ongoing expenditure of capital in Macau and Singapore**, which forced the Company to divert funds from other operations to develop its Asian properties; (iii) the Company could not, in fact, weather the economic downturn, because the credit markets were drying up and Las Vegas Sands had failed to timely access those markets; and (iv) **increasing visitor restrictions in Macau**, which Defendants represented would not impact the Company, were expected by Defendants to have a devastating effect on Las Vegas Sands.
Example of a COVID Direct Involvement Case

Inovio Pharmaceuticals, Inc.

Inovio made false and misleading statements claiming unequivocally that the Company had successfully developed a vaccine against the spread of COVID-19 and that it anticipated rapidly bringing that vaccine to market. ... Defendants knew and were deliberately reckless as to the falsity of their claims.
Example of COVID Direct Involvement Case
Norwegian Cruise Lines

Defendants made false and/or misleading statements and/or failed to disclose that: (1) the Company was employing sales tactics of providing customers with unproven and/or blatantly false statements about COVID-19 to entice customers to purchase cruises, thus endangering the lives of both their customers and crew members; and (2) as a result, Defendants’ statements regarding the Company’s business and operations were false and misleading.
Example of a COVID Crash *Reveal* Case

RTI Surgical Holdings, Inc.

On March 16, 2020, RTI announced that it would file a Form 12b-25 with SEC due to its inability to timely file its Form 10-K for the fiscal year ended December 31, 2019. The Company disclosed that the cause of the delay was that its Audit Committee was investigating the Company’s revenue recognition practice.
Example of COVID Crash *Reveal* Case Cronos Group Inc.

Defendants made false and/or misleading statements and/or failed to disclose that: (i) Cronos had engaged in significant transactions for which its revenue recognition was inappropriate;
COVID Crash Exposure Cases
Division of Corporation Finance Securities and Exchange Commission

Coronavirus (COVID-19)

Division of Corporation Finance
Securities and Exchange Commission

CF Disclosure Guidance: Topic No. 9

Date: March 25, 2020

Summary: This guidance provides the Division of Corporation Finance’s current views regarding disclosure and other securities law obligations that companies should consider with respect to the coronavirus disease 2019 (COVID-19) and related business and market disruptions.
“Assessing the evolving effects of COVID-19 and related risks will be a facts and circumstances analysis. Disclosure about these risks and effects, including how the company and management are responding to them, should be specific to a company’s situation. As companies assess COVID-19-related effects and consider their disclosure obligations, questions to consider with respect to their present and future operations include:”

“How has COVID-19 impacted your capital and financial resources, including your overall liquidity position and outlook?”

“How do you expect COVID-19 to affect assets on your balance sheet and your ability to timely account for those assets?”

“Do you expect COVID-19 to materially affect demand for your products or services?”

“Are travel restrictions and border closures expected to have a material impact on your ability to operate and achieve your business goals?”

“Assessing and disclosing the evolving impact of COVID-19: Assessing the evolving effects of COVID-19 and related risks will be a facts and circumstances analysis. Disclosure about these risks and effects, including how the company and management are responding to them, should be specific to a company’s situation. As companies assess COVID-19-related effects and consider their disclosure obligations, questions to consider with respect to their present and future operations include:”

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COVID Crash *Exposure* Cases

SEC “roadmap” of disclosures:
- If companies abide and disclose, they will avoid exposure case litigation.
- If they try to conceal, they will get into trouble.
- Time will tell.

Lesson from 2008 and BP
- What companies disclose will determine if/what litigation ensues.
After a crash … a surge in litigation

- Other kinds of cases:
  - ERISA
  - Insider trading
  - Mismanagement, Fiduciary responsibility, Derivative cases
  - Insurance (covered or excluded)
  - Bankruptcies
  - Misconduct, e.g. price gouging or improper foreclosures
  - Busted deals (M&A, real estate, covered/uncovered adverse event)
    - Who was supposed to bear the risk?
  - Turn to courts to sort out all kinds of ambiguities and uncertainties
Financial Analysis and Econometrics in Securities Litigation

**In Section 10b-5 cases:**
Plaintiffs have to prove:

1. Information moves the security price
2. The price was inflated by the misrepresentations and omissions
3. Corrective disclosure caused the price to fall
4. Investors suffered loss as a result

**In Section 11 and 12 cases:**
The burden of proof is reversed.
Defendants have to prove how much loss was not caused by the misrepresentations.
The Finance Expert's Arsenal

- Event Studies
- Financial Economic Principles
- Valuation Tools

(not exhaustive)
Evasion Tactics

*Because corporations and their advisors know what plaintiffs must prove in a fraud suit, they are aware of tactics that can be used to avoid or evade a lawsuit.*

*Because plaintiffs’ forensic experts know corporation's tactics, they develop analyses to thwart those tactics.*

*Because corporations and their advisors know how plaintiffs thwart evasion tactics … etc., etc., etc.*

- #1: Don't commit fraud. Disclose honestly.
- Trickle out – disclosure spread out over several non-stat-sig events
- Third party disclosures – lessen impact
- Countervailing confounding announcements
- Kitchen sink – combine fraud and non-fraud negative disclosures
- Hide fraud disclosure among bigger news (e.g. COVID crash)
  - Cronos? RTI?
Fundamental Research and Securities Litigation

- Tail events
- Return modeling
- R-squared
- High volatility environment
French Laundry Partners LP vs. Hartford Insurance

“The Insured Properties include two different prominent restaurants located in Napa Valley County, The French Laundry and Bouchon Bistro, which are owned, leased by, managed, and/or controlled by the plaintiffs.”

“The virus is physically impacting public and private property, and physical spaces in cities around the world and the United States. Any effort by the HARTFORD DEFENDANTS to deny the reality that the virus causes physical loss and damage would constitute a false and potentially fraudulent misrepresentation that could endanger policyholders and the public.”
Burr Insider Trading Case

“... Senator Burr possessed material nonpublic information regarding the impact of COVID-19 on the United States, and in particular on the U.S. stock market. Senator Burr learned this material nonpublic information by virtue of his duties as a United States Senator. Senator Burr owed a duty to Congress, the United States government, and citizens of the United States, including Plaintiff, not to use material nonpublic information that he learned by virtue of his duties as a United States Senator in connection with the sale or purchase of any security. Senator Burr breached that duty by selling stock, including Wyndham stock, based on that material nonpublic information.”