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A Proposed SEC Cyber Data Disclosure Advisory Commission — *By Lawrence J. Trautman and Neal F. Newman*

SPACs Are Not That Special Under the Investment Company Act of 1940 — *By Brooke Reichardt*

The First Trial and Conviction of a Goldman Sachs Banker in the 1MDB Scandal — *By Robert A. Barron*

Quarterly Survey of SEC Rulemaking and Major Appellate Decisions — *By Kenneth M. Silverman and Brian Katz*

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Quarterly Survey of SEC Rulemaking and Major Appellate Decisions (April 1, 2022 – June 30, 2022)

*By Kenneth M. Silverman and Brian Katz**

This issue's Survey focuses on the U.S. Securities and Exchange Commission's ("SEC") rulemaking activities and other decisions relating to the Securities Act of 1933, as amended (the "1933 Act"), the Securities Exchange Act of 1934, as amended (the "1934 Act"), and other federal securities laws from April 1, 2022 through June 30, 2022.

This quarter, the SEC proposed six new rules and approved three final rules. However, three of the six proposed new rules were to reopen comment periods of previously published proposed rules, and one of the three final rules was an update to the SEC's EDGAR filing manual. In comparison to the last quarter, there was a significant decrease in the number of proposed rules issued by the SEC. It appears that Chair Gary Gensler was very focused on releasing significant rule proposals last quarter such as the ones relating to special purpose acquisition companies (SPACs), cybersecurity disclosures and climate change-related disclosure reforms. However, it appears that Chair Gensler and the SEC staff are currently reviewing the regulations related to payment for order flow due in part to address concerns regarding the rise of "meme" stock trading. Reforms to the regulations governing payment for order flow could bring sweeping changes to the brokerage industry.

Final Rules

Updated EDGAR Filing Requirements

On June 2, 2022, the SEC adopted final rules relating to EDGAR filing requirements. The final rules mandate the electronic filing or submission of forms and documents that were previously permitted or required to be filed in paper format. The forms and documents that will be required to be electronically filed are:

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*Mr. Silverman and Mr. Katz are members of the New York Bar and Partners at Olshan Frome Wolosky LLP. Associates Scott Kilian-Clark, Tara Richelo, Zachary Freedman and Cindy Zhang, and Summer Associate Judith Renner assisted the authors.

1. glossy annual reports to shareholders;
2. notices of exempt solicitation furnished pursuant to 1934 Act Rule 4a-6(g) and notice of exempt preliminary roll-up communications pursuant to 1934 Act Rule 14a-6(n);
3. annual reports for employee benefit plans on Form 11-K;
4. Form 144 where the issuer of the securities is subject to reporting requirements under Section 13 or 15(d) of the 1934 Act;
5. certain reports or other documents submitted by a foreign private issuer under cover of Form 6-K; and
6. documents filed pursuant to Section 33 of the Investment Company Act of 1940 (the “Investment Company Act”).

The SEC emphasized efficiency and transparency as some of the driving factors behind mandating the electronic filing of the forms and documents listed above.

Mandatory Electronic Filing of Form 144

Form 144 is a notice of intent to sell securities that must be filed with the SEC when an affiliate intends to resell restricted or control securities during any three-month period if the sale involves more than 5,000 shares or an aggregate sales price of more than $50,000. The final rules will require Forms 144 to be filed electronically via EDGAR when the issuer of the securities is a reporting company under the 1934 Act.

Prior to the adoption of the final rules, Rule 101(b) of Regulation S-T allowed Forms 144 to be filed either electronically or in paper form if the issuer of the securities was a reporting company. Although most Forms 144 are eligible for electronic filing due to the broad reach of these reporting requirements, the SEC reported that only 234 Forms 144 were filed electronically in calendar year 2021. This number represents just 0.8% of all Forms 144 filed that year. In addition, due to the COVID-19 pandemic, filers were permitted to submit Forms 144 in PDF form via email. The final rules eliminate both paper and email filing options in favor of electronic submission for Forms 144 filed in connection with securities issued by a reporting company.

