SUMMER 2020

The Bulletin is a quarterly newsletter by Kessler Topaz Meltzer & Check to help institutional investors stay

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HIGHLIGHTS

KTMC Appointed as Co-Lead Counsel in Investors' Class Action Against Luckin Coffee

The Second Circuit Rejects Defendants' Effort to Introduce Merits Challenges as a Basis to Undermine Class Certification

Businesses Across the Country Seek Recoveries After Insurers Deny Business Interruption Coverage for Losses Caused by the COVID-19 Public Safety Threat.

Ninth Circuit to Revisit the Extent of *Affiliated Ute* Reliance in Securities Omission Cases

EVENTS — What's to Come

KESSLERTOPAZ MELTZERCHECK LLP

KTMC APPOINTED AS CO-LEAD COUNSEL IN INVESTORS' CLASS ACTION AGAINST LUCKIN COFFEE

Ryan T. Degnan, Esquire

On June 12, 2020, the Honorable Lewis J. Liman of the United States District Court for the Southern District of New York appointed Sjunde AP-Fonden ("AP7") and Louisiana Sheriffs' Pension & Relief Fund ("Louisiana Sheriffs") to serve as co-lead plaintiffs in the pending securities class action alleging that Luckin Coffee Inc. ("Luckin Coffee" of the "Company") fabricated hundreds of millions of dollars of sales. *See Cohen v. Luckin Coffee Inc., et al.*, No. 1:20-cv-01293-LJL, 2020 WL 3127808 (S.D.N.Y. June 12, 2020) ("*Luckin Coffee*").[1]

(continued on page 4)

[1] AP7 is represented by Kessler Topaz Meltzer & Check, LLP.

THE SECOND CIRCUIT REJECTS DEFENDANTS' EFFORT TO INTRODUCE MERITS CHALLENGES AS A BASIS TO UNDERMINE CLASS CERTIFICATION

Karissa J. Sauder, Esquire

The Second Circuit's recent decision in *Arkansas Teacher Retirement System v. Goldman Sachs Group, Inc.*, 955 F.3d 254 (2d Cir. 2020) ("*Goldman*"), stands as an important class certification victory for securities fraud plaintiffs, rebuffing the defendants' attempts to relitigate merits issues — like materiality — that were previously decided on a motion to dismiss under Fed. R. Civ. P. 12(b)(6), and reinforcing that it is defendants' clear burden to rebut the legal presumption of class-wide reliance under *Basic v. Levinson*, 485 U.S. 224 (1988) ("*Basic*").

The *Goldman* Allegations

Goldman centers on alleged misrepresentations concerning Goldman Sachs Group, Inc.'s ("Goldman") commitment to avoiding conflicts of interest. Specifically, Plaintiffs allege that although Defendants — Goldman and certain of its executive officers — had

(continued on page 8)

Institutional Investor

KESSLERTOPAZ MELTZERCHECK LLP

DECEMBER 8-9, 2020 • APELLA • NEW YORK

Litigation & Governance Trends for Asset Management Firms

Special Guest

Chuck Todd

NBC News Political Director and Moderator of Meet the Press and MTP Daily

When is taking action appropriate for your firm and your clients?

As old standards and norms change and new trends and priorities emerge, active investors have a lot to worry about at both the macro and the firm levels. From the fiduciary, legal and investment ramifications of climate change to firm-specific concerns of privacy and data as well as the altered role of the legal team within the decision-making structure from increasing privacy concern to climate change and from cryptocurrency to power shifts within the company, times they are a-changing. And one of those changes is the way an increasing number and diversity of asset management firms are approaching their obligations when it comes to protecting and recovering assets, and integral to this process is the question of when and how to get involved when the need arises.

This year's Litigation & Governance Trends program is going to focus more on the how than the why, reflecting the growing acknowledgment of the value and efficacy of appropriate shareholder litigation and next-generation corporate governance efforts. This day and half event is the third event in a three-part annual global series focusing exclusively on the needs of legal and compliance teams at global asset management firms through the lens of active engagement, shareholder actions, and affirmative litigation.

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BUSINESSES ACROSS THE COUNTRY SEEK RECOVERIES AFTER INSURERS DENY BUSINESS INTERRUPTION COVERAGE FOR LOSSES CAUSED BY THE COVID-19 PUBLIC SAFETY THREAT.

Jordan Jacobson, Esquire

Kessler Topaz recently filed a complaint on behalf of businesses against an insurer that wrongfully denied coverage for business interruption caused by the COVID-19 pandemic. The complaint was filed against State Farm Automobile Insurance Company and State Farm Florida Insurance Company (collectively "State Farm"), on behalf of a class represented by Royal Palm Optical, Inc. ("Royal Palm").[1] Royal Palm is a business that has provided eyewear and sunglasses to the Boca Raton and Delray Beach communities in Florida since 1985. Like numerous businesses throughout the country, Royal Palm purchased commercial property insurance from State Farm to protect itself against losses stemming from an unexpected interruption to its business. The complaint, filed by Kessler Topaz in the Southern District of Florida, seeks to enforce State Farm's business interruption insurance policy so that class members may recover income lost after the cessation of normal business operations required in response to the COVID-19 pandemic.

