Securities Regulation Law Journal

Volume 48 Number 4 Winter 2020

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Quarterly Survey of SEC Rulemaking and Major Appellate Decisions (July 1, 2020–September 30, 2020)

*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 major federal appellate or 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 July 1, 2020 through September 30, 2020.

The SEC finalized eleven new rules for implementation, and proposed five new rules this quarter. After devoting substantial time and attention to the addressing challenges created by the COVID-19 pandemic in the second quarter, the SEC has had a much more active rulemaking quarter. The rules finalized in this quarter show that the SEC is determined to streamline disclosure and create efficiencies for registrants and market participants by reducing what the SEC determined to be unnecessary costs where possible.

Proposed Rules

Increase of Form 13F Reporting Threshold

The SEC has proposed an amendment to rule 13f-1 and Form 13F that would increase the reporting threshold for Form 13F from $100 million to $3.5 billion. The SEC also proposed to eliminate the de minimis omission exception for individual securities on Form 13F and to require an institutional investment manager that files Form 13F to provide certain identifying information.

The SEC believes an amendment to increase the reporting threshold to $3.5 billion would help account for the change in the size and structure of the U.S. equities market since 1975 when the Form 13F reporting requirement was introduced. The initial $100 million threshold was adopted to limit the number of reporting persons and to limit the reporting burden that comes with a

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Section 13 filing to the largest institutional investment managers. However, over the last 45 years, the U.S. equities market has greatly expanded and the Form 13F reporting threshold has never been increased. As a result, an increasing number of managers met the $100 million threshold while, at the same time, managing a minimum of $100 million in securities has decreased in significance. The SEC expects that this proposed threshold increase would help reflect the changes in markets within the last 45 years.

After considering various metrics, the SEC proposed a new threshold based on the U.S. equities market rather than the Consumer Price Inflation (CPI) or measures of stock market return. Under CPI, the SEC evaluated two potential CPI calculations. The SEC found that using the Personal Consumption Expenditure Price Index inflation standard from 1975 to 2018 would set the threshold at $358 million. Using the CPI inflation standard from 1975 to 2018 would set the threshold at $450 million. The SEC believes that both thresholds fail to sufficiently account for the huge market growth since 1975. The SEC found that relying on stock market returns from 1975 to 2018 would set the threshold at $9.5 billion which would hinder the initial objective of Section 13(f), to provide transparency into the securities market.

Basing the threshold on the growth of the U.S. equities market would strike an appropriate balance. This threshold would not only account for the expansion in the U.S. equities market but also preserves transparency by maintaining the disclosure of 90.8 percent of the dollar value of Form 13F holdings data that are currently reported. Furthermore, a $3.5 billion threshold reduces the compliance burden for smaller managers, as they may not need to file a Form 13F if they do not meet the new reporting threshold. Smaller managers may be better able to devote more resources to market research that could potentially promote price discovery without bearing such compliance costs.

The SEC recognized the importance of being more responsive to the changes in the U.S. equity market but rejected an automatic future threshold adjustment on a prescribed timetable because that would create volatile changes in the reporting threshold. Going forward, the SEC will consider any future adjustments based on periodic staff reviews and recommendations.

The SEC further proposed to eliminate the disclosure exception for de minimis holdings of individual securities (the "omission threshold") on Form 13F. Currently, Form 13F permits managers to omit holdings of fewer than 10,000 shares and less than $200,000 aggregate fair market value because an aggregate hold-

ing in such an amount would have only a minimal impact on the market and does not justify the cost and burden of filing a Section 13 report.

The decision to eliminate the omission threshold was based primarily on two principles. First, the proposed $3.5 billion threshold would now allocate the burden to comply with a Section 13 filing only to the largest institutional investment managers. Requiring large investment managers to report all their holdings would not be burdensome as investment managers of such size would have the necessary resources to absorb the cost of the additional reporting. Second, based on past experience, the SEC found that even when an omission was permitted, many managers still chose to not omit. The SEC recognizes the concern that by eliminating the omission threshold, there is now a requirement to disclose smaller holdings that might threaten confidentiality. Yet such concern can be addressed by filing a Form 13F CTR to protect confidential information.

