

Pomerantz Secures Major Victory for Investors in Case Against Deutsche Bank

“This case has been particularly meaningful to me, given the misconduct at issue – Deutsche Bank’s lending and servicing of Jeffrey Epstein’s accounts – despite knowledge that he sexually abused at least 40 girls.”

– Partner Emma Gilmore

By Emma Gilmore

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Pomerantz clinched a significant victory for investors in a securities fraud class action brought against Deutsche Bank for its false and misleading representations about the Bank’s Know Your Customer procedures—an important aspect of the Bank’s anti-money-laundering processes. On May 18, 2022, Judge Jed S. Rakoff of the United States District Court for the Southern District of New York denied in large part defendants’ motion to dismiss all claims in *Karimi v. Deutsche Bank AG*, in which Pomerantz serves as sole Lead Counsel.

The complaint alleges that during the relevant Class Period, Deutsche Bank and several of its executives, including its CEO, made materially false and misleading statements about its anti-money-laundering (“AML”) deficiencies and failed to properly monitor or gave exemptions to customers it considered high risk, such as financier and accused sex offender, Jeffrey Epstein. For example, defendants repeatedly assured investors that Deutsche Bank had “developed effective procedures for assessing clients (Know Your Customer or KYC) and a process for accepting new clients in order to facilitate comprehensive compliance,” and insisted that “[o]ur KYC procedures start with intensive checks before accepting a client and continue in the form of regular reviews.” Defendants also claimed Deutsche Bank’s “robust and strict” KYC program “includes strict identification requirements, name screening procedures and the ongoing monitoring and regular review of all existing business relationships,” with “[s]pecial safeguards... implemented for...politically exposed persons.”

In truth, however, far from implementing a “robust and strict” KYC program with “special safeguards” for politically exposed persons (“PEPs”), during the Class Period, defendants repeatedly exempted high-net-worth individuals and PEPs—including unsavory figures like Jeffrey Epstein and individuals sponsoring terrorism—from any meaningful due diligence, enabling their criminal activities through the use of the Bank’s facilities. That practice commenced with Deutsche Bank’s former CEOs onboarding, retaining and servicing Russian oligarchs and PEPs reportedly engaged in criminal activities.

For example, despite widespread coverage of Epstein’s child sex trafficking and abuse, Deutsche Bank’s executives onboarded Epstein as a client in 2013, enabling his

criminal activities to not only continue, but also to flourish. In addition to opening and servicing wealth-management accounts for Epstein, Deutsche Bank also provided loans to Epstein and his businesses. Epstein was onboarded based on the lucrative business he would generate for the bank, with Deutsche Bank estimating “flows of \$100-300 [million] overtime [SIC] (possibly more) w/ revenue of \$2-4 million annually over time....” Despite knowing that by 2011, “40 underage girls had come forward with testimony of Epstein sexually assaulting them,” Deutsche Bank remained “comfortable with things continuing” with Epstein, “not[ing] a number of sizable deals recently.” One of several confidential witnesses with knowledge of Deutsche Bank’s KYC processes explained that, after Epstein was onboarded, decisions about whether to continue keeping him as a client were repeatedly escalated, including to Deutsche Bank’s Reputational Risk Committee and members of Deutsche Bank’s Executive Committee for the Bank’s Global Wealth Management. Despite these warnings, Deutsche Bank repeatedly approved retaining and servicing Epstein. From the time of Epstein’s onboarding, the relationship was classified by Deutsche Bank as “high-risk” and therefore should have been subject to enhanced due diligence. Instead, in a sordid twist of irony, the Bank designated Epstein an “Honorary PEP.”

Defendants made a number of arguments that Pomerantz defeated. For example, defendants argued that Deutsche Bank’s representations to investors about their Know Your Customer procedures were aspirational and immaterial and that, in any event, the investing public was provided with more than enough information to understand the state of Deutsche Bank’s AML and KYC processes (the so called “truth-on-the-market” defense). Pomerantz successfully countered that defendants’ representations were material to investors because, by exempting PEPs and other high-risk individuals from any meaningful KYC procedures, the risk to the Bank’s reputation and the risks of criminal and civil liability were significantly heightened. The



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materiality of defendants' statements was also demonstrated by defendants' repeated discussion of these topics throughout the Class Period. Pomerantz successfully defeated defendants' "truth-on-the-market" argument that investors knew Deutsche Bank's AML procedures were not always effective, explaining that such defense on this record was intensely fact-specific and improperly raised at the motion to dismiss stage, particularly given Deutsche Bank's affirmative representations of compliance made throughout the Class Period.

Judge Rakoff set a trial date for November 2022.

Partner Emma Gilmore, who leads the litigation, said, in response to Judge Rakoff's decision, "This case has been particularly meaningful to me, given the misconduct at issue – Deutsche Bank's lending and servicing of Jeffrey Epstein's accounts – despite knowledge that he sexually abused at least 40 girls." ■

Pomerantz Achieves Victory for Defrauded Chicago Bridge & Iron Investors

By Joshua B. Silverman

In a victory for investors, Pomerantz, as counsel for two of the three court-appointed class representatives, achieved a \$44 million settlement in a securities fraud class action against Chicago Bridge & Iron Co., N.V. ("CBI") and its former Chief Executive Officer, Chief Financial Officer, and Chief Accounting Officer. The Honorable Lorna G. Schofield of the United States District Court for the Southern District of New York granted preliminary approval of the settlement on March 30, 2022 and set the final approval hearing for July 25, 2022.

CBI is an energy services company specializing in the engineering, procurement and construction of energy plants and related facilities. In 2013, CBI entered the nuclear fabrication business by acquiring The Shaw Group for \$3.3 billion. The crown jewel of the acquisition was Shaw's nuclear construction unit, which was part of a consortium building the first new nuclear plants in the United States in decades, two at a Georgia facility called Vogtle and two at the V.C. Summer facility in South Carolina. CBI and its CEO claimed to have conducted thorough due diligence prior to the acquisition and to have gained a clear understanding of the status of the nuclear projects.