(continued on page 6)

[1] The complaint is ECF No. 1 on the docket for Civil Action No. 9:20-cv-80749.

NINTH CIRCUIT TO REVISIT THE EXTENT OF *AFFILIATED UTE* RELIANCE IN SECURITIES OMISSION CASES

Geoffrey C. Jarvis, Esquire and Raphael Janove, Esquire

The U.S. Court of Appeals for the Ninth Circuit has agreed to hear an interlocutory appeal that will provide it with an opportunity to clarify when courts may presume reliance in securities cases based on omissions. The appeal arises out of the denial of Defendants' motion for summary judgment in *BRS v. Volkswagen AG, et al.* ("*BRS*"),[1] one of the cases in the *In re Volkswagen "Clean Diesel" Marketing, Sales Practices, and Products Liability Litigation* MDL. *BRS* is a securities class action based on allegations that Volkswagen failed to disclose in a private-placement bond-offering memorandum "that for years, it had been secretly installing defeat devices in its 'clean diesel' line of cars to mask unlawfully high emissions, and that it was at risk of losing billions of dollars in fines and penalties if it was caught."[2] Plaintiff alleged that the bond memorandum, which referred more broadly to the Company's legal compliance and research and development efforts, was allegedly misleading because of the failure to disclose.

The appeal centers on the *Affiliated Ute*[3] presumption of reliance — named after a 1972 U.S. Supreme Court Decision and often invoked by bondholders in securities class actions — which allows a court to presume reliance in omissions cases. In 1975, the Ninth Circuit in *Blackie v. Barrack* "embraced this presumption because of the difficulty of proving 'a speculative negative' — that the plaintiff relied on what was not said."[4] In 1999, the Circuit clarified that, although *Affiliated Ute* can apply in cases involving affirmative misrepresentations, the presumption is "confined to cases that primarily allege omissions."[5] And in 2009, the Court in *Desai v. Deutsche Bank Sec. Ltd.*, reiterated that the presumption is limited to cases "primarily alleging omissions."[6] Since *Desai,* however, the Ninth Circuit has not thoroughly examined *Affiliated Ute*, and lower courts have had difficulty demarcating the line between a case that is primarily based on affirmative misrepresentations and one primarily based on omissions.

Because Volkswagen sold these bonds in an initial offering and Plaintiff purchased them by private placement, the market for these bonds was not efficient. Accordingly, the District Court rejected application of the *Basic* fraud-on-the market presumption of reliance.[7] Volkswagen later moved for summary judgment on the *Affiliated Ute*

(continued on page 10)

[1] Case No. 16-cv-3435 (N.D. Cal.); Appeal No. 20-80026 (9th Cir.)

[2] *In re Volkswagen "Clean Diesel" Mktg., Sales Practices, & Prod. Liab. Litig.*, No. MDL 2672 CRB (JSC), 2019 WL 4727338, at *1 (N.D. Cal. Sept. 26, 2019).

[3] *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128 (1972).

[4] *Binder v. Gillespie*, 184 F.3d 1059, 1064 (9th Cir. 1999) (quoting *Blackie v. Barrak*, 524 F.2d 891, 908 (9th Cir. 1975)).

[5] 184 F.3d at 1064.

[6] 573 F.3d 931, 946 (9th Cir. 2009) (alteration omitted).

[7] *In re Volkswagen "Clean Diesel" Mktg., Sales Practices, & Prod. Liab. Litig.*, 328 F. Supp. 3d 963 (N.D. Cal. 2018).

KTMC APPOINTED AS CO-LEAD COUNSEL IN INVESTORS' CLASS ACTION AGAINST LUCKIN COFFEE

(continued from page 1)

The class action against Luckin Coffee involves one of the largest cases of securities fraud involving a Chinese company trading on U.S. stock markets. In late January 2020, noted short-seller Muddy Waters Research published an eighty-nine page report alleging that Luckin Coffee had fabricated certain financial figures in 2019. According to the report, which was based on the review of more than 11,000 hours of store video, more than 25,000 customer receipts, and the Company's mobile application data, Luckin Coffee had inflated per-store, per-day sales figures, net selling price per-item metrics, its advertising expenses, and certain revenue metrics. Luckin Coffee dismissed the report as containing "misleading and false allegations." However, on April 2, 2020, Luckin Coffee admitted that an internal investigation had preliminarily determined that Jian Liu, the Company's Chief Operating Officer, and several employees reporting to him, had fabricated approximately RMB2.2 billion (more than $300 million) in sales during the second, third, and fourth quarters of 2019 — accounting for nearly half of Luckin Coffee's revenues during this time period. The Company's stock now trades below $4 per share after trading above $50 per share in mid-January 2020. Before the truth emerged, Luckin Coffee raised more than $1 billion from investors when it completed its initial public offering in 2019 and a secondary public offering in January 2020. The offerings were underwritten by several notable banks including, Credit Suisse and Morgan Stanley.