In regard to filing a Form 13F CTR, the SEC proposed that filers must show that the information requested to be kept confidential is customarily treated as confidential, has remained confidential and that the release of such information could cause harm to the managers. The proposed required showing is in response to the U.S. Supreme Court decision in *Food Marketing Institute v. Argus Leader Media*, *139 S.Ct. 2356 (2019)*, in which the Supreme Court altered the standard for determining whether certain information is considered "confidential" under exemption 4 of the Freedom of Information Act ("FOIA"). As a Form 13 CTR determination involves a FOIA analysis, the SEC believed that this proposed amendment is necessary.

Final Rules

Amendments to Proxy Rules for Proxy Voting Advice

The SEC has finalized its amendments to the rules governing proxy voting advice. The final rules aim to offer investors, who rely on proxy advisory firms, a more transparent process by subjecting such advisory firms to federal proxy rules and requiring the firms to disclose conflicts of interest and to adopt written procedures designed to increase the accessibility of information.

Interpretation of "Solicitation"

Under the final rules, offering proxy voting advice is a form of "solicitation" within the meaning of Section 14(a) of the 1934 Act and is thus subject to the federal proxy rules. Specifically, the SEC states that under the new rule, "solicitation" includes proxy voting advice from a person who offers such advice, separately

from other kinds of investment advice, to a shareholder for a fee with the expectation that the shareholder will incorporate the advice into such shareholder's voting decision. Whether other communications would be considered a "solicitation" and subject to the federal proxy rules would depend on the specific nature, content, the timing of the communication and the circumstances under which the communication was made.

The SEC recognizes that the additional compliance and regulation for proxy voting advisory firms will increase the firms' cost in conducting their businesses. However, the SEC believes this cost increase is immaterial and will have a minimal impact on the advisory firms' operations because both the SEC and the market have customarily recognized proxy voting advice as "solicitation." Therefore, the SEC reasoned any effect from merely codifying this would have already been reflected in the manner the firms provide their services and their pricing.

Change in Exemption Requirements (1) Disclosing Conflicts of Interest and (2) Notice of Proxy Voting Response and Advice

(1) Disclosing Conflicts of Interest

Given the prominent role that proxy advisory firms play the proxy voting process, the SEC seeks to standardize and to require conflicts of interest disclosures through implementation of this final rule. The goal is to ensure that sufficient information regarding the advisory firm's conflicts of interest are properly disclosed to its clients. Thus, under the final rules, for proxy voting advisory firms to rely on the exemptions under 1934 Act Rule 14a-2(b)(1) or (b)(3) and avoid having to file solicitation materials, the firms must disclose specific conflicts of interest in their proxy voting advice or in an electronic medium used to deliver the proxy voting advice. The traditional boilerplate conflicts of interest disclosures will no longer be sufficient to satisfy the exemption requirements.

Furthermore, the advisory firms must also provide the procedures and policies used to identify and address the conflicts of interest. The SEC will permit firms to exercise their discretion in determining which situations require conflicts disclosure and the level of disclosure that is necessary. The key factor in this determination is whether the information is material to the evaluation of the proxy voting advisory firm's objectivity.

(2) Notice of Proxy Voting Response and Advice

The SEC believes that the proxy voting process would benefit

from a robust exchange of information between the registrants that are the subject of proxy voting advice and the advisory firms' clients. Therefore, to rely on the exemptions under 1934 Act Rule 14a-2(b)(1) or (b)(3), the proxy voting advisory firms must update current practices substantially and adopt and publicly disclose written policies and procedures designed to ensure registrants that are the subject of proxy voting advice are aware of the advice. The firm's advice must be made available to the registrant at or before the time such advice is disseminated to the firm's clients. In addition, the proxy voting advisory firms must reasonably ensure that its clients are aware of any written response or rebuttal from the registrants who are the subject of such advice.