Between October 2013 and January 2015, CBI and its executives made several positive but false statements about the progress of the nuclear projects, hid adverse information about schedule delays and cost overruns, and claimed in periodic reports filed with the Securities and Exchange Commission that there were no indicators of impairment despite significant internal red flags indicating that the

nuclear projects were unlikely to ever yield the profits that the company had modeled. They also misrepresented CBI's ability to recover for unapproved change orders ("UCOs")—massive but disputed invoices for expenses stemming from design changes. Although the electric utilities that owned the nuclear projects and CBI's consortium partner refused to reimburse CBI for the UCOs, CBI nonetheless told investors that payment was probable and booked them as revenue.

In mid-2014, institutional analyst firm Vertical Research and short seller Prescience Point each put out negative reports about CBI's nuclear construction business. By early 2015, it was clear to CBI (and increasingly to investors) that the nuclear construction business was a disaster. CBI began to negotiate a "quit claim" deal with its consortium partner, Westinghouse, to essentially walk away from the nuclear construction projects, stemming losses but receiving virtually nothing for the business it had paid billions for just two years earlier. In October 2015, CBI announced that it would transfer the nuclear construction business to Westinghouse for only a true up of expenses incurred during the transition.

Early motion practice wins established a momentum that carried plaintiffs to trial. First, plaintiffs defeated defendants' attempt to transfer the lawsuit to the Southern District of Texas, where CBI would enjoy a "home court" advantage. Then, plaintiffs defeated defendants' motions to dismiss.

Years of discovery developed strong evidence that defendants had concealed adverse information about the nuclear projects from investors. Pomerantz and other plaintiffs' counsel reviewed over 9 million pages of documents and took approximately 30 depositions. They uncovered evidence that CBI had manipulated its financial reporting by mixing the nuclear construction business with other profitable businesses into a single reporting unit to hide deterioration and avoid a write-down, that both the owners and Westinghouse had rejected CBI's view that the contracts required reimbursement of UCOs, and that CBI internally did not expect to be paid on many items booked as revenue for several years, if ever.

In addition to uncovering strong factual evidence, plaintiffs also put together a world-class slate of expert witnesses on the topics of market efficiency, damages/loss causation, accounting, and materiality. These experts were particularly crucial at class certification, where both sides' economic experts testified during an eleven-hour hearing before the Special Master appointed by the Court, the Honorable Shira Scheindlin (Ret.). Pomerantz played a key role, cross-examining defendants' expert and exposing the weaknesses in her price impact analysis. The Special Master ruled in a 107-page Report & Recommendation that certification should be granted, which the District Court adopted. After full briefing, the United States Court of Appeals declined to consider an appeal of that ruling.

Unbowed, and despite the considerable evidentiary record amassed by plaintiffs, defendants moved for summary



Joshua B. Silverman, Partner

judgment on all claims. After full briefing, the district court denied that motion and set the case for trial in February 2022.

Trial always involves risks, and this one more so than others. Defendants had won a jury trial of similar claims in Texas state court against a hedge fund that opted out of the class action. Although Pomerantz believed that its case did not suffer from the flaws that sunk the Texas case, the Texas trial showed that the risk of an adverse verdict was substantial. Against these risks, the class action plaintiffs had limited upside to proceeding to trial. The corporate defendant and its parent had both declared bankruptcy, and the individual defendants did not have sufficient resources to satisfy a large jury award. While Pomerantz and other plaintiffs' counsel retained bankruptcy counsel to make sure that bankruptcy releases did not bar class claims, the bankruptcy effectively meant that recovery was limited to a rapidly eroding insurance stack.

Acknowledging the risks that both sides faced at trial, the parties decided to take a final run at mediation before the Honorable Layn R. Phillips (Ret.). Ultimately, both sides accepted a mediator's proposal to settle the case for \$44 million, an excellent recovery under the circumstances. Despite the bankruptcy, Pomerantz's perseverance resulted in a class recovery that was significantly higher than the median for comparable class actions. ■

A Case for Statistical Evidence in Insider Trading Claims

By Dolgora Dorzhieva

Insider trading is tough to prove, and it can take years to gather enough evidence to successfully prosecute it. Preet Bharara, the former U.S. Attorney for the Southern District of New York, has called insider trading, undertaken by company insiders and hedge funds, "rampant." The SEC has developed data analytics tools to aid the investigation of insider trading cases with statistical evidence. However, in *SEC v. Clark and Wright*, the court rejected the SEC's statistical evidence as "just a matter of speculation." On occasion, evidence of insider trading is used to determine whether scienter exists in Rule 10b-5 or securities fraud cases. This article will describe the value of statistical evidence and explain what steps plaintiffs' lawyers can take to leverage such evidence in prosecuting insider trading claims.

What is Insider Trading?

Insider trading involves trading in a public company's stock by someone who has material nonpublic information ("MNPI") about that stock. MNPI is data relating to a company that has not been made public but would have an impact on its share price when made public. Insider trading is often carried out by a group of people rather than

by an individual acting alone. Frequently, the person who receives inside information from within an organization ("a tipper") does not trade on that information, but rather passes information on to others ("tippees"), who ultimately trade based on that information. This type of insider trading is illegal because insiders cannot "misappropriate" information for their own benefit.

Investors may be deterred from participating in the market if they know that others are trading on nonpublic information. However, insider trading violations are difficult both to prosecute and to prove. Often, defendants in insider trading cases will deny their awareness of MNPI at the time of a securities trade, or defendants will claim that their reason for trading was completely unrelated to the information in their possession. Because insider trading involves secret information and communications, it is rare to find a smoking gun proving that a trader was tipped and by whom (i.e., what they knew, when they knew it, and how they found out). Therefore, the government and the plaintiffs' bar often rely—at least initially—on circumstantial evidence to draw the strong inference that the defendant was aware of MNPI and used that information for personal profit when trading.

