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Quarterly Survey of SEC Rulemaking and Major Appellate Decisions (January 1, 2021–March 31, 2021)

*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 January 1, 2021 through March 31, 2021.

The SEC finalized one new, technical rule for implementation this quarter. Due to the transition from the Trump administration to the Biden administration, there has been a lack of rulemaking during this quarter. Moreover, since Jay Clayton's resignation as Chair of the SEC on December 23, 2020, the SEC has not had a U.S. Senate confirmed Chair. Allison Herren Lee has been serving as the Acting Chair of the SEC since January 21, 2021. President Biden has nominated Gary Gensler, who served as Chair of the Commodities Futures Trading Commission from May 2009 to January 2014, to serve as the Chair of the SEC. On March 2, 2021, the U.S. Senate Committee on Banking, Housing and Urban Affairs confirmed the nomination of Gary Gensler as Chair of the SEC. On April 20, 2021, the full U.S. Senate confirmed Mr. Gensler's nomination for a term expiring June 5, 2026.

With the lack of rulemaking this quarter, and given the interest in unregistered finders in capital-raising transactions, this article will discuss the proposed exemptive order that was announced by the SEC during the fourth quarter of 2020.

Proposed Exemptive Order

On October 7, 2020, the SEC proposed to grant a non-exclusive safe harbor for certain finders from the broker registration requirements of Section 15(a) of the 1934 Act (the "Proposed Order"). For companies seeking capital, a finder, a person or an entity that connects companies with investors typically in exchange for a fee based on the value of the securities sold, can

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play a significant role. However, the SEC currently requires finders to register as broker-dealers under Section 15 of the 1934 Act, with limited exceptions. Under the Proposed Order, natural persons would be permitted to engage in certain limited capital raising activities involving accredited investors without registering as a broker-dealer under Section 15 of the 1934 Act. The Proposed Order creates two classes of exempt finders, Tier I Finders and Tier II Finders, that would be subject to conditions tailored to the scope of their respective activities. Tier I and Tier II Finders would both be permitted to accept transaction-based compensation under the terms of the Proposed Order.

Tier I Finders' acceptable activities would be much more limited than those of Tier II Finders. Tier I Finders would be limited to providing contact information of potential investors in connection with only a single capital raising transaction by a single issuer in a 12-month period. A Tier I Finder would not be authorized to have any contact with a potential investor about the issuer. However, Tier II Finders would be permitted to solicit investors on behalf of the issuer, but the solicitation-related activities would be limited to: (i) identifying, screening and contacting potential investors; (ii) distributing issuer offering materials to investors; (iii) discussing issuer information included in any offering materials, provided that the Tier II Finders do not provide advice as to the valuation or advisability of the investment; and (iv) arranging or participating in meetings with the issuer and investor. Tier II Finders would be required to disclose their role and compensation at the time of the solicitation.

The safe harbor provided by the Proposed Order would only apply in limited situations. Tier I and Tier II Finders could rely on the safe harbor only when:

1. the issuer is not required to file reports under Section 13 or Section 15(d) of the 1934 Act, such as, but not limited to, Schedule 13D, Annual Reports under Form 10-K and Quarterly Reports under Form 10-Q;
2. the issuer is seeking to conduct the securities offering in reliance on an applicable exemption from registration under the 1933 Act;
3. the Finder does not engage in a general solicitation of prospective investors;
4. the potential investor is an "accredited investor" as defined in Rule 501 of Regulation D or the Finder has a reasonable belief that the potential investor is an "accredited investor";
5. the Finder and the issuer enter into a written agreement that includes a description of the services provided and associated compensation;
6. the Finder is not an associated person of a broker-dealer; and

7. the Finder is not subject to statutory disqualification, as that term is defined in Section 3(a)(39) of the 1934 Act, at the time of his or her participation.