Notably, the final rules do not adopt the initial proposal to eliminate Form 144 filing requirements for sales of securities issued by non-reporting companies. Instead, affiliates that file a Form 144 in connection with securities issued by non-reporting companies will still be required to file the Form 144 in paper format. The final rules further amend Rule 144(h)(1) to remove the requirement that an affiliate send a copy of the Form 144 notice to the principal exchange, if any, on which the restricted securities are traded.

Many filers who will be required to file their Forms 144 via EDGAR will need to submit an application with the SEC to apply for access to EDGAR. Once filers gain access to EDGAR, they will be issued personal identification codes that the SEC uses to identify filers. The SEC estimates that approximately 12,250 filers will need to apply for these codes in order to gain access to EDGAR.

The SEC noted that, presently, review of paper filings must either occur in person or the information must be obtained through a paid third-party service that scans and distributes the paper filings. Electronic filing will eliminate the time and expense necessary to obtain information from paper filings. Forms 144 will be available through EDGAR almost immediately after filing, providing easier and more rapid public access. In fact, once the final rules are in effect, Form 144 filings may be the first notice of trading activity by certain insiders instead of a Form 4, which is required to be filed within two business days after a reportable transaction. The SEC noted that EDGAR allows users to bulk-file forms, including for different filers. Thus, broker-dealers could bulk-file Forms 144 simultaneously for multiple clients. However, it is not clear whether logistical changes due to electronic filing will cause a shift in how firms engage broker-dealers to file Forms 144.

Mandatory Electronic Filing of the Glossy Annual Report

The glossy annual report is a company's annual report that accompanies such company's proxy statement when furnished to shareholders prior to an annual meeting. It is frequently referred to as "glossy" because it is often printed on high gloss paper. The final rules will require that companies submit their glossy annual reports to shareholders via an electronic submission on EDGAR, instead of allowing companies to have the option to furnish the glossy annual report to the SEC in paper format.

Prior to adoption of the final rules, companies had the option to furnish their glossy annual report to the SEC in either paper format or electronically via EDGAR. However, most companies complied with the 2016 SEC staff interpretive guidance that allowed companies to satisfy their delivery obligations by posting their glossy annual reports on their corporate websites. Pursuant to the final rules, this 2016 interpretive guidance will be withdrawn. Going forward, companies will be required to submit their glossy annual reports via EDGAR in PDF format.

Interestingly, the SEC noted a concern that electronic versions of glossy annual reports that are posted on a company's website are archived eventually and that such information can be lost over time. By mandating that the glossy annual report be

electronically filed via EDGAR, such glossy annual reports will be permanently viewable on the SEC's EDGAR filings webpage. Although the SEC started pushing the concept about 15 years ago that a company's website should be an alternative location at which such company's SEC filings could be viewed, in addition to the SEC's EDGAR filings webpage, it appears that the SEC may be reverting back to encouraging reliance on the SEC as the main source of information for SEC filings.

Compliance Dates

The final rules go into effect on July 11, 2022, however, the SEC implemented transition periods for compliance with the final rules. Starting January 11, 2023, filers will be required to electronically file the glossy annual reports in PDF format via EDGAR, notices of exempt solicitations and exempt preliminary roll-up communications and reports or other documents submitted by a foreign private issuer under cover of Form 6-K.

The requirement to file Forms 144 via EDGAR will commence six months following the date that the Federal Register publishes the SEC's adopted version of the EDGAR Filer Manual that addresses the Form 144 electronic filing updates. The SEC notes that it is expected to adopt the updated version of the EDGAR Filer Manual in September 2022, with publication in the Federal Register to follow thereafter. Thus, given that estimated timeline, Forms 144 will be required to be filed via EDGAR starting in March 2023. The SEC indicated that this transition period is intended to provide filers with enough time to apply for EDGAR access, which could become a long process given the 12,250 filers that the SEC expects to apply for EDGAR access.