Safe Harbor Provision

The new rules include a safe harbor provision to assure proxy voting advisory firms that their written policies and procedures satisfy the above requirements. The safe harbor provision will apply if the advisory firms have written policies and procedures that are reasonably designed to provide registrants with a copy of the proxy voting advice, at no charge, no later than the time it is disseminated to the firms' clients. Lastly, the SEC modified Rule 14a-9 to include examples of when failure to disclose certain material information by a proxy voting advisor would be considered misleading. Some of the examples the SEC provided involve material information about the proxy voting advisor's business's methodology, sources of information or conflicts of interest.

The final rules will be effective 60 days after publication in the Federal Register. However, affected proxy voting advisory firms will not be subject to these final rules until December 1, 2021.

Amendments to Financial Disclosures Regarding Acquired and Disposed of Businesses

The SEC has finalized its amendments to the financial disclosure requirements relating to the acquisition and disposition of businesses. The goal of the new amendments is to streamline access to information and reduce the costs and complexity associated with such disclosure.

Amendment to the Definition of "Significant Subsidiary"

Whether an acquisition is considered significant under Regulation S-X Rule 3-05 is determined by the result of the Investment Test, Asset Test and Income Test. Under the final rules, the SEC made substantive revisions to the Investment Test and Income Test.

Investment Test

Currently, the Investment Test compares the registrants' and its subsidiaries' investments in and advances to the tested subsidiary to the total assets of the registrant and its subsidiaries. Under the final rules, the comparison will focus on the registrant's and its subsidiaries' investment and advances to the tested subsidiary in the aggregate worldwide market value of the registrant's voting and non-voting common equity. The SEC believes that unlike total assets, aggregate worldwide market value is more readily available and objectively determinable by the market. However, the current Investment Test that relies on asset test for acquisitions and dispositions will continue to remain applicable for (1) registrants that do not have an aggregate worldwide market value and (2) when used for the additional purposes for which the Rule 1-02(w) definition is applicable.

Income Test

Currently, the Income Test compares the registrants' equity in the tested subsidiaries' income from continuing operations before income taxes (exclusive of amounts attributable to any noncontrolling interests) to such income of the registrants for the most recently completed fiscal year. Under the final rules, the SEC included a revenue component. The revenue component compares its registrants' and its other subsidiaries' proportionate share of the tested subsidiary's consolidated total revenues (after intercompany eliminations) to the consolidated total revenues of the registrant for the most recently completed fiscal year. The revenue component will not apply if either the registrant and its subsidiaries consolidated, or the tested subsidiary did not have material revenue in each of the two most recently completed fiscal years. Despite the material revenue exception, both the current income component and the new revenue component must be met to satisfy the Income Test under the new rules.

Amendments Relating to Rule 3-05 Financial Statements for Acquired Businesses

Depending on the significance of the acquired or to be acquired business, Rule 3-05 Financial Statements may be required for up to three years. The SEC now requires up to two years of Rule 3-05 Financial Statements. Furthermore, the SEC amended Rule 3-05 to require, in some circumstances, financial statements for the most recent interim period specified in Rules 3-01 and 3-02 rather than any interim period. The SEC believes the most recent interim period provides the most relevant and material information to investors. However, additional financial statements may be required if the trends depicted by the most recent interim period are misleading or incomplete.

Abbreviated Financial Statements

The SEC recognizes the difficulties and costs registrants face in preparing Rule 3-05 Financial Statements. This prompted the SEC to permit the ability to use audited abbreviated financial statements in certain situations. The abbreviated financial statements may consist of statements of assets acquired and liabilities assumed and statements of revenues and expenses.

Foreign Businesses

The SEC also amended Rule 3-05 to permit target company financial statements to follow International Financial Reporting Standards ("IFRS") rather than the U.S. GAAP if the target company qualifies, as a SEC registrant, to use IFRS.

Use of Pro Forma Financial Information to Measure Significance

The SEC expanded the use of pro forma financial information in measuring significance. Under the new rule, issuers are now permitted to use pro forma, rather than historical, financial information when the issuer made a significant acquisition after its latest fiscal year-end and filed target company financial statements, including pro forma financial statements relating to the acquisition, with the SEC.