SEC v. Clark and Wright and the SEC's Data Analytics Tools

To aid the investigation of insider trading cases, the SEC has developed numerous data analytics tools for analyzing massive amounts of data to identify suspicious trading, such as improbably successful trading across different securities over time. In *SEC v. Clark and Wright*, the SEC argued that the trades in question were suspicious because they had "an improbable success rate." The SEC alleged that Christopher Clark and his brother-in-law, William Wright, the former controller for CEB, Inc., engaged in insider trading in advance of CEB's acquisition. Based on the information tipped by Wright, Clark allegedly purchased highly speculative, out-of-the-money call options. The SEC further alleged that, after the public announcement of the acquisition of CEB for \$2.6 billion, Clark liquidated his CEB options and made a profit of over \$240,000. The cornerstone of the SEC's case was "suspicious trading": Clark and his son purchased CEB's highly risky options before the merger announcement after Clark maxed out his family's credit line, took out a loan on his car and liquidated his wife's IRA account to finance these trades. According to the SEC, Clark and his son "were the only investors in the entire world willing to buy such risky options" and accounted for 100% of the buy-side volume on the days in question. The SEC took the position that Clark's too-good-to-be-true trades, combined with the fact that Clark borrowed money to make the trades, spent ample time with Wright, and traded after communicating with Wright, clearly pointed to insider trading. Instead of initially presenting testimony or other direct evidence, which is hard to obtain at the outset of insider trading cases, the SEC's case largely hinged on its statistical surveillance tools' identification of the trades as "highly suspicious."

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Wright settled with the SEC in October 2021. Clark proceeded to trial. Courts have repeatedly held that evidence of suspicious trading that coincides with communications between the alleged tippee and tipper should go to the jury. Judge Hilton, however, ended the SEC's trial against Clark without hearing Clark's arguments or allowing the jury to weigh in, finding that the SEC's statistical evidence was "just a matter of speculation" and that the "improbable success rate" of Clark's trades was not evidence of anything at all: "the government can speculate that he made a little too much money, he was a little successful or more successful than he ought to be, so therefore he's getting insider information, but there's no evidence of it." Judge Hilton added that "[t]here's just simply no circumstantial evidence here that gives rise to an inference that he received the insider information."

The Role of Statistical Evidence in Civil Cases

Is there a qualitative distinction between statistical and non-statistical evidence? According to Judge Posner, "[t]he probabilities that are derived from statistical studies are no less reliable in general than the probabilities that are derived from direct observation, from intuition, or from case studies of a single person or event." The ambiguity of "statistical" evidence does not differ in kind from the ambiguity of "non-statistical" evidence. The "real problem" of statistical evidence is not the explicit characteristics of the evidence itself; it is instead the interpretation given to that evidence. At its core, evidence takes on meaning for trials only through the process of being considered by an individual. And Judge Hilton's interpretation of the SEC's statistical evidence of "suspicious trading" could have been very different from the jury's interpretation of the same evidence. Moreover, while the use of statistical analysis to identify insider trading is novel, the use of statistical analysis in other fields to provide legal proof is not. Many courts have permitted proof of causation through statistically-based evidence in toxic tort cases, even when the evidence is thin and attenuated, and stronger and better evidence is unavailable. The courts and regulators also rely on statistical analysis to help prove systemic employment discrimination and the efficacy of treatments in clinical trials. This is because the approach employed in statistical analysis of arriving at a conclusion by ruling out plausible alternative explanations is consistent with judicial fact-finding.

The SEC has been very successful in litigating insider trading claims solely on the basis of statistical evidence. For example, in *SEC v. Ieremenko, et. al.*, a case brought against a hacker and several traders who traded on nonpublic information stolen from the SEC's EDGAR database, the SEC successfully argued that the defendants' trading was correlated with the EDGAR hacks: "[i]t is virtually impossible that [the suspicious trading] could have occurred by random chance. Statistical analysis shows that for each of the Trader Defendants, the odds of that trader trading so disproportionately in hacked events by random chance ranged from less than 7 in 10 million to

less than 1 in 1 trillion. This means that for each of the Trader Defendants, it is nearly impossible that their trading is uncorrelated with the hack of the EDGAR system."

Thus, it is surprising that the SEC's case against Clark was dismissed so early. The SEC appealed and, if it prevails, the ultimate legal impact of Judge Hilton's outlier decision should be minimal. Judge Hilton did not give the SEC a chance to establish evidence of scienter based on strong circumstantial statistical evidence.

An Expert's Advice for the Plaintiffs' Bar for Successful Prosecution of Insider Trading Claims

What steps can plaintiffs' lawyers take to leverage the value of statistical evidence in identifying and deterring wrongdoing in insider trading cases? To find out, I interviewed Daniel Taylor, a professor at The Wharton School of the University of Pennsylvania, who leads the Wharton Forensic Analytics Lab and has done extensive research on insider trading. According to Taylor, a weakness of the plaintiffs' bar is that it tends to rely on experts who are credentialed law professors not trained in data analysis and visualization. Lawyers don't understand the power of data and often do not know how to convincingly present statistical evidence to a fact-finder. Taylor says that the plaintiffs' bar needs a broader expert network for insider trading that includes experts in data analysis and the tools for presenting that analysis to laymen, such as charts and graphs. According to Taylor, there is a lack of visualization within many legal briefs that allege suspicious trading. Taylor says that in an insider trading case, persuasive and compelling evidence would consist of probability calculations and an analysis of counter-factuals. For example, one can highlight an extreme outlier trade by comparing the trade to the distribution of normal trades. Another helpful technique would be to explain the counter-factual: for example, as it was with Clark, it is exceptionally rare for an individual to liquidate their retirement accounts, max out their credit lines, take out an auto loan, and risk those proceeds investing in out-of-the-money options unless the individual knew they had MNPI. ■

COVID-19 and the Litigation Pandemic

By the Editors

In January 2020, as the novel coronavirus spread globally and the death toll rose, so too did peoples' fears. While many companies diligently shared information about their new risks with shareholders, others sought to profit from the widespread anxiety. On March 12, 2020, one day after the World Health Organization declared the novel coronavirus to be a pandemic, the first COVID-19-related securities class action lawsuits were filed. Each of these litigations is representative of a separate trend in subsequent securities class actions related to COVID-19: cases that target industries, such as pharmaceuticals, whose products are involved in responding to the coronavirus, and cases that

target industries that the virus directly affected, such as cruise lines.

One of the two securities class actions filed on March 12, 2020, targeted Inovio Pharmaceuticals, Inc. (“Inovio”) and its CEO, J. Joseph Kim. Kim, in two public appearances in February 2020 – one on Fox Business News and one with President Trump – claimed that Inovio had already developed a COVID-19 vaccine and would start phase one testing in the early summer. Inovio’s stock price skyrocketed amidst a buying frenzy – that is, until Citron Research disclosed that Inovio did not, in fact, have a viable vaccine. Subsequently, the company was forced to acknowledge that it had merely “designed” one. According to the complaint, that disclosure led to a two-day drop in Inovio’s share price that “wiped out approximately \$643 million in market capitalization for the Company, marking a 71% decline from its Class Period high.”