Electronic Filing Requirements for Investment Advisers and Institutional Investment Managers and Amendments to Modernize Form 13F

Continuing with the SEC's theme of greater efficiency and transparency, on June 23, 2022, the SEC adopted final rules to require certain documents filed by investment advisers, institutional investment managers and certain other entities to be filed or submitted electronically. The final rules also make a few technical changes to modernize Form 13F.

Electronic Filing Requirements

Section 206A of the Investment Advisers Act of 1940 (the "Advisers Act") gives the SEC the authority to provide exemptions from any provision of the Advisers Act or any rule or regulation thereunder, provided the exemption is necessary or appropri-

ate in the public interest and consistent with protection of investors. Applicants seeking an exemption must apply to the SEC to obtain an order for the exemption. The final rules will require applicants to file the exemption applications electronically via EDGAR. The final rules will now sync the Advisers Act with the Investment Company Act, which has required applicants to file similar requests under the Investment Company Act through EDGAR since 2009.

The final rules also require Form ADV-NR filers to file such forms electronically through the Investment Adviser Registration Depository ("IARD"), rather than in paper format. Form ADV-NR is a mandatory filing for non-resident general partners and non-resident managing agents of SEC-registered investment advisers and exempt reporting advisers, which must be filed in connection with an adviser's initial Form ADV application or report.

These final rules will be subject to a six month transition period to give advisers and applicants time to modify their procedures to implement the new rules. The final rules will go into effect on March 1, 2023, which is the date that is six months after the effective date of the amended rule.

Form 13F Amendments

Pursuant to Section 13(f) of the 1934 Act and Rule 13f-1 promulgated by the SEC thereunder, institutional investment managers that exercise investment discretion over at least $100 million of U.S. exchange-listed equity securities and options are required to publicly disclose their positions in Section 13(f) securities as of the end of each calendar quarter on Form 13F within 45 days following the end of such quarter.

Pursuant to Section 13(f) of the 1934 Act and the Freedom of Information Act ("FOIA"), the SEC permits Form 13F filers to submit confidential treatment requests seeking permission from the SEC to omit certain positions from their Form 13F filings for up to one year that constitute "confidential, commercial or financial information" by demonstrating that prematurely disclosing such position to the public on Form 13F would reveal ongoing investment strategy to competitors and cause substantial harm.

The final rules eliminate the current paper filing requirement for confidential treatment requests and require such requests be filed electronically via EDGAR. The SEC noted that confidential treatment requests in paper format are subject to a time consuming review process that could lead to undue procedural delays and increase the time that the information receives de facto confidential treatment while the SEC staff processes the request. The SEC stated that requiring such requests to be filed electronically will expedite the SEC staff's review process and reduce the

period of de facto confidential treatment that accrues pending review. Managers seeking confidential treatment must demonstrate that the information is customarily and actually kept private by the manager and that failure to grant the request would likely cause harm to the manager, which conforms to a 2019 U.S. Supreme Court decision that overturned the standard for determining whether information is deemed confidential under Exemption 4 of FOIA.

The final rules will also require Form 13F filers to provide additional identifying information such as providing its Central Registration Depository number and SEC file number, if any. In addition, managers will be allowed to disclose, for each security reported on Form 13F, the security's Financial Instrument Global Identifier ("FIGI") in addition to its CUSIP number. Finally, the final rules will simplify the rounding conventions of Form 13F by requiring all dollar values listed to be rounded to the nearest dollar, rather than to the nearest one thousand dollars as is currently required.

The final rules related to the confidential treatment requests will go into effect on March 1, 2023, which is the date that is six months after the effective date of the amended rule. With respect to the other amendments to Form 13F, the final rules will go into effect on January 3, 2023.

Proposed Rules

Enhanced ESG Disclosure Requirements for Registered Funds and Advisers

On May 25, 2022, the SEC proposed rules that would impose disclosure requirements related to environmental, social and governance ("ESG") factors for certain registered funds and advisers. The rules would require specific ESG disclosures in fund prospectuses, annual reports and adviser brochures in response to heightened investor interest in ESG strategies. Currently, there are no specific requirements dictating the content of ESG disclosures for registered funds or advisers. The SEC has expressed concern about the practice of "greenwashing": the making of exaggerated or unsupported claims about ESG practices in order to attract investors. The objective of the SEC's proposed rules is to increase the availability of consistent, comparable, and reliable information regarding ESG strategies to facilitate informed investor decision making.