Disclosure Requirements for Individually Insignificant Acquisitions

Under the final rules, the SEC will now require disclosure if the aggregate impact of individually insignificant businesses acquired or to be acquired since the date of the issuer's most recent audited balance sheet filed for the registrant exceeds 50 percent. The amended rules will continue to require registrants to provide pro forma financial information depicting the aggregate effects of all "individually insignificant businesses" in all material respects. However, under the new rules, financial information will be required only for those businesses whose individual significance exceeds 20 percent.

Rule 3-14 Financial Statements of Real Estate Operations Acquired or to be Acquired

Currently, Rule 3-14 of Regulation S-X for real estate and Rule 3-05 of Regulation S-X for other businesses differ in several ways. Thus, the final rules will reconcile the differences in Rule 3-14 and Rule 3-05 by aligning the target company financial statement requirements for real estate operations and other business operations. However, the two rules will continue to maintain dif-

ferences in areas where retaining industry-specific disclosure is necessary for investors to make informed investment decisions.

The SEC made further clarification regarding the determination for significance, the need for interim income statements, special provisions for blind pool offering and the scope of the rule's requirement.

Pro Forma Financial Information

Under the final rules, the current pro forma adjustment criteria have been replaced with three categories of pro forma adjustment criteria listed below.

(1) *Transaction Accounting Adjustments*: reflecting the application of required accounting for the transaction by U.S. GAAP or IFRS.

(2) *Autonomous Entity Adjustments*: reflecting the operations and financial position of the registrant as an autonomous entity, if the registrant was previously part of another entity; and

(3) *Management's Adjustments*: reflecting synergies and dis-synergies of the acquisitions and dispositions for which pro forma effect is being given if such adjustments would enhance an understanding of the pro forma effects of the transaction and certain conditions related to the basis and the form of presentation are met.

Transaction Accounting Adjustments and Autonomous Entity Adjustments are mandatory in the preparation of pro forma financial statements. However, Management's Adjustments will remain optional in the preparation of pro forma financial statements.

Additional Amendments

Lastly, the SEC made changes to the smaller reporting company requirements in Article 8 of Regulation S-X which will also apply to issuers relying on Regulation A. The SEC further amended the definition of "significant subsidiary" to provide a definition that is tailored for investment companies. The SEC also added new Rule 6-11 and amended Form N-14 to cover financial reporting for fund acquisition by investment companies and business development companies.

The final rules are effective on January 1, 2021. However, filers are permitted to voluntarily comply with the final rules before the effective date.

Modernization Efforts: the Accredited Investor Definition and Regulation S-K

On August 26, 2020, the SEC issued two new final rules that

work towards the simplification of existing rule regimes. Firstly, the SEC seeks to update the definition of accredited investors, which represents a foundational concept in the SEC's private offering framework. Secondly, in the culmination of a four-year process dating back to the SEC's initial Concept Release on modernizing Regulation S-K issued in April 2016, the SEC adopted a final rule adopting a number of changes to Regulation S-K.

Accredited Investor Definition

The SEC has expressed a view that the applicable financial threshold should not be the only proxy for assessing whether a person has sufficient financial sophistication and knowledge that they may invest in unregistered securities and understand the inherent risks of such investments. The newly adopted revisions to the definition include persons holding certain professional certifications, regardless of income. In addition, the SEC established certain criteria according to which it will consider in future issuing orders to bring holders of additional professional certifications within the definition. Commenters were generally supportive of this approach, though the SEC received numerous recommendations for various ways to determine which professional credentials should qualify. Initially, the SEC has ordered holders of the Series 7, Series 65 and Series 82 licenses shall qualify as accredited investors, regardless of income. The SEC may use its authority to expand the list of professional credentials that qualify for accredited investor status, subject to further public review and comment regarding such an order. Along the same lines, the SEC has finalized as the proposed rule with respect to "knowledgeable employees" of private funds, who by virtue of retention in certain professional capacities with such a fund for a year or more, shall qualify as accredited investors (regardless of income) with respect to investments they make in vehicles managed by the fund for which they work.

The SEC made certain other changes to expand accredited investor status to registered investment advisors (those registered at either the federal or state level), limited liability companies and certain rural business development companies. The rule also includes a new catch-all provision designed to allow entities of a kind not explicitly named to qualify as accredited investors if they own investments with a value of at least $5 million.