Further, Tier I and Tier II Finders would not be able to rely on this Proposed Order to facilitate a registered offering, a resale of securities, or the sale of securities to investors that are not accredited investors or that the Finder does not reasonably believe are accredited investors. Finally, a Tier I and Tier II Finder would not be authorized to (i) be involved in structuring the transaction or negotiating the terms of the offering; (ii) handle customer funds or securities or bind the issuer or investor; (iii) participate in the preparation of any sales materials; (iv) perform any independent analysis of the sale; (v) engage in any due diligence activities; (vi) assist or provide financing for such purchases; or (vii) provide advice as to the valuation or financial advisability of the investment.

When the Proposed Order was released, the SEC believed that the Proposed Order would "bring clarity to finders' regulatory status in a tailored manner" that in turn could help smaller private companies that may have difficulty obtaining the assistance of a registered broker-dealer to raise capital. Public comments were submitted through January 2021. Following confirmation of a new SEC Chair, it is will be interesting whether the new SEC leadership will support passage of the Proposed Order.

United States Court of Appeals for the Ninth Circuit Upholds Dismissal of Case Against Tesla, Analyzing the "Safe Harbor" for Forward-Looking Statements

On January 26, 2021, the United States Court of Appeals for the Ninth Circuit affirmed the dismissal of a securities law case against Tesla Inc. ("Tesla") and certain of its officers (collectively, "Defendants") based on its analysis of the "safe harbor" provision of the Private securities Litigation Reform Act ("PSLRA") and protects forward-looking statements pertaining to the company's plans and projections.

Beginning in May 2017, Tesla made statements about its plan to scale production for its Model 3 electric vehicle, but cautioned that it may experience "significant delays or other complications in the design, manufacture, launch and production ramp of new vehicles and other products." Thereafter, between May and November of 2017, Defendants made several statements regarding the progress of such production goals and the Company's ability to meet them. Plaintiffs allege those progress related statements were false based on information from a former employee who informed Tesla's CEO that there was "zero chance" the company would be able to meet those goals.

In early October, the *Wall Street Journal* published an article broke the news that most Model 3 cars were still being assembled manually, as opposed to an automated production line. The stock fell from $356.88 to $299.29. However, the stock quickly bounced back to $355.59 on October 10, 2017, and traded between $350 and $360 throughout the week.

Plaintiff filed suit on October 10, 2017, and in a Second Amended Complaint filed in September 2018, alleged violations of Section 10(b) of the securities Exchange Act of 1934 and Rule 10b-5 for false and misleading statements. Tesla moved to dismiss for failure to state a claim, which the district court granted without leave to amend because plaintiffs "failed to plead any material misrepresentation that was not within the PSLRA's safe harbor for 'forward-looking' statements 'accompanied by meaningful cautionary statements.' " Plaintiffs appealed.

With respect to "forward-looking statements," the Ninth Circuit carefully analyzed the alleged misstatements and found that each one was either forward-looking *or* accompanied by cautionary language. For example, Tesla's goal to produce 5,000 vehicles per week was a "plan" or "objective of management." Other phrases such as "on track," "confidence we can . . . achieve," and "making great progress" were similarly treated as forward-looking and reaffirming the company's plan and objectives.

Notably, with respect to loss causation, the Ninth Circuit found amending the Complaint would be futile because despite the steep price drop, the immediate recovery in the following days "refutes the inference that the alleged concealment of this particular fact caused any material drop in the stock price."

Wochos v. Tesla, Inc., 2021 WL 246210 (9th Cir. Jan. 26, 2021).

United States District Court for the Southern District of New York Dismisses Suit Against Diebold Nixdorf Inc. Following $1.8B Merger

On March 31, 2021, the United States District Court for the Southern District of New York dismissed a suit against Diebold Nixdorf Inc. ("Diebold"), a company that makes, sells, and installs self-service transactions systems such as ATMs, filed by the Indiana Laborers Pension and Welfare Funds ("Plaintiffs") for alleged violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder, and Section 20(a) of the Exchange Act, for false and misleading statements concerning the true extent of the Diebold's difficulties following its merger with its competitor.