The allegations and the Company's admissions have triggered significant interest from the financial press as well as investors seeking to lead the class action lawsuit in the United States. Eighteen movants filed motions seeking to lead this action. No other case filed this year has resulted in more leadership applications. The movants claimed losses ranging from $19 million to $5,000, with AP7 and Louisiana Sheriffs claiming a combined loss of nearly $7 million, third among the movants. While the movant asserting the largest loss is typically appointed as the lead plaintiff under the Private Securities Litigation Reform Act of 1995 ("PSLRA"), AP7's investigation uncovered serious concerns with the two movants asserting larger losses. In addition to flagging these concerns, AP7 successfully fended off challenges to its own appointment. Specifically, competing movants argued that: (1) AP7, as a non-U.S. asset manager, lacked standing under Article III of the United States Constitution to assert claims in connection with purchases by its Equity Fund, and (2) AP7 was an atypical lead plaintiff because AP7's status as a Swedish pension fund posed a *res judicata* risk that Swedish courts would not recognize any judgment issued by U.S. courts in this case. Both of these arguments were rejected the court.

The Competing Lead Plaintiff Motions

Following Luckin Coffee's spectacular collapse in April 2020, eighteen movants — including AP7 and Louisiana Sheriffs — filed motions seeking appointment as lead plaintiff in the *Luckin Coffee* securities class action. While AP7 and Louisiana Sheriffs did not assert the largest losses of the movants before the court, AP7 and Louisiana Sheriffs's investigation of the two competing movants asserting larger losses — the Chesi Group[2] and the Luckin Investor Group[3] — uncovered serious deficiencies calling into question their ability to effectively represent the class. Appointing an unqualified lead plaintiff potentially jeopardizes all class members' claims as a court could deny class certification (and potentially terminating all claims) if the lead plaintiff is deemed to be inadequate. Honesty, trustworthiness, and the ability to actively lead a case are a few of the many criteria used by courts to assess adequacy.

As an initial matter, AP7 and Louisiana Sheriffs determined that a key member of the Chesi Group — which claimed to have suffered the largest

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[2] The Chesi Group is comprised of Chesi Assets Limited and Interactive Digital Finance Limited.

[3] The Luckin Investor Group is comprised of John Hickey, Regent Mercantile Holdings Limited, James Sproul, Li Tutang, and Khaled Abdullah Almdamegh.

losses — had previous pled guilty to securities fraud violations in Malaysia. After AP7 and Louisiana Sheriffs's raised their concerns about allowing an admitted fraudster to represent the class, the court requested additional information from the Chesi Group regarding the guilty plea. Rather than provide the documentation requested by the court, the Chesi Group withdrew its motion. *See Luckin Coffee*, 2020 WL 3127808 at *3 n.5.

AP7 and Louisiana Sheriffs also raised concerns about the ability of the five unrelated investors comprising the Luckin Investor Group to adequately oversee counsel and zealously represent the class. Indeed, unlike AP7 and Louisiana Sheriffs, the Luckin Investor Group consisted of individual investors that had no experience litigating federal securities claims and who had failed to provide any evidence establishing protocols for the management of the litigation. AP7 and Louisiana Sheriffs further noted that the Luckin Investor Group's willingness to support the appointment of the Chesi Group (rather than oppose the Chesi Group's motion) demonstrated inadequate representation.[4]

Given these facts, AP7 and Louisiana Sheriffs argued that they were the movant that asserted the largest financial interest in the litigation *and* satisfied the PSLRA's adequacy and typicality. However, in opposing AP7 and Louisiana Sheriffs's motion, certain competing movants argued that AP7 lacked Article III standing, and could not act as a lead plaintiff, because the losses asserted by AP7 in the litigation were based on purchases of Luckin Coffee securities by AP7's Equity Fund (and not AP7 itself). According to these movants, AP7 was not the proper party to assert claims because it had not directly purchased any Luckin Coffee securities, and thus did not suffer any injury as required by Article III of the U.S. Constitution.[5] Additionally, one competing movant argued that AP7, as a Swedish entity, was subject to unique *res judicata* defenses because defendants might later argue that a Swedish court would not recognize any judgment issued in this litigation by a U.S. court, and thus created the risk that claims would be relitigated against the defendants in Sweden.

AP7 countered that courts had repeatedly determined that AP7 and other European asset managers had standing to pursue claims on behalf of their managed funds under the "prudential exception" to Article III when they "can demonstrate (1) a close relationship to the injured party and (2) a barrier to the injured party's ability to assert its own interests."[6] AP7 further explained that because it is exclusively authorized under Swedish law to act on behalf of the Equity Fund, and the Equity Fund is a pool of assets that has no board, no management, no employees, and no independent legal identity or ability to take legal action on its own, the prudential exception clearly applied. Separately, AP7 argued that the competing movant's *res judicata* concerns were speculative and inapplicable to foreign lead plaintiff movants given that courts frequently appoint non-U.S. investors as lead plaintiffs and that AP7 had never faced a successful *res judicata* challenge from defendants despite serving as a lead plaintiff in more than a half-dozen other securities class actions.