Disclosure Requirements for Registered Funds

Prospectus Disclosure Enhancements

The SEC is proposing to require funds to provide additional in-

formation regarding their ESG investing activities. The proposed rules categorize the required levels of disclosure by the extent to which ESG factors are considered in a fund's investment strategy. Under the SEC's proposal, a fund would be considered an "Integration Fund," an "ESG-Focused Fund" or a sub-category of an ESG-Focused Fund, an "Impact Fund."

An Integration Fund is a fund that considers one or more ESG factors alongside non-ESG factors when making investment decisions. For these funds, ESG factors are important factors in investment decisions but are not determinative. Under the proposed rules, an Integration Fund would be required to briefly summarize in its prospectus how ESG factors are used when making investment decisions, including which factors the fund considers. In addition, Integration Funds that consider greenhouse gas ("GHG") emissions of portfolio holdings as an ESG factor would be required to describe the methodology used when considering such emissions in its investment decisions.

An ESG-Focused Fund is a fund that uses one or more ESG factors as a significant consideration in (1) selecting investments or (2) its engagement strategy with the companies in which such funds invest. ESG-Focused Funds encompass those funds that market themselves, whether through name or marketing materials, as having an ESG focus. However, merely using advertisements or sales materials that include ESG factors, but are not significant or main considerations in such fund's investment or engagement strategy, would not alone result in classification as an ESG-Focused Fund. A sub-category of ESG-Focused Funds are Impact Funds. An Impact Fund is an ESG-Focused Fund with a stated goal of achieving one or more specific ESG impacts.

ESG-Focused Funds would be required to provide a brief disclosure about such fund's consideration of ESG factors in a table in the fund's prospectus. The required information in the table would include (1) an overview of the fund's ESG strategy, (2) how the fund incorporates ESG factors in its investment decision making and (3) how the fund votes proxies and/or engages with companies regarding ESG issues. More extensive disclosure on these points and other available information would be required in other parts of the prospectus.

Impact Funds would have to comply with the same proposed ESG-Focused Fund disclosure requirements mentioned above, as well as disclose the following: (1) how the fund measures progress toward its stated impact goal(s), (2) the timeline used to measure such progress and (3) the relationship between the desired impact and the fund's financial returns. In addition, Impact Funds would be required to disclose the ESG impact that the fund seeks to achieve with its investment.

Annual Report Disclosures

The SEC is proposing to require enhanced annual report disclosures to provide additional ESG information. ESG-Focused Funds that significantly rely on proxy voting to implement ESG strategies would be required to disclose information about how the fund voted proxies relating to portfolio securities on ESG matters. These disclosures would include the percentage of ESG-related matters in which the fund voted to further such fund's ESG goals and referring investors to the fund's full voting record on Form N-PX. Funds that engage with issuers through means other than proxy voting as a significant method of implementing ESG strategies would be required to disclose progress on any key performance indicators of these engagements. The proposed rules would also mandate disclosure of the number or percentage of issuers with whom the funds held "ESG engagement meetings" related to ESG issues and the total number of such meetings. An ESG engagement meeting is defined in the proposed rules as a substantive discussion with an issuer's management to advocate for specific ESG goals to be accomplished over a given period of time, where progress on achieving such goals are measurable.

Under the proposal, Impact Funds would be required to report progress made toward accomplishing their stated impact goals. This reporting would include the key factors that significantly affected a fund's ability to achieve these impacts.