The new rule will become effective on December 8, 2020.

Regulation S-K

The final rule adopts the amendments proposed in the proposing release with minimal changes. The new disclosure regime will be much more principles-based, an approach the SEC believes will elicit more meaningful disclosure from registrants.

A number of the proposed changes received substantial support from commenters and are being adopted largely in the form initially proposed. Such rules include amended Item 101(a) and 101(h), whereby the prescribed five-year timeframe (and three-year timeframe for smaller reporting companies) for discussion of the development of an issuer's business shall be eliminated. Instead, registrants will be directed to discuss information material to understanding the general development of their businesses, without regard to time. Moreover, registrants may forgo full annual disclosure of the development of their business, and instead simply incorporate prior disclosure by reference, and note material updates from their initial disclosure, if appropriate. Amended Item 101(c), which has been adopted as proposed, reduces the list of topics for registrants to discuss, and directs registrants to exercise judgment as to whether the topics are material for their business and its segments. Among the topics to be considered by registrants are human capital management and regulatory compliance of all material governmental regulations, not just environmental laws. Amended Item 105, setting forth guidance on preparing risk factors, has also been adopted as proposed, with changes intended to reduce lengthy and generic risk factor disclosure. By updating the threshold for inclusion of a risk from "significant" to "material," the SEC hopes to encourage registrants to be more thoughtful and selective in the risks to their business they choose to highlight for the benefit of investors. In addition, registrants with risk factors exceeding 15 pages in length will be required to provide a summary of no more than two pages distilling such disclosure in a more accessible manner for investors.

Though few commenters objected to the principles-based framework adopted, there was internal pressure from Democratic Commissioners Crenshaw and Lee to expand the disclosure prescriptions to include more coverage of human capital and climate change topics. Both issued dissenting statements that expressed a desire to see greater provision made in public company disclosure for such matters.

The new rule regarding Regulation S-K will become effective on November 9, 2020, meaning that for all filings submitted to the SEC after 5:30pm November 6, 2020 must comply with the applicable amendments.

Shareholder Proposal Thresholds

On September 23, 2020, the SEC released a much-anticipated final rule on shareholder proposal thresholds that will likely have a substantial impact on shareholder activism. Amended Rule 14a-8(b) dictates that to be eligible to submit a shareholder pro-

posal for a vote, a shareholder will need to demonstrate continuous ownership of at least (i) $2,000 of a company's securities for at least three years, (ii) $15,000 of a company's securities for at least two years or (iii) $25,000 of a company's securities for at least one year (although the current $2,000/one year threshold will remain in certain circumstances for an annual or special meeting to be held prior to January 1, 2023). These standards represent a substantial increase from the current standard requiring that a holder continuously hold $2,000 or 1% of a company's securities for one year. In addition, the new rule eliminates the ability of shareholders co-sponsoring a proposal to satisfy the thresholds in the aggregate. Instead, each co-sponsoring shareholder must meet one of the applicable thresholds. In addition, the amendments to the resubmission thresholds revise the levels of shareholder support a proposal must receive to be eligible for resubmission at the same company's future shareholders' meetings from 3, 6, and 10 percent to 5, 15, and 25 percent, respectively.

In part, as noted in the final rule release, an increase in the monetary thresholds was needed to adjust for inflation and the increase in the cumulative value of equity markets since the thresholds were last amended in 1998. Moreover, the SEC noted that technological advances have facilitated alternative means of shareholder communication with management. Costs are also a major concern, as estimates for the cost to a company of processing shareholder proposals run from approximately $50,000 to $150,000 per proposal. Particularly in the case of shareholder resubmissions, the SEC strongly implies that continuing to impose such costs on shareholders should require greater commitment from the proposing parties and greater enthusiasm for the proposals from other shareholders. SEC Chair Clayton emphasized this focus in a call discussing the new rule, describing the intent of the amendment as requiring "a credible demonstration that the proponent's interests are aligned with all of the others' interests from an investment or ownership standpoint."[1]

Many critics of the changes have argued that the rule is intended to hamper shareholder proposals advocating for greater corporate social responsibility. However, the rule release objects to that characterization, emphasizing that the amendments are content-neutral and viewpoint-neutral.