The Court's Opinion

In appointing AP7 and Louisiana Sheriffs as lead plaintiff, the court rejected the standing and *res judicata* challenges lodged against AP7 and concluded that AP7 and Louisiana Sheriffs had satisfied the PSLRA's largest financial interest, adequacy, and typicality requirements.

Rejecting arguments challenging AP7's standing, the court specifically noted AP7's recent appointments in *Ocwen*, *Goldman Sachs*, and *General Electric*, where courts concluded "that concerns about AP7's standing 'are not grounded in evidence.'" *Luckin Coffee*, 2020 WL 3127808 at *7.[7] Critically, the court echoed the determination in *Goldman Sachs* that the movant "opposing AP7's appointment 'ha[d] not identified a single case' in which AP7's standing was 'successfully challenged'" by defendants and concluded that "[c] ompeting movants have not presented . . . proof" that AP7 lacked standing. *Id.* (citing *Goldman Sachs*, 2019 WL 4512774 at *6 n.12).

Similarly, the court determined that it "does not find the opposing movants' *res judicata* argument persuasive." *Id.* at *6. Specifically, Judge Liman explained that *res judicata* concerns "are not an

(continued on page 7)

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[4] In its response brief, the Luckin Investor Group represented that the Chesi Group "made the requisite *prima facie* showing of its typicality and adequacy" necessary for appointment as lead plaintiff. *Luckin Coffee*, No. 1:20-cv-01293-LJL (S.D.N.Y.), ECF No. 93 at 2.

[5] Generally speaking, Article III of the United States Constitution requires plaintiffs to establish, among other things, that they personally suffered an injury-in-fact. *See Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560 (1992) ("As the parties invoking federal jurisdiction, respondents bear the burden of showing standing by establishing, *inter alia*, that they have suffered an injury in fact, *i.e.*, a concrete and particularized, actual or imminent invasion of a legally protected interest.").

[6] *See W.R. Huff Asset Mgmt. Co. v. Deloitte & Touche LLP*, 549 F.3d 100, 109-10 (2d Cir. 2008) (setting forth requirements to meet prudential exception to Article III standing).

[7] *See also United Union of Roofers, Waterproofers & Allied Workers Local Union No. 8 v. Ocwen Fin. Corp.*, 2014 WL 7236985, at *3 (S.D. Fla. Nov. 7, 2014); *Plaut v. Goldman Sachs Grp., Inc.*, 2019 WL 4512774, at *6 (S.D.N.Y. Sept. 19, 2019); *Hachem v. Gen. Elec. Inc.*, No. 17-cv-8457, Dkt. No. 139 (S.D.N.Y. May 23, 2018).

BUSINESSES ACROSS THE COUNTRY SEEK RECOVERIES AFTER INSURERS DENY BUSINESS INTERRUPTION COVERAGE FOR LOSSES CAUSED BY THE COVID-19 PUBLIC SAFETY THREAT.

(continued from page 3)

Beginning in March 2020, in order to slow the spread of COVID-19, states and localities throughout the country issued orders that limited human interaction, required residents to stay home, and mandated that all noncritical retail and commercial businesses close. These orders are often referred to as stay-at-home orders. As of May 5, 2020, thirty-eight states and parts of seven additional states, had versions of these stay-at-home orders requiring nonessential businesses to close whereas only five states had no such protective orders. As a result of these orders, Royal Palm and other similarly situated businesses were forced to substantially reduce business operations and to operate on an emergency basis only. Through no fault of their own, this disruption to normal business operations has resulted in a substantial loss of revenue for businesses like Royal Palm throughout the state of Florida and the country.

In 2003, State Farm sold Royal Palm an insurance policy that included loss of income and extra expense coverage. Royal Palm timely paid insurance premiums and this policy is effective through March 20, 2021. This policy is an "all risk" commercial property policy, which covers loss or damage to the business owner's covered premises resulting from all risks other than those expressly excluded. After having to cease normal business operations and experiencing a loss of income due to state and local stay-at-home orders, Royal Palm submitted a claim for loss of business income. On the same day the claim was submitted, State Farm denied Royal Palm's claim. State Farm's denial letter asserted that Royal Palm's business interruption insurance policy does not cover loss of income resulting from mandatory business shutdowns due to COVID-19. However, the policy exclusions cited in State Farm's denial letter do not actually exclude losses resulting from stay-at-home orders; it is believed that State Farm similarly denied coverage to businesses nationwide for lost income sustained as a result of COVID-19 related stay at home orders.