The proposed rules would also introduce a requirement for ESG-Focused Funds that consider environmental factors to disclose aggregated GHG emissions metrics associated with their portfolios. Specifically, funds that include environmental factors in their investment strategies would be required to disclose both the carbon footprint and the weighted average carbon intensity ("WACI") of the fund's portfolio. Funds that are not environmentally focused would be exempt from this requirement but would have to state in its annual report that they do not consider issuer GHG emissions when selecting investments. The proposed rules also include several specific instructions that would apply to a fund when calculating its carbon footprint and WACI. The instructions would specify that a fund must obtain information to calculate a portfolio company's carbon footprint, WACI and information regarding GHG emissions from the company's most recent regulatory filings or from the company itself if otherwise unavailable. Funds may have difficulty complying with these requirements due to the current lack of disclosure of GHG emission metrics in the industry.

<u>Disclosure Requirements for Advisers</u>

The SEC's proposed rules include amendments to Part 2A of

Form ADV to require disclosures about a registered investment adviser's ESG practices. The proposed rules would require an adviser to describe the ESG factors it considers for each significant investment strategy or method of analysis it uses. Like registered funds, the adviser would be obligated to explain how integration and/or ESG-focused strategies are used (and if ESG-focused, how the adviser uses ESG impact strategies, if any). The proposal would further require advisers to describe any criteria or methodologies used to evaluate, select, or exclude investments based on the consideration of ESG factors. In addition, the proposed rules would also require advisers to disclose material relationships or arrangements with any related person that is an ESG consultant or other ESG service provider. Advisers that have specific voting policies and procedures that include ESG considerations when voting client securities would be required to describe which ESG factors were considered and how they were considered. Finally, the proposed rules would require ESG disclosure for advisers that have wrap fee programs.

Regulatory Reporting - Forms N-CEN and Part 1A of Form ADV

The proposed rules would also impose additional regulatory reporting requirements for Form N-CEN and Part 1A of Form ADV in an effort to collect census-type information about such funds' and advisers' use of ESG factors and ESG providers. Form N-CEN would be amended to require each fund that uses ESG factors to report the type of ESG strategy it employs, the ESG factors and the method used to implement such ESG strategy. The amended form would also collect information indicating whether a fund considers ESG-related information or scores provided by ESG providers and, if so, the fund would be required to identify such ESG providers and whether they are affiliated persons of the fund. The proposed amendments would further require funds to report the full names of any third-party ESG frameworks that the fund follows.

Amendments to Part 1A of Form ADV would require advisers to disclose whether ESG factors are considered in the strategies employed to advise its separately managed account clients. If applicable, the adviser would be required to disclose whether an integration and/or ESG-focused approach is used. The amendments would further require disclosure of any third-party ESG frameworks that are followed in connection with providing advisory services. Finally, advisers would be required to disclose whether they conduct other business activities as ESG providers or related persons that are ESG providers.

Comments regarding the proposed rule amendments are due by August 16, 2022.

Expansion of the Names Rule Requirements

The SEC proposed amendments to Rule 35d-1 of the Investment Company Act of 1940 (the "Names Rule"). To prevent "materially deceptive or misleading" names, the Names Rule currently requires certain funds to adopt a policy to invest at least 80% of their assets according to the investment focus implied by that fund's name. The SEC proposes to extend this 80% rule to any fund name containing terms that suggest a focus on investments that have, or investments whose issuers have, certain characteristics. These terms would include, for example, "growth," "value," or other terms suggesting consideration of ESG factors. The proposal would also prohibit Integration Funds from using names implying that one or more ESG factors are incorporated in its investment decision making. The proposal also enumerates specific circumstances under which a fund could temporarily depart from its 80% policy and sets certain time limits by which such fund must get back into compliance with the rule. The proposed amendments would also require a fund to disclose in its prospectus how its name tracks its investments. The amendments would further require that, unless the 80% investment policy is a fundamental policy of the fund, the fund's shareholders must be notified of any changes to such 80% investment policy. Form N-PORT would also be amended to require additional information for non-money-market funds that are subject to the 80% policy. Such funds that file Form N-PORT on a monthly basis would be required to indicate whether each portfolio investment is included in the fund's 80% basket. Finally, the proposal would impose a requirement to document compliance with the 80% rule in Form N-PORT, or state that the fund is not subject to this rule.