Though much of the final rule tracks the proposing release issued in November 2019, the SEC did decide to drop the "momentum requirement" for shareholder proposal resubmission. The proposed momentum requirement would have excluded proposals dealing with substantially the same subject matter as proposals previously voted on by shareholders three or more times in the

preceding five calendar years that would not otherwise be excludable under the 25 percent threshold if (i) the most recently voted on proposal received less than a majority of the votes cast and (ii) support declined by 10 percent or more compared to the immediately preceding shareholder vote on the matter. The SEC received a wide range of comments in opposition, the most persuasive of which was the concern that proposals with higher overall support would be at *greater* risk of exclusion under the momentum rule than comparable proposals with lower overall support, but less downward momentum.

The new thresholds and procedural requirements set forth in the final rule will be effective 60 days after publication in the Federal Register and will apply to shareholder proposals submitted for an annual or special meeting to be held on or January 1, 2022.

New Whistleblower Program Rules

In response to the mandate established by the Dodd-Frank Act, in May 2011 the SEC adopted rules to implement a whistleblower reward program intended to provide monetary incentives to individuals that alert the SEC of ongoing securities laws violations. Whistleblowers who provide a tip that leads to a successful enforcement action may be eligible to receive a reward from the Investor Protection Fund, a pool of money funded by the proceeds of sanctions paid to the SEC by securities law violators.

Regulation 21F sets forth the rules for the program. Currently, whistleblowers may receive up to a maximum of 30% of the portion of a monetary sanction collected that exceeds $1 million. Pursuant to the amendments adopted on September 23, 2020, whistleblowers with potential awards of less than $5 million, which historically have represented nearly 75% of all whistleblower awards, subject to certain criteria, will qualify for a presumption that they will receive the maximum statutory award amount where none of the negative factors are present. However, the SEC retained its broad discretion to review and downsize large awards in excess of $30 million, despite receiving numerous comments in opposition to that aspect of Regulation 21F, and in support of proposed Rule 21F-6(d)(2), which would have mandated a more rigorous procedure for the SEC to use its discretion to review such awards. This particular provision had been a source of internal controversy, with the Democratic commissioners favoring greater restraint on the SEC's ability to reduce awards.

The amendments embodied in the final rule also include a number of updates and clarifications. In particular, the final rule revised the definition of whistleblower to accord with recent Supreme Court precedent in *Digital Realty Trust, Inc. v. Somer*.

As amended, Regulation 21F requires that a person must provide information to the SEC in writing *before* experiencing any retaliation in order to qualify for payment from the SEC. New paragraph (3) to Rule 21F-4(d) further clarifies and broadens the scope of "actions" that may result in a qualifying award to include sanctions issued in connection with certain deferred prosecution or non-prosecution and settlement agreements when entered into by the SEC outside of the context of judicial or administrative proceedings to address violations of securities laws. The amendments further clarify the scope of recovery available in "related actions," in particular by requiring that for an action by another qualifying state authority to be "related," it must be predicted on original information the whistleblower provides directly to such other authority, or on original information provided by the whistleblower that is passed on directly to such other authority by the SEC.

The amendments to the whistleblower rules become effective 30 days after publication in the Federal Register.

United States District Court for the Southern District of New York Dismisses Shareholder Allegations that AT&T and its Senior Management Misled Investors

On August 18, 2020, the United States District Court for the Southern District of New York dismissed a Class Action Complaint brought by several investors (collectively, "Plaintiffs") against AT&T Inc. ("AT&T") and members of its senior management (collectively, "Defendants"). Plaintiffs alleged that Defendants violated Section 10(b) of the Securities Exchange Act and Rule 10b-5 promulgated thereunder and violated Section 20(a) of the Securities Exchange Act by misleading investors through a series of statements released in AT&T SEC filings, and via omitted statements concerning the profitability and viability of AT&T's video streaming service, DirecTV Now ("DTVN").