As a result of State Farm's wrongful denial, Kessler Topaz filed suit so that Royal Palm, and other class members to whom State Farm wrongfully denied policy coverage, may enforce their business interruption insurance policies and recover damages from the denial of coverage.

Royal Palm and its fellow class members are not alone — numerous insurers have denied business interruption claims filed after losses caused by COVID-19 stay-at-home orders. To date, over one hundred lawsuits have been filed by businesses against various insurers across the country because of insurers' failure to pay business interruption claims. The issue presented in these lawsuits — whether business interruption insurance policies are triggered when governmental orders issued during a global pandemic cause business disruption — is of great national importance because it will affect the ability of many businesses to survive. This is an issue impacting industries across the entire spectrum of the economy and will impact not only individual businesses' survival but also the recovery of the entire economy.

Considering the breadth of filings concerning the pressing and important issue of whether business interruption policies cover losses sustained from COVID-19 stay-at-home orders, multiple plaintiffs have sought to consolidate pre-trail proceedings in all related lawsuits.[2] Specifically, certain plaintiffs have filed motions before the Judicial Panel on Multidistrict Litigation, seeking to consolidate actions filed in federal courts across the country related to this issue. These motions seek to transfer and consolidate all lawsuits concerning business interruption insurance claims stemming from COVID-19 governmental orders, for pre-trail proceedings under the Multidistrict Litigation statute. Pursuant to this federal statute, parties may seek pre–trial consolidation of actions pending in different federal district courts when such actions involve one or more common questions of fact, the consolidation will be for the convenience of the parties and witnesses, and consolidation will promote the just and efficient conduct of such actions.[3]

There are currently competing motions seeking consolidation of these business interruption

[2] The motions for transfer and consolidation are ECF Nos. 1, 4, and 9 on the docket for Multidistrict Litigation Case No. 2942.

[3] 28 U.S.C. § 1407(a).

insurance cases in different jurisdictions. Two plaintiffs filed a motion seeking to consolidate these actions in the Eastern District of Pennsylvania while other plaintiffs have filed a motion to consolidate these cases in the Northern District of Illinois and a third set of plaintiffs seeks to consolidate these cases in the Southern District of Florida. Each of these motions argues that their proposed jurisdiction is the best location for consolidated pre–trial proceedings because of either geographic centrality to parties and witnesses and/or because the jurisdiction was heavily impacted by COVID-19 and will therefore have many impacted litigants. These motions also contend that consolidation is appropriate because these lawsuits concern similar issues and consolidation will eliminate the likelihood of duplicative discovery, will avoid inconsistent rulings, and will prevent judicial resources from being needlessly wasted. One opposition to these consolidation motions has been filed,[4] arguing that consolidation is inappropriate because these lawsuits were filed against different insurers, concern different insurance policies, advance different claims and concern different states' laws. The opposition argues that these differences mean that the factual inquiries of each lawsuit will be distinct, and therefore pre-trial consolidation is not appropriate. These motions and opposition are currently pending before the Judicial Panel on Multidistrict Litigation and a decision on whether to centralize these actions and, if so, which jurisdiction to send them to, will be issued in the coming months.

Once the Judicial Panel on Multidistrict Litigation rules on the pending motions, Kessler Topaz will vigorously pursue this important and timely litigation for class members in either the multidistrict jurisdiction or in the Southern District of Florida, where the Royal Palm complaint was filed. This case illustrates Kessler Topaz's nimble, adaptive, and forward-looking practice as it seeks to protect businesses and consumers after the unforeseen financial damage caused by the COVID-19 pandemic which will be felt in the months, and possibly, years to come. ■

[4] The opposition to motions for transfer and consolidation is ECF No. 198 on the docket for Multidistrict Litigation Case No. 2942.

KTMC APPOINTED AS CO-LEAD COUNSEL IN INVESTORS' CLASS ACTION AGAINST LUCKIN COFFEE

(continued from page 5)

issue with respect to the selection of Lead Plaintiffs, since those persons will clearly be bound by the judgment of the court," and acknowledged that "courts routinely appoint foreign investors as lead plaintiffs" and that "foreign lead plaintiffs have been responsible for many large securities class actions." *Id.* (citing *Takeda v. Turbodyne Techs., Inc.*, 67 F. Supp. 2d 1129, 1139 (C.D. Cal. 1999); *Sgalambo v. McKenzie*, 268 F.R.D. 170, 176 (S.D.N.Y. 2010)). Moreover, the court highlighted the decision in *Stone v. Agnico-Eagle Mines Ltd.*, 280 F.R.D. 142, 146 (S.D.N.Y. 2012), where another judge in the Southern District of New York appointed another AP fund, AP1, as a lead plaintiff and concluded that "*res judicata* concerns are 'explicitly rejected when the foreign lead plaintiff movants are suing as a result of purchases made on a domestic securities exchange.'" *Id.*

Furthermore, the court shared AP7 and Louisiana Sheriffs's concerns that the Luckin Investor Group would not adequately represent the class. As a threshold matter, the court concluded that the Luckin Investor Group was "a random assemblage" that "does not provide evidence that any member of the group — much less the group as a whole — has had significant involvement in the litigation thus far," that "the group members provide no plan for communicating with one another across time zones" given that its members were located in Georgia, Toronto, England, Saudi Arabia, and China, and that "there is every reason to believe that the members agreed to be assembled by counsel and to ratify counsel's representation of them — rather than that they gathered together and engaged in a truly independent selection of counsel." *Id.* at *4.