The second COVID-19-related securities action filed on that day sued Norwegian Cruise Line Holdings (“NCL”) on behalf of a proposed class of shareholders who had purchased shares of the company during the three weeks before the pandemic was declared. On February 20, 2020, NCL issued a press release stating that “despite the current known impact” from the coronavirus outbreak, as of the week ending February 14, 2020, “the Company’s booked position remained ahead of prior year and at higher prices on a comparable basis.” In other words, they had plenty of ticketed passengers and NCL was still planning on setting sail with them. It further stated that the company “has an exemplary track record of demonstrating its resilience in challenging environments” and that NCL had “proactively implemented several preventive measures to reduce potential exposure and transmission of COVID-19.”

The complaint alleged that these statements, as well as others in the company’s SEC filings published concurrently with the press release, were false and misleading. The complaint quoted a *Miami New Times* article that reported that leaked internal NCL emails demonstrated that the company had pressured its sales teams to mislead customers about the coronavirus and to respond to customers’ concerns by suggesting, among other things, that the virus could not survive in warm Caribbean climates. The article further reported that while news of the coronavirus was dramatically reducing cruise bookings, management was “trying to downplay the disruption in sales at all costs.”

The Securities and Exchange Commission (“SEC”) gave initial COVID-19 guidance to companies when, on April 8, 2020, its Chairman, Jay Clayton, and Director, Division of Corporation Finance, William Hinman, issued a joint statement titled “For Investors, Markets and Our Fight Against COVID-19.” They stated that company disclosures should “respond to investor interest in: (1) where the company stands today, operationally and financially, (2) how the company’s COVID-19 response, including its efforts to protect the health and well-being of its workforce and its customers, is progressing, and (3) how its operations and

financial condition may change as all our efforts to fight COVID-19 progress. Historical information may be relatively less significant.”

Inovio and Norwegian Cruise Line: The Rulings

In February 2021, the court largely upheld the *Inovio* plaintiffs’ claims described above; the case is ongoing.

As for *Norwegian Cruise Line*, on April 10, 2021, Judge Robert N. Scola, Jr. of the Southern District of Florida granted NCL’s motion to dismiss with prejudice. As Kevin M. LaCroix posted on the D&O Diary on April 12, 2021 “Judge Scola seemed comprehensively skeptical of the plaintiff’s case.” The judge held that the statements at issue were protected by the “safe harbor” provision for forward-looking statements of the Private Securities Litigation Reform Act of 1995. This provision encourages companies to provide projections of future financial results and other forward-looking statements, so long as such statements are identified as forward-looking and accompanied by strong cautionary disclosure about factors that could cause actual results to differ materially from those disclosed in the statements.

Judge Scola also held that, as to the alleged marketing scheme to downplay the impact of the coronavirus, plaintiff made the assumption “that at the time these statements were made, the statements were false,” but the Judge wrote that “it is worth noting that at the time the alleged marketing scheme was taking place, then-President Trump made similar statements regarding COVID-19 and therefore it is arguable that these statements were not even deceptive, insofar as they aligned with the pronouncements of our nation’s President.”

Lest some are tempted to speculate on Judge Scola’s political leanings, given his reliance on President Trump as an arbiter of truth, the *Monitor* would like to point out that the judge was appointed by President Obama.

The Trajectory: Then to Now

Early COVID-related securities actions focused on companies that relied on misrepresentation to increase share price and insufficient risk disclosures prior to the pandemic. Years later, these continue to be central to many complaints. The initial cases primarily targeted companies that the virus directly impacted, such as pharmaceutical companies and cruise lines. As allegations broadened to include challenges to companies’ representations about how the pandemic impacted projections of future financial performance and consumer behavior, so too, the types of industries targeted by securities lawsuits expanded. Technology companies, manufacturers of pandemic-related products, travel companies, finance, utility, and social media companies have all been sued for violations of the federal securities laws. The Securities and Exchange Commission (“SEC”) has stepped in to address COVID-19 related fraud with enforcement actions. Derivative cases

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stemming from COVID-19 securities class actions have been filed against directors of corporations for inadequately fulfilling their fiduciary duties during the pandemic.

On January 26, 2022, Pomerantz was appointed co-lead counsel in a putative securities class action lawsuit against biotechnology company, Novavax, Inc., arising from Novavax's statements made in connection with its failed attempt to bring its COVID-19 vaccine candidate, NVX-CoV2373, to market. Plaintiffs allege that Novavax misled investors about the vaccine's purported successful development, production, and imminent approval by the U.S. Food and Drug Administration ("FDA"). "In reality," according to the complaint, "Novavax's vaccine was nowhere close to being approved for use: (a) because the vaccine's purity and potency numbers fell well below FDA safety requirements as a result of severe manufacturing problems including several undisclosed contamination events at its two U.S. manufacturing facilities; (b) because of a failure to manufacture the vaccine at scale; and (c) because of supply chain disruptions—all of which caused significant delays that jeopardized any chance Novavax had to capitalize on the market for Covid-19 vaccines."

A series of partial disclosures, beginning on May 10, 2021, revealed problems with NVX-CoV2373, including manufacturing issues and delays with its application for Emergency Use Authorization from the FDA. Finally, on October 19, 2021, *Politico* published an article entitled "They rushed the process: Vaccine maker's woes hamper global inoculation campaign." The article reported that Novavax "faces significant hurdles in proving it can manufacture a shot that meets regulators' quality standards" with respect to NVX-CoV2373" and cited anonymous sources as stating that Novavax's "issues are more concerning than previously understood" and that the company could take until the end of 2022 to resolve its manufacturing issues and win regulatory authorizations and approvals.