On April 1, 2019, Plaintiffs commenced this action against Defendants on behalf of investors who purchased or otherwise acquired AT&T securities from September 21, 2016 through January 30, 2019 (the "Class Period"). On October 24, 2018, AT&T experienced an 8% drop in its share price. Plaintiffs alleged that statements made by Defendants touting the success and potential of DTVN during the Class Period were misleading. First, Plaintiffs alleged that Defendants failed to disclose that DTVN experienced technical issues which rendered its service unusable at times, thus affecting the retention of customers. Second, Plaintiffs alleged that Defendants failed to disclose that DTVN was being sold at promotional rates, which included free

giveaways, which led to subscribers not renewing their subscriptions at the end of the promotional periods. Third, Plaintiffs alleged that DTVN experienced low usage rates and a high risk of churn, which meant that subscribers would likely discontinue their subscriptions. Plaintiffs cited 25 statements made between September 21, 2016, and September 12, 2018 to support their claims.

The United States District Court for the Southern District of New York found that Plaintiffs failed to allege facts giving rise to a strong inference of scienter, as Defendants publicly announced its promotional offers during the launch event on November 30, 2016 and in the following weeks. The Court further found that several statements made by Defendants concerning profitability were expressions of corporate optimism and puffery.

In re AT&T/DirecTV Now Securities Litigation, 2020 WL 4909718 (S.D.N.Y. Aug. 18, 2020).

United States District Court for the Eastern District of New York Dismisses Shareholder Allegations that Revlon and its Executives Misled Investors

On September 17, 2020, the United States District for the Eastern District of New York dismissed a Class Action Lawsuit brought by a single-shareholder ("Plaintiff") on behalf of similarly-situated shareholders against Revlon, Inc. ("Revlon") and certain of its current and former executives ("Defendants"). Plaintiff alleged that Defendants violated Section 10(b) of the Securities Exchange Act and Rule 10b-5 promulgated thereunder and Section 20(a) of the Securities Exchange Act by making misrepresentations to shareholders concerning the quality of its newly implemented software.

On May 14, 2019, Plaintiff filed a Putative Class Action Complaint on behalf of investors who purchased or otherwise acquired Revlon securities between March 3, 2017, and March 28, 2019. Plaintiff alleged that Defendants intentionally misled investors by failing to disclosure that a system implemented for tracking areas of Revlon's operations caused production delays, led to lost sales, and weakened the Revlon's internal controls over financial reporting. The alleged misrepresentations concerned three areas—(i) statements concerning the new system prior to its launch, (ii) statements concerning the new system's launch and remedial efforts after its launch, and (iii) statements made before and after the launch concerning Revlon's internal controls over financial reporting. Although Revlon disclosed potential shortcomings of its new software, Plaintiff alleged that Defendants did not offer specific additional warnings. Notwithstanding Plaintiff's desire for specific additional warnings, Defendants made several state-

ments concerning potential drawbacks of the new software. For example, in its 2016 10-K, which was filed on March 3, 2017, Defendants stated that there were inherent risks associated with the new software which included the risk that Revlon would not be able to fill customer orders accurately or on a timely basis, or at all. The 2016 10-K also stated that there was a risk of disruption of Revlon's internal control structure. Further, Revlon's 2017 10-K stated that there were difficulties in implementing Revlon's new software. The 2017 10-K also mentioned that the launch of the new software caused Revlon's Oxford facility to experience disruptions which impacted Revlon's ability to manufacture certain goods and fulfill shipments.

The United States District Court for the Eastern District of New York found that Plaintiff failed to allege facts giving rise to a strong inference of scienter, as Defendants provided "abundant disclosures regarding the disruptions that the transition caused." The Court held that the "steady streams" of warnings provided by Defendants rendered Plaintiff's claim of scienter implausible.

Lachman v. Revlon, et al., 2020 WL 5577406 (E.D. N.Y. 2020).

NOTES:

[1]The Wall Street Journal, Paul Kiernan, September 23, 2020, available at https://www.wsj.com/articles/sec-raises-bar-for-shareholder-resolutions-11600877050?mod=searchresults&page=1&pos=11.