In contrast, the court concluded that AP7 and Louisiana Sheriffs "are institutional plaintiffs who have acted as fiduciaries and who have combined assets under management of $64 billion along with track records of successfully serving in lead plaintiff groups under the PSLRA," that "their combined experience and resources give some confidence that the group members will have the knowledge and background to appropriately supervise counsel and protect against lawyer-driven litigation," and that "both members and their selected counsel bring benefits of long-standing lawyer-client relationships, which include, *inter alia*, trust, effective communication, and cost-effectiveness." *Id.* at *6.

Luckin Coffee adds to the growing body of case law recognizing that non-U.S. asset managers — like AP7 — are appropriate lead plaintiff representatives in securities class actions. Moreover, the case also illustrates the need for lead plaintiff movants to actively vet competing movants to ensure that their and the class's claims will not be jeopardized by the appointment of an unqualified movant. ■

THE SECOND CIRCUIT REJECTS DEFENDANTS' EFFORT TO INTRODUCE MERITS CHALLENGES AS A BASIS TO UNDERMINE CLASS CERTIFICATION

(continued from page 1)

represented, among other things, that Goldman maintains "extensive procedures and controls that are designed to identify and address conflicts of interest," and that Goldman's "clients' interests always come first," Defendants had failed to disclose that Goldman had substantial conflicts of interest with respect to at least four collateralized debt obligation ("CDO") transactions involving subprime mortgages.[1] Most notably, in a transaction involving the Abacus 2007 AC-1 ("Abacus") CDO, Goldman secretly allowed a hedge fund — Paulson & Co. ("Paulson") — to dictate the composition of the mortgages within the Abacus CDO while also taking a short position against the CDO. As a result, Paulson received a significant profit when Abacus collapsed in the midst of the 2008 financial crisis. Goldman later paid a record $550 million to settle claims brought by the U.S. Securities and Exchange Commission for its role in Abacus. In other instances, Goldman represented to investors that its interests were aligned with theirs, while Goldman was in fact short selling against its' clients positions.[2]

The plaintiffs in *Goldman* are Goldman shareholders alleging securities fraud claims under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 (the "Exchange Act"). The Southern District of New York first certified a class of Goldman shareholders in 2015. Defendants appealed, and the Second Circuit remanded with instructions for the district court to reconsider Defendants' evidence against class certification. On remand, the district court once again certified a class of Goldman shareholders, and once again, Defendants appealed.

The Second Circuit Declines to Narrow the Inflation-Maintenance Theory and Refuses to Consider Materiality at Class Certification

The first issue raised by Defendants on appeal was the district court's application of the inflation-maintenance theory. There are two types of false statements that can have "price impact," or affect the market price of a security, in a securities fraud case under Section 10(b): statements that *introduce* price inflation and statements that *maintain* existing price inflation.[3] The plaintiffs in *Goldman* relied on an inflation-maintenance theory: that Defendants' misrepresentations and omissions regarding conflicts of interest impacted the price of Goldman's stock by maintaining price inflation rather than introducing it.[4]

With respect to the inflation-maintenance theory, Defendants argued that plaintiffs must show that the initial price inflation being maintained must be "fraud-induced." The Second Circuit, however, disagreed, holding that the "actual issue is simply whether Goldman's share price was inflated," and that under the inflation-maintenance theory, "if a court finds a disclosure caused a reduction in a defendant's share price, it can infer that the price was inflated by the amount of the reduction."[5] Defendants next argued that the inflation-maintenance theory should apply only in special circumstances (*i.e.*, as to optimistic statements to stop stock price declines or to statements that falsely convey that market expectations have been met) and not with respect to "general statements." The Second Circuit again rejected Defendants' argument, explaining that Defendants' proposed standard was "really a means for smuggling materiality into Rule 23" and that Defendants' test "would commandeer the inflation-maintenance theory by essentially requiring courts to ask whether the alleged misstatements are, in Goldman's words, 'immaterial as a matter of law.'"[6] As the Second Circuit noted, materiality is properly considered in a motion to dismiss and later at summary judgment — not at class certification, where it is irrelevant because "[w]in or lose, the issue [of materiality] is common to all class members."[7] The Court further noted that Defendants' attempt to narrow the inflation-maintenance theory is squarely at odds with the Second

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[1] *Arkansas Teacher Ret. Sys. v. Goldman Sachs Grp., Inc.*, 955 F.3d 254, 258-59 (2d Cir. 2020).