Pomerantz is vigorously fighting to vindicate defrauded Novavax shareholders' rights and recover their losses caused by fraud. ■

The Fourth Circuit Raises the Bar for Plaintiffs Pleading Scierter

By Christopher Tourek

A core pillar in many securities fraud actions is scierter – i.e., whether a defendant acted with an intent to deceive, manipulate, defraud, or was severely reckless, which is defined as carelessness so unreasonable that it risked misleading shareholders. To make it past the motion to dismiss stage, plaintiffs are required to allege sufficient facts to establish that the likelihood of fraudulent intent – the inference of scierter – is at least as strong as the

likelihood of any non-fraudulent explanation for a defendant's actions. The Court of Appeals for the Fourth Circuit recently addressed the issue of which elements must be pled to establish scierter in a securities fraud case and, in doing so, highlighted the uphill battle that plaintiffs face in sufficiently pleading scierter to survive a motion to dismiss.

As set forth in *In re DXC Technology Company Securities Litigation*, DXC issued a press release touting its financial success, but months later, the company revised its projected revenue downward by approximately \$800 million, causing the company's share price to drop. Plaintiffs subsequently brought suit against DXC and its executives, alleging that they knew, contrary to DXC's press release, that cost-cutting measures in 2018 would impede the company's ability to draw revenue. The District Court for the Eastern District of Virginia dismissed the complaint, and the plaintiffs appealed that decision to the Court of Appeals for the Fourth Circuit.

The Fourth Circuit affirmed the District Court's dismissal of the stockholders' claim of securities fraud and, in doing so, analyzed the five different categories of scierter that the plaintiffs relied upon. Specifically, to determine whether the requisite scierter existed, the Fourth Circuit analyzed (1) statements of unnamed former employees, (2) the core-operations theory, (3) allegations by a former executive, (4) stock sales made by the defendants, and (5) the temporal proximity between the defendants' optimistic statements and the ultimate admission of disappointing revenue. In ruling against the plaintiffs, the Fourth Circuit discounted most of the plaintiffs' allegations on which they premised scierter and, in doing so, emphasized the high bar that plaintiffs must meet to make it past a defendant's motion to dismiss.

The Fourth Circuit first reviewed the statements of unnamed former employees to the effect that they were concerned about the cost-cutting measures. There, the Fourth Circuit found that, by and large, the former employees had little or no contact with the defendants and did not pass along their concerns to the defendants. This, combined with the fact that the few times employees did notify the defendants of their concerns were described by the complaint in a vague and conclusory fashion, led the Fourth Circuit to discount this factor. Thus, plaintiffs who rely on statements of former employees in the future will need to make sure that those employees had direct contact with the defendants and describe those interactions with particularity.

Similarly, the Fourth Circuit discounted the plaintiffs' core operations theory because, as with the statements of former employees, the complaint lacked "particularized allegations" regarding the defendants' knowledge of the shortcomings due to the cost-cutting measures.

The Fourth Circuit also analyzed the plaintiffs' claims that a former executive told the defendants that cost-cutting



Christopher Tourek, Associate

measures could impede revenue. The Fourth Circuit found that the defendants were never alleged to have agreed with the former executive and therefore this could be chalked up to a simple disagreement among executives, negating any inference of scienter. Significantly, the Fourth Circuit's analysis makes clear that for plaintiffs to effectively plead scienter, they **must** allege that not only were defendants aware of concerns that their statements to investors were false, but also that they agreed with those concerns.

The Fourth Circuit's discussion of stock sales by the defendants should similarly raise concern for plaintiffs who are filing a securities fraud action. In its opinion, the Fourth Circuit found that while one defendant sold 77% of his stock during the class period, he also sold more stock before the class period. Thus, according to the Fourth Circuit, despite the massive amount of stock sold during the class period, if a defendant sells less stock during the class period than before it, scienter is unlikely to be found. Concerning the other defendant, while he sold no stock before the class period, the Fourth Circuit found that he only sold 17% of his stock (amounting to approximately \$10 million) during the class period, which was *de minimis*. The Appellate Court also noted that the plaintiffs failed to explain why the defendant selling 17% of his holdings was not *de minimis*. Thus, due to the plaintiffs' failure to address the *de minimis* issue in their briefing, a defendant's sale of 17% or less of stock during a class period is unlikely to raise the spectrum of scienter.

Even more concerning for potential plaintiffs was the Fourth Circuit's notice of the defendants' 10b5-1 trading plans in its analysis. While the Fourth Circuit recognized that the record is silent about when the defendants entered the plans (and thus cannot say whether the plans mitigate a suggestion of motive) and that 10b5-1 trading plans are effectively affirmative defenses that should not be considered at the motion to dismiss stage, the Appellate Court still considered them in its analysis of the defendants' stock sales and held that the plans "weaken[s] any inference of fraudulent purpose." Thus, despite itself acknowledging that there is no evidence to show that the defendants entered into the trading plans after the class period began or that it should not be considering the trading plans at all on a motion to dismiss, the Fourth Circuit still used them to discount any inference of scienter from the defendants' stock sales. The holding of the Fourth Circuit warns potential plaintiffs that they must carefully examine the stock sales of defendants before and during the class period, as well as thoroughly attack any use by defendants of 10b5-1 trading plans to weaken an inference of scienter.

Finally, the Fourth Circuit considered the temporal proximity between the defendants' allegedly false statements and the subsequent disclosure of truth and found that while the three-month gap between the rosy picture painted by the defendants and the truth of falling revenue was relevant, it alone could not establish a strong inference of scienter. Ultimately, after discounting most of the plaintiffs' allegations

of scienter, the Fourth Circuit held that, under a holistic analysis, the non-fraudulent inference was more compelling than the requisite inference that the defendants knowingly or recklessly misled investors about the company's financial health.

While the full implications of the Fourth Circuit's opinion are yet to be seen, the opinion outlines a difficult road ahead for plaintiffs trying to plead scienter. Moving forward, plaintiffs would be wise to learn from the failings of the *DXC* plaintiffs and plead their complaints with the particularity and detail that the Fourth Circuit found lacking, address both a defendant's stock sales *and* any 10b5-1 trading plans – irrespective of whether they should be considered on a motion to dismiss, and work to find evidence that a defendant not only heard evidence that their statements were misleading, but agreed with that evidence. ■

SPAC Attack: How Pomerantz and the SEC Are Tackling SPAC Liability

By James M. LoPiano

By now, many investors are aware of that recently trending phenomenon, the Special Purpose Acquisition Company, or "SPAC" for short. However, investors may confuse going public via "de-SPAC" transactions, whereby a SPAC takes a private company public, as equivalent to traditional initial public offerings, or "IPOs." Others may be unaware that SPACs first conduct their own IPO before taking other companies public.

IPOs and de-SPAC transactions are subject to very different rules, and holding SPACs, and companies formed by de-SPAC transactions ("de-SPAC companies"), accountable in connection with IPOs and de-SPAC transactions may prove more complicated than holding other companies accountable in connection with IPOs. Recognizing this, both Pomerantz and the SEC have been formulating their own ways to harmonize SPAC-related liabilities with traditional IPO liabilities.

Most investors are familiar with the idea of a "traditional" IPO, whereby a private company, supported by underwriters, satisfies certain conditions to begin publicly trading on a national securities exchange at a pre-determined initial offering price. For example, take a hypothetical private company called "XYZ Corp." that conducts an IPO and thereby first begins publicly offering its shares to the public under the ticker symbol "XYZ" at an IPO price of \$10 per share.

Recently, however, private companies have increasingly gone public through business combinations with SPACs, also called "blank-check companies," which are development

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stage companies that have no operations of their own, apart from looking for private entities with which to engage in a merger or acquisition (called “target” companies) to take the target public. The SPAC has already gone public via its own IPO in this scenario and, indeed, a SPAC usually touts its management’s ability to identify and merge with potentially lucrative targets in the registration statement for its IPO.

So, what does a de-SPAC transaction look like? Let’s assume a hypothetical SPAC called “ABC Company” recently went public via an IPO. Individuals invested in ABC Company’s IPO on the understanding that its management have expertise in identifying targets and conducting due diligence in selecting and closing mergers with those targets. ABC Company then identifies several targets looking to go public, including our hypothetical XYZ Corp., and agrees to take XYZ Corp. public. ABC Company then merges with XYZ Corp. and, in the process of doing so, changes its name and business operations to XYZ Corp.’s name and business operations (or something similar), issues new shares under a new ticker symbol reflecting its new identity (for example, converts “ABC” shares to “XYZ” shares), and some or all of XYZ Corp.’s management starts running the newly combined company. In our hypothetical, XYZ Corp. has essentially “gone public” through the already-public ABC Company’s transformation into, essentially, what was XYZ Corp.

In this way, SPACs are like shapeshifters or doppelgängers; they are publicly listed blank slates waiting to take on the persona, business operations, and executive teams of private companies. However, these de-SPAC transactions present their own issues that individuals may be unaware of when investing in the post-merger de-SPAC company or pre-merger SPAC.

When individuals lose money on their investments in IPOs, they may seek relief under the federal securities laws through a strict liability claim under Section 11 of the Securities Act of 1933. Under Section 11, public companies can be held strictly liable in connection with material misstatements or omissions made in the IPO’s registration statement—which is required to register new shares and conduct the IPO—so long as the Section 11 claim is brought within a time limit set by the law. When investors purchase shares pursuant or traceable to an IPO’s registration statement, they typically show a loss on their investment for Section 11 purposes by comparing the share’s IPO price to its current trading price.

In the context of a SPAC IPO or de-SPAC transaction, however, it can be difficult to identify whether the original security is trading below its initially offered price. Why? The answer depends on whether you are bringing a Section 11 claim based on the SPAC’s IPO, or the de-SPAC transaction.

Shares offered in a SPAC’s IPO, usually called units, typically become stock and warrants that eventually list under

different ticker symbols at different prices. Additionally, the SPAC’s securities (unit, stock, warrant, or otherwise) will typically convert into shares of the de-SPAC company following the de-SPAC transaction. Under both scenarios, shares purchased pursuant or traceable to the SPAC’s IPO may not be listed anymore, so it becomes difficult to know what their current market value is and to compare that value to the IPO price for purposes of Section 11.

De-SPAC transactions present their own issues simply because, unlike IPOs, they often do not have an IPO price or other formally, predetermined, easy to identify initial trading value to compare to current market values.

In bringing SPAC cases to the courthouse, Pomerantz has formulated several potential solutions to these problems. For example, if an investor wants to bring a Section 11 lawsuit in connection with shares purchased in a SPAC’s IPO (let us say they are units), and the units no longer trade, so there is no current unit price to compare to the IPO price, you might allege liability by seeing whether whatever the units transformed into—stock, warrants, or otherwise—are trading so far below the unit’s IPO as to be reasonably certain that you lost money on your investment.

On the other hand, if an investor wants to bring a Section 11 lawsuit in connection with shares purchased in a de-SPAC transaction, and they see that the shares purchased in the de-SPAC transaction are trading low, but there is no IPO price, per se, to compare it to, the investor might allege liability by substituting a formal IPO price for the de-SPAC company’s first publicly listed closing price.

Moving beyond strict liability claims under Section 11 of the Securities Act, an investor may opt to allege securities fraud claims under Section 10(b) of the Securities Exchange Act of 1934. Although more difficult to allege, in this scenario an investor might argue that the SPAC and its management knowingly overstated their expertise and due diligence efforts in identifying and acquiring a target company. Alternatively, investors might argue that the target company and its management knowingly hid issues from the SPAC or the public when announcing it would go public via a de-SPAC transaction.

Additionally, somewhat like a Section 11 claim under the Securities Act, there is a Section 14(a) claim under the Exchange Act, which investors can bring in connection with material misstatements or omissions made in a merger’s registration statement. Here, too, there may not be a formal IPO or other predetermined listing price for new shares created in a merger for a de-SPAC transaction, so one might compare the de-SPAC company’s current trading price to its first publicly listed closing price to allege liability.

The SEC, on the other hand, has proposed sweeping rule changes for SPACs that, if adopted, could better align de-SPAC transaction liability with traditional IPO liability. As noted by *The National Law Review*, these proposed



James M. LoPiano, Associate

Q&A

Christine Simmons



Chief Operating Officer, Academy of Motion Pictures Arts and Sciences

Partner Jennifer Pafiti: You are the first African American and woman to serve as COO for the Academy and you lead its first Office of Representation, Inclusion, and Equity. What do these firsts mean for you and for the motion picture industry?

Christine Simmons: My perspective on firsts has evolved. There always has to be a first. But now I ask, "Why has it taken so long?" We have to reflect back on the system, the organization, and the various industries, and really analyze the 'whys.' Why is there only one? What can we do systematically to create more opportunities? Until we look at some of the systematic constructs that affirm or even recreate inequities, then we will continue to have them. Vice President Kamala Harris said, "I may be the first woman to hold this office. But I won't be the last." If that happens, then that means that we failed. I don't want to be the best Black COO. I don't want to be the best female anything. I just want to be the best me, period. The challenge is acknowledging the inequities that exist because it is not an equal race, period. We have a responsibility here in the film and TV business, and in entertainment in general, to make sure that we're putting forward images that show people that they can break the mold and be so many different things.

JP: What is the next step for the Academy in regard to DEI?

CS: Keep going, go deeper, go farther, go faster. The Academy is turning 95 this year. You can imagine that helping your 95-year-old grandfather evolve and learn new things is quite the challenge, right? So, from year zero to #OscarSoWhite, the runway keeps getting shorter, and the need to make change is getting more urgent. Little bite-sized changes are no longer enough. But we can't just blow up the system. Some of it is good, so let's figure out how we can break those institutionalized constructs that have continued to reaffirm inequity. After #OscarsSoWhite, our goal was to double the number of women and double the number of people who identify in historically underutilized ethnic or racial communities by 2020. We met and exceeded those goals, in addition to adding some board seats. The challenge with diversity is, if you're only counting numbers, it doesn't help people understand the "why." And if you don't have the common language and vocabulary and understanding of ideologies that create inequities, you look at it as an attack. We want to make sure that all of our allies are coming along with us to help understand that diversity actually enhances the art form. A big step is the launch of our inclusion standards around Best Picture: If you are interested in submitting your film for Best Picture, then you will need to meet two of four diversity standards. We want to make sure that it's not limiting or censoring in any way. Our initiative is to broaden the aperture through which excellence is recognized. Because if you're only looking at your aperture in one place, then you're missing all this beautiful excellence everywhere else. We're also looking at supplier diversity, our marketing spend, and our investment portfolio. Our investment committee has directed significant dollars to diverse portfolio managers, which I'm extremely proud of. And those are just some of the behind-the-scenes actions that folks aren't even aware of, but we know that the ripple effect helps.

JP: What mistakes do even well-intentioned companies make in their diversity plans?

CS: One of my dear friends was chair of OB-GYN at a major hospital. The hospital kept setting meetings at the exact time she had to drop her kids off at school in the morning. Her experience as a working mother was not being heard. That's why it's important to have different perspectives on the female-lived experience or the Latino-lived experience in that case because there are aspects of that lived experience that you could study in a book or see on TV, but without living it, you can't fully understand and account for it in the way you manage your staff. Wanting the numbers, wanting it reflective of the population is beautiful, we love that. But if you don't create a community, a village, and a safe space where people can feel heard and valued, then it actually sometimes can be worse than if you didn't bring them in at all. If you feel like you're constantly demeaned or you're constantly pushed aside or you're mansplained, then the numbers don't matter. There's a whole revolution happening in corporate culture right now in which, if you don't have an empathetic ear, if you're not a servant leader, you'll find your people joining the Great Resignation. Leaders need to pause for a second to figure what's going on in this person's life. And that way, they can hopefully find ways to inspire and motivate and empower their people. When that happens, the organization is always better off.

JP: If an organization takes just one step toward diversity, what should that be?

CS: I would start with education. We all have to understand each other and have a common language. It really starts with ideologies and understanding the difference between ideological oppression, institutionalized oppression, internalized oppression, and interpersonal oppression. People tend to think things are the way they are because that's just how it always was. Well, there's a reason why it was that way. Our unconscious bias trainer tells a story about a fish just swimming in the water, not even knowing that the water exists because that's its life. In that way, a lot of the sexist, racist, and other negative ideologies are just water that's around us and we don't even realize it, because we've just been in it our whole lives. Stopping the automaticity of the ideologies that we have been swimming in is important for helping people understand. When you think of a CEO, people think of white men. When people think about a convict, they think of black or Latino men, right? They don't think of maybe an affluent white-collar criminal, and we know some notable ones! Ideologies, education, and building a common vocabulary, start there. Then start looking at the systems.

JP: Can you foresee a time when DEI programs won't be necessary?

CS: No. But I'm a hopeless idealist and optimist, so I think the beauty is, and my hope and prayer is, that eventually, it goes from fixing the systems to getting to celebrate diversity. What does that look like? I'm about to march in my first Pride Parade, walking next to my brothers and sisters in the LGBTQ community, and we're going to have a great time. I'm going to celebrate them in their life and in their love. Even though I'm not a member of that community, I get to celebrate them. For me, that's what it looks like. In regards to racism, folks often talk about being colorblind. Colorblind is beautiful, in its ideology and in theory, but when you turn a

Q&A: *Continued from page 9*

blind eye to something, then you make it invisible. We don't want to make anything invisible; we want to celebrate it.

JP: You have said that you like to inspire people to be their best selves. What is the most effective way to do that?

CS: It starts with just being present and listening. People want to be seen, first and foremost, they want to know that you're present, that you're listening, that you care. So, to actually be there is important. And, more importantly, I want everyone to feel as joyful as I feel, as beautiful as I may feel in that moment. And I truly mean it from the inside. Like, that self-love and joy from the inside that makes someone glow. I like to pull that out of people. I want to listen to what they want to do, and then help push them forward and help them live their dreams. Just one conversation can literally change someone's life because they may not know what type of career they want. That conversation may expose them to a whole other world – a job or a path or a choice that they never knew existed.

JP: You are a volunteer for Brown Girls Dream. What advice do you give to young leaders of color?

CS: One of my besties, Cari Champion, a broadcaster, producer and phenomenal woman, tapped into all of her besties in the entertainment and sports businesses, like Jemele Hill (The Atlantic Contributor and Host of Unbothered), Bozoma Saint John (Hall of Fame Marketing Exec), Nischelle Turner (5x Emmy-winning host of Entertainment Tonight and a Producer) and myself, to mentor young 20-somethings who aspire to similar careers. And it's been great. I get three to four mentees a year. They come to us for career advice and guidance. What I'm loving most is seeing the network they're creating amongst themselves. What we do is really a level beyond mentorship – it is sponsorship because we have actually hired many of the extraordinary women within our various organizations. We're removing many of the roadblocks that we had to face so they can get here faster, with less pain, drama, and trauma, so they can make an even bigger impact. One of the hardest lessons that young leaders and executives have to learn is that as you go up, as you become more successful, we have to solve

multiple people's problems and multiple organizational problems. And so, we help them navigate all of that to show them the different perspectives through our lived experiences.