In 2015, Diebold acquired its German competitor, Wincor Nixdorf (the "Acquisition"). Plaintiffs alleged that Diebold and its

former CEO made misleading statements regarding the integration process following the Acquisition when in reality Diebold suffered from inefficiencies and loss in revenue. Starting in July 2017, Diebold experienced significant drops in stock price, each following announcements of the company's underestimate of the challenges of integrating the companies. By December 2018, the stock fell more than 90% from its high between February 14, 2017, and August 1, 2018 (the designated Class Period).

The Court looked at four categories of statements, the largest of which were "Integration Statements." These Integration Statements were generally either "corporate optimism" or status of the "integration efforts." For example, in a February 14, 2017, press release following Diebold's merger, Diebold attributed its optimism to "our collaborative teamwork during the full quarter for our newly combined company." Additionally, the press release stated that Diebold was "leveraging a stronger, fully aligned global sales force and a solid solutions portfolio with ample opportunity to success in the dynamic financial and retain markets."

In analyzing phrases and terms such as "aligned," "progress," "excellence," "confidence," "synergies," and "collaborative," the Court found that none of these optimistic statements were actionable and disagreed with Plaintiff's arguments that such "puffery" statements amounted to "half-truths." Furthermore, the Court found that Plaintiffs "failed to plead with particularity that Defendants knew that their statements were misleading when they were made." The Court further stated that Plaintiffs failed to point to any data, such as documents, reports or analyses, to support its claims.

In re Diebold Nixdorf, Inc. Securities Litigation, No.1:19-cv-06180 (S.D.N.Y. Mar. 31, 2021).

United States District Court for the Southern District of New York Dismisses Shareholder Allegations that Hexo Corp. and Misled Investors

On March 8, 2021, the United States District Court for the Southern District of New York dismissed a Putative Class Action Lawsuit brought by investors ("Plaintiffs") against Hexo Corp. ("Hexo") and certain of Hexo's senior executives (collectively, "Defendants"). Plaintiffs 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 overstating Hexo's expected demands and revenue for its products.

Plaintiffs alleged that Defendants intentionally misled investors through its statements and conduct after Canada legalized recreational cannabis use on October 17, 2018. In support of their

claim, Plaintiffs pointed to several facts. First, Hexo entered into a supply agreement on April 11, 2018, (the "Supply Agreement") in anticipation of the increased demand of its product after the expected legalization. Second, on December 20, 2018, in anticipation of its IPO, Hexo filed a registration statement which registered $600 million worth of shares for trading on the Toronto Stok Exchange and the NYSE American Exchange. Third, a March 13, 2019, press release announced that Hexo would expand its operations. Fourth, on March 13, 2019, Hexo released its Management's Discussion and Analysis which stated "we currently possess the single largest and longest Canadian forward supply amount among all licensed producers, based upon announced provincial supply agreements." Beginning in October 2019, Hexo experienced a series of setbacks, which led to, amongst other things, its stock price falling from $4.06 on October 4, 2019, to $0.79 per share by the end of March 2020. Plaintiffs ultimately alleged that Defendants had knowledge of future insufficient demands and revenue but failed to disclose this information, which thereby misled investors.

The District Court found that Plaintiffs failed to allege facts giving rise to a strong inference of scienter. The Court found that Plaintiffs failed to plead enough allegations demonstrating that defendants were neither aware of loss figures prior to releasing such information publicly, or of the failures associated with Supply Agreement. The Court regarded Defendants' statement concerning the "fluctuat[ing]" nature of the cannabis industry, along with statements concerning the novelty of the cannabis industry as evidence to support dismissal.

In re Hexo Corp. Securities Litigation, Civ. No. 19-Civ. 10965 (NRB) (S.D.N.Y. Mar. 8, 2021).