[2] *See id.*

[3] *See In re Vivendi, S.A. Sec. Litig.*, 838 F.3d 223, 259 (2d Cir. 2016).

[4] See Goldman, 955 F.3d at 262-64.

[5] *Id.* at 265.

[6] *Id.* at 267-68.

[7] *Id.* at 268-70.

Circuit's prior decision in *Vivendi*, which held that "inflation maintenance" and "inflation introduction" are not separate legal categories of price impact.

The Second Circuit Reiterates That Defendants Bear the Burden of Persuasion in Rebutting the *Basic* Presumption

Defendants also argued that the district court abused its discretion when it found that Defendants had failed to rebut the "*Basic* presumption." The *Basic* presumption — which is essential to class certification in a securities class action — allows courts to presume that an entire class of shareholders relied on the defendants' misrepresentations in choosing to purchase the relevant securities if the plaintiffs establish that: (1) the defendants' false statements were publicly known; (2) the relevant shares traded in an efficient market; and (3) the plaintiffs purchased their shares at the market price after the misrepresentations were made but before the truth was revealed.[8] Once a plaintiff makes this showing, the reliance requirement is satisfied under Section 10(b), and the burden shifts to the defendant to rebut the presumption. The presumption may be rebutted "by showing, by a preponderance of the evidence, that the entire price decline on the corrective-disclosure dates was due to something other than its alleged misstatements."[9]

After examining the evidence presented by Defendants — which included expert testimony concerning thirty-six media reports that discussed Goldman's conflicts of interest prior to the corrective disclosures, as well as an event study that attributed no price movement to the corrective disclosures — the Second Circuit held that the district court had not erred in concluding that Defendants had failed to rebut the *Basic* presumption. In particular, the Second Circuit credited the district court's finding that the corrective disclosures had revealed new information that was not included in the prior media reports and that the event study was flawed.

In rejecting Defendants' argument that the district court had improperly weighed the evidence, the Second Circuit noted that, under the inflation-maintenance theory, "Goldman's burden is to show that the market would not have reacted had Goldman told the truth about its alleged failure to manage its conflicts."[10] And, because "[i]t is difficult to imagine that Goldman's shareholders would have been indifferent had Goldman disclosed its alleged failure to prevent employees from illegally advising clients to buy into CDOs that were built to fail by a hedge fund secretly shorting the investors' positions," the Second Circuit concluded that it is reasonable to assume that the resulting harm to Goldman's reputation would have "caused the market to devalue [Goldman's] share price accordingly."[11]

In its decision, the Second Circuit recognized the "heavy burden" the *Basic* presumption places on defendants:

> [F]or a defendant to erase the inference that the corrective disclosure had price impact — *i.e.*, that it played some role in the price decline — it must demonstrate under the preponderance-of-the-evidence standard, using event studies or other means, that the other events explain the entire price drop.[12]

The Second Circuit also rejected Defendants' contention that the plaintiffs had failed to introduce sufficient evidence of price impact, concluding that the district court properly credited plaintiffs' evidence and noting that "the question is not which side has better evidence, but whether the defendant has rebutted the presumption."[13]

Accordingly, the Second Circuit affirmed the district court's decision granting class certification.

Future Impact

The Second Circuit's decision in *Goldman* is a clear endorsement of the inflation-maintenance theory and further precludes defendants from re-litigating the issue of materiality at the class certification stage. Moreover, the decision reaffirms prior precedent, explaining that it is *defendants'* burden to set forth evidence rebutting the *Basic* presumption — and not plaintiffs' burden to undermine defendants' evidence. Thus, this decision is likely to serve as helpful authority to support class certification in future securities fraud actions.[14] ■

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[8] *See In re Goldman Sachs Grp., Inc. Sec. Litig.*, No. 10 Civ. 3461, 2015 WL 5613150, at *3-6 (S.D.N.Y. Sept. 24, 2015); *see also Basic*, 485 U.S. at 248-49.

[9] *Goldman*, 955 F.3d at 270.

[10] *Id.* at 271.

[11] *Id.* at 271-72.

[12] *Id.* at 270 n.18.

[13] *Id.* at 272 n.19.

[14] Notably, however, Defendants have filed a petition for a panel rehearing or rehearing *en banc*. If their petition is granted, the result or reasoning may change in any decision following rehearing.

NINTH CIRCUIT TO REVISIT THE EXTENT OF *AFFILIATED UTE* RELIANCE IN SECURITIES OMISSION CASES

(continued from page 3)

presumption of reliance, arguing that Plaintiff could not invoke it because, among other things, Volkswagen did not owe any duty to disclose the omitted information.