JP: From YMCA Visionary to Ebony's Power 100 list and being touted as one of LA's most influential people, you have received many accolades. Is there one accomplishment that makes you proudest?

CS: Honestly, all of those make me really proud. But there was a time, around the time Hillary was running for president – it was actually the night before – and I was watching and very stressed. My son was like, "Mom, what's wrong?" He was five or six at the time, and I had started working at Sparks when he was about three. So, I told him that tomorrow we might have our first female president. Now, mind you, I'm a single mom, so I had been taking him with me to the games and to board meetings of the UCLA Alumni Association when I was president. And he would just sit in the corner at all of the work events and watch. So, he said, "But Mom, you're a president." And in that moment, first – I had tears. Second – it was mom for the win, right? Because there was so much guilt with sometimes having to parent in front of 10,000 fans at Staples Center because I needed to bring him with me. There was guilt when I saw my boss and I had my son on my hip. Then I thought – Look, you run this organization, Christine, you have to set the tone. You have to tell people, it's okay. I just had to shift my mentality and not worry about that. Moms know how mom guilt works – you have a late meeting and they're asking "Mom, are you coming home?" but you can't be there all the time. They don't mean to make you feel bad, but they just miss you. So, when he said that, I thought – exposure works! One of the things that I think as a society, we don't do enough, is expose. He's been exposed to women presidents in all areas of life, so why wouldn't one be President of the United States, right? I think it's that if we expose young men and young girls to all of this more often, then we'll be in a much better place. So, for me, yes, those awards are phenomenal and they're affirming but I think more about the impact that we're making for the next generation. And, that night, that did it for me. So that's most important. ■

SPAC Attack: *Continued from page 8*

rule changes cover six broad areas: (1) specialized SPAC disclosure requirements; (2) aligning de-SPAC transactions with traditional IPOs; (3) business combinations involving shell companies; (4) increased projections disclosures; (5) Investment Company Act safe harbor for SPACs; and (6) fairness of the de-SPAC transaction.

One such rule could effectively end protections afforded to companies under the Private Securities Litigation Reform Act of 1995 ("PSLRA") when making forward-looking statements accompanied by meaningful cautionary language in connection with de-SPAC transactions. These safe harbor protections essentially boil down to companies and management disclaiming liability for positive statements made about potential future projections, earnings, results, plans, etc. (hence, "forward-looking" statements) when paired with adequate warnings about the certainty of these events occurring. Companies provide safe harbor warnings in many contexts, including earnings releases, quarterly reports, and even investor calls. The SEC's proposed rule changes would modify the definition of a "blank check company" for the purposes of the PSLRA to include SPACs, and the PSLRA bars such safe harbor from applying to forward-looking statements made in connection with traditional IPOs or securities offerings by blank check companies.

Another example of rules aimed at harmonizing de-SPAC transaction

liability with IPO liability includes a proposal that would amend registration statements issued in connection with de-SPAC transactions. Under this rule change, the target company would have to sign as a co-registrant on the registration form filed by the SPAC for the de-SPAC transaction. Additional signatories could include the target company's principal executive officer, principal financial officer, controller/principal accounting officer, and board members, who could then be held strictly liable under Section 11 of the Securities Act for any material misstatements or omissions in the registration statement.

As stated by SEC Chair Gary Gensler, "Functionally, the SPAC target IPO is being used as an alternative means to conduct an IPO. Thus, investors deserve the protections they receive from traditional IPOs, with respect to information asymmetries, fraud, and conflicts, and when it comes to disclosure, marketing practices, gatekeepers, and issuers."

Although Pomerantz and the SEC are using different government branches to tackle these issues—for Pomerantz, the courthouses of the judicial branch, and for the SEC, the rule-making process of the executive branch—both are working to harmonize SPAC-related liabilities with traditional IPO liabilities. All the same, investors should avoid confusing IPOs with de-SPAC transactions and remain aware of the foregoing issues when deciding to invest in either SPAC IPOs or de-SPAC transactions. ■



Jeremy A. Lieberman



Jennifer Pafiti



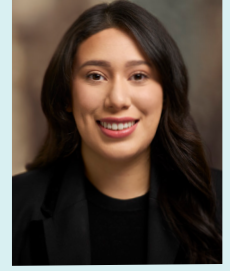
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NOTABLE DATES ON THE POMERANTZ HORIZON

IF YOU WILL BE ATTENDING ANY OF THESE EVENTS AND WOULD LIKE TO MEET WITH US, SEND US A MESSAGE AT EVENTS@POMLAW.COM.

JEREMY LIEBERMAN, MARC GROSS, EMMA GILMORE and JENNIFER PAFITI will all be featured speakers at Pomerantz's **Corporate Governance Roundtable** on June 14 in Beverly Hills, CA. JEREMY will speak on a panel titled "Covid-19 and the Litigation Pandemic," MARC will be featured on "Forced Arbitration and the Repercussions for Institutional Investors," EMMA will moderate "Securities Litigation Update: Engagement & Litigation" and JENNIFER will deliver the **Closing Roundup** for the event.

JENNIFER will also be attending the **NAPPA Legal Education Conference** in Louisville, KY from June 21-24.

JANALEE SPENCER and KAYLAN PEREZ will both attend the **38th Annual FPPTA Conference** in Orlando, FL from June 26-29, as well as **NAPO's 44th Annual Convention** in Cleveland, OH from July 25-28.

JANALEE will attend the **NASRA Annual Conference** in Long Beach, CA from August 6-10, and JENNIFER and KAYLAN will join her in attending the **NCPERS Public Pension Funding Forum** in Los Angeles, CA from August 21-23.

Later in the summer, JANALEE will attend the **IBEW Member Development Conference** in San Antonio, TX from August 30-September 1.

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to all who traveled far and wide to participate. The event brought together institutional investors and corporate governance professionals to discuss the evolving landscape of ESG risks and corporate governance challenges. Highlights included remarks by President Bill Clinton and Robert J. Jackson