Comments regarding the proposed rule amendments are due by August 16, 2022.

On the Horizon

Potential Payment for Order Flow Reforms

On June 8, 2022, Chair Gensler announced at the Piper Sandler Global Exchange & FinTech Conference (the "Conference") that the SEC is reviewing the rules that govern how payment for order flow is regulated in the brokerage industry. Chair Gensler's announcement seems to indicate that proposals to amend such rules may be released by the SEC in the near future, potentially bringing sweeping changes to the brokerage industry.

Payment for order flow is the compensation that brokerage firms receive for directing orders for trade execution to a particular market maker. These payments are often fractions of a penny

per transaction, but they account for a substantial proportion of revenue for brokerages that offer commission-free trading. Under the current rules, brokers are required to perform reasonable diligence to determine the best market for executing a trade to get the best price for customers, which is known as "best execution."

Recently, payment for order flow has received a significant of attention due to the trading activity in shares of the Class A common stock of Gamestop Corp.and other "meme" stocks, whereby many retail investors place trades through no-fee brokerage firms. Chair Gensler mentioned at the Conference that payment for order flow has the potential to create conflicts of interest and limit competition for individual orders to a select number of market makers that currently dominate the industry. Conflicts of interest and limits on competition could arise when brokerage firms prioritize the compensation received from the payment for order flow arrangement rather than the best execution for customers.

To address these concerns, Chair Gensler noted that an auction process could be a solution to create more competition in the industry and better prices for customers. Chair Gensler even mentioned that he directed staff at the SEC to review the possibility of allowing stock exchanges to quote shares in increments of less than one cent. This could allow Nasdaq or the New York Stock Exchange to compete and would level the playing field with some of the market makers. For further transparency, the SEC is also reviewing the possibility of requiring brokers to file monthly reports to disclose the prices their customers receive for trades, which is not a current requirement for all brokers.

This announcement by Chair Gensler has created uproar in the industry. Many brokerage firms and market makers do not see a need for the SEC to step in, arguing that the market operates efficiently for investors under the current system. Industry leaders have noted that these proposals could have a negative impact on investors, especially by impacting the low trading costs that investors currently have.

As Chair Gensler mentioned at the Conference, these are possible proposals that the SEC staff are currently reviewing, there has not been any formal proposal announced by the SEC to implement these rules at this time. In fact, on June 24, 2022, the U.S. House of Representatives' Financial Services Committee (the "Committee") issued a report regarding meme stocks and noted in its report a similar concern over payment for order flow arrangements in the industry. In its report, the Committee called for the SEC and FINRA to impose further regulations on payment for order flow. It remains to be seen what regulation will be promulgated, but momentum in government appears to be gathering for reforms to trading practices.

Ninth Circuit Affirms Dismissal of 10b-5 Claim Against Pharmaceutical Company

On May 19, 2022, the Ninth Circuit affirmed the Northern District of California's dismissal of a complaint brought by several investors (collectively, "Plaintiffs") against Nektar Therapeutics ("Nektar" or the "Company") for alleged violations of Section 10(b) of the Securities Exchange Act. Plaintiffs commenced the action in October 2018 based on allegations that the Company touted successful clinical trial results that relied on outlier data from a single patient. The Ninth Circuit found the Plaintiff's failed to plausibly allege falsity and loss causation.

Nektar developed an experimental anti-cancer drug, NKTR-214. Nektar conducted an initial Phase 1 clinical trial that showed promising results. The trial attempted to treat 28 patients and the company released early results that showed that 10 patients had a 30-fold increase in the number of T-cells in their body that were intended to attack the cancer cells. In a subsequent clinical trial, Nektar attempted to treat patients with NKTR-214 coupled with another cancer treating drug. That trial did not yield results that were as promising, with the overall response rate dropping from 85% to 50%. Nektar's stock price dropped 42% upon the release of the data. Four months after the results of the second trial were released, anonymous short sellers released a report called the Plainview Report which claimed that Nektar's initial data for the first clinical trial contained outlier data from a single patient, which skewed the results and resulted in the 30-fold increase. Nektar's stock price declined another 7%.