The District Court preliminary noted that in a "run-of-the-mill" omissions case it might have been unwilling to find an actionable omission and not have applied the *Affiliated Ute* presumption of reliance. Here, however, the gravity of the omission led the Court to conclude that the *Affiliated Ute* presumption was appropriate:

> If Volkswagen had disclosed its defeat-device scheme in its 2014 bond offering memorandum, instead of waiting until September 2015, the same publicity, and the same response by Plaintiff's investment manager, would likely have followed. The scheme was so substantial and blatant that it is hard to fathom that its disclosure would have gone unnoticed by the investing public, and that Plaintiff's investment manager would not have been made aware of it.[8]

In other words, although the District Court acknowledged that as a general matter, a defendant normally does not have a duty to disclose, because of the gravity of Volkswagen's fraud here, the omission was nonetheless actionable.

Volkswagen then asked the District Court for permission to seek an interlocutory appeal of the denial of summary judgment, asserting, *inter alia*, that "corporations owe no-free standing affirmative duty to accuse themselves of wrongdoing."[9] It argued that "Defendants were under no obligation to disclose to Plaintiff the existence of the defeat devices . . . *except* to the extent necessary not to make [affirmative statements] misleading *in the 'context' of the Offering Memorandum*." To Volkswagen, the gravity of the underlying fraud has no bearing, relying on out-of-circuit cases noting that there is no duty to disclose "how significant the scandal would have been to the market" or "merely because a reasonable investor would very much like to know that information." Thus, Defendants had to disclose only the minimum "facts necessary to make statements" regarding the company's general legal issues and research into emissions technologies — not misleading, "regardless of the 'substantial and blatant' nature of the defeat device 'scheme.'"

Plaintiff's opposition to the interlocutory appeal contended that the District Court's order broke no new ground, and applied the Ninth Circuit's *Binder* decision, which "affirmed that the *Affiliated Ute* presumption of reliance can be applied to a 'mixed' case alleging both affirmative misstatements and omissions, so long as the case alleges primarily omissions."[10] It specifically pointed out that a duty to disclose arises when disclosure is necessary to make affirmative statements not misleading.

On January 22, 2020, the District Court certified the interlocutory appeal, and on March 31, 2020, the Ninth Circuit agreed to take the appeal. Although there are many possible ways that the Ninth Circuit might address this case, its future decision could clarify the significance that the gravity of the omitted fact has on determining whether a duty to disclose arises. If the Ninth Circuit were to affirm the District Court's decision, it might adopt the District Court's underlying reasoning that, where the alleged omissions and underlying fraud is so "substantial or blatant," a duty to disclose might arise more easily than in a "run of the mill" omissions case. On the other hand, if the Ninth Circuit agrees with Volkswagen's view that the significance or gravity of the omitted fact is irrelevant to the duty to disclose, and emphasize that the duty to disclose is based on the context of the false statements and the omitted material, or whether the case was primarily about affirmative falsity or omissions or the existence of a special relationship, such a decision conceivably could narrow the application of *Affiliated Ute* going forward in cases involving both affirmative false statements and omissions. ■

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[8] 2019 WL 4727338, at *3.

[9] ECF No. 6845 Case No. 15-md-02762 (N.D. Cal. Oct. 30, 2019). Volkswagen did not ask for a stay pending appeal and no stay was entered.

[10] ECF No. 6985 Case No. 15-md-02762 (N.D. Cal. Dec. 12, 2019).

EVENTS

WHAT'S TO COME

AUGUST 2020

Texas Association of Public Employee Retirement Systems (TEXPERS) Summer Educational Forum

August 16 – 18

Grand Hyatt ■ San Antonio, TX

County Commissioners Association of Pennsylvania (CCAP) Annual Conference and Trade Show

August 16 – 19

Seven Springs Mountain Resort
Somerset County, PA

SEPTEMBER 2020

Michigan Association of Public Employee Retirement Systems (MAPERS) 2020 Fall Conference

September 12 – 15

The Grand Hotel
Mackinac Island, MI

Council of Institutional Investors (CII) 2020 Fall Conference

September 21 – 23

Westin St. Francis ■ San Francisco, CA

Georgia Association of Public Pension Trustees (GAPPT) 7th Annual Trustee School – Virtual Edition

September 21 – 28

Virtual Edition

Litigation & Governance Trends for Nordic Asset Management & Owners

September 24

The Grand Hotel ■ Stockholm, Sweden

Illinois Public Pension Fund Association (IPPFA) 2020 Mid-America Pension Conference

September 30

Embassy Suites Hotel ■ Naperville, IL

OCTOBER 2020

Florida Public Pensions Trustees Association (FPPTA) Fall Trustee School

October 4 – 7

Hilton Bonnet Creek ■ Orlando, FL

NOVEMBER 2020

State Association of County Retirement Systems (SACRS) Fall Conference

November 10 – 13

Renaissance Esmeralda Resort & Spa
Indian Wells, CA

International Foundation of Employee Benefit Programs (IFEBP) 66th Annual Employee Benefits Conference

November 14 – 18

Hawaii Convention Center ■ Honolulu, HI

County Commissioners Association of Pennsylvania (CCAP) Fall Conference

November 22 – 24

The Hotel Hershey ■ Dauphin County, PA

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