First, the Ninth Circuit found that the Plaintiffs did not satisfy the falsity element of a 10b-5 claim because Plaintiffs failed to explain why inclusion of the outlier patient was materially misleading. The Court found including the outlier data was not materially misleading because Plaintiffs did not provide "any meaningful context or information about why an investor's assessment of Nektar would have changed" had the outlier data been excluded. The opinion noted that it would have been misleading if the Company had omitted outlier data that had skewed the results in a negative direction, and that further, the Plaintiffs had not pled what the data would have looked like without the outlier patient and how it would have been material to investors if the data showed a lower overall response rate, and therefore, there was no materiality or falsity.

Second, the Plaintiffs failed to allege loss causation because the results of the second clinical trial did not correct data from the first trial. Rather, the data from the second trial "merely showed that results from a different and more comprehensive test were not as promising as those from the more limited Phase 1" trial.

The Court also rejected the Plaintiffs' attempts to establish loss causation based on the Plainview Report, citing precedent that it is a high bar to establish a claim of securities fraud based upon a self-interested short seller's report, which disavowed any accuracy. The Court noted it was the Plaintiffs' duty to scrutinize such reports and not to place an outsize weight on reports generated by "self-interested and anonymous short-sellers."

In re Nektar Therapeutics Securities Litigation, 34 F.4th 828 (9th Cir. 2022) available at https://cdn.ca9.uscourts.gov/datastore/opinions/2022/05/19/21-15170.pdf.

Investors Survive Defendant's Motion to Dismiss Security Fraud Claims in SolarWinds Suit

On March 30, 2022, Western District of Texas denied SolarWinds Corporation's ("SolarWinds" or the "Company") motion to dismiss an investor class action alleging the Company and its executives violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 by disseminating false and misleading statements about its data security and its business prospects. Plaintiffs commenced the action in January 2021 based on allegations that the Company made false and misleading statements concerning SolarWinds cybersecurity system and practices. The District Court denied the motion to dismiss against the Vice President of Security Architecture, and denied the motion to dismiss against the CEO as to Section 20(a) claims.

SolarWinds is a publicly traded company (SWI) that provides network security services. The Company's clients include U.S. Departments of Homeland Security, Commerce and Treasury, and around 100 private businesses, chiefly Microsoft Corp. and Cisco Systems. In December 2020, the Company discovered (and it is not disputed) that the Russian Foreign Intelligence Service infected SolarWinds "Orion" software. The breach meant that a customer downloading Orion was at risk of having their server compromised by the infected code. The Company reported the incident and its stock price fell by approximately 17%.

Plaintiffs claim the Company made misleading statements prior to the breach which falsely touted its robust security. The Company's Vice President of Security Architecture ("VPSA") regularly appeared in interviews discussing SolarWinds' "heavy-duty hygiene" on cybersecurity issues. Furthermore, the Company's former Global Cybersecurity Strategist gave multiple warnings about security risks such as that the Company had "no corporate security" and no dedicated security positions. SolarWind apparently ignored these warnings. The Company had also suffered previous security breaches. For example, the Company had inadvertently disclosed a simple password set by an intern -

"solarwinds123" - for one of its servers on a public website for 18 months. The security flaw was eventually discovered by a cybersecurity researcher.

The Court held that the complaint sufficiently pled that the Company and the VPSA acted with "severe recklessness" when making at least a dozen statements about the Company's focus on security "hygiene." The Court further held the statements concerning security were not mere puffery, and were "specific statements of fact." Finally, Plaintiffs sufficiently alleged loss causation through a series of corrective disclosures tied to a stock price drop closely following the corrective disclosure.

In re SolarWinds Corp. Securities Litigation, No. 1:21-cv-00138 (W.D. Tex. Mar. 30, 2022) available here: https://www.lit-sl.shearman.com/siteFiles/39368/SL4_Solarwinds.pdf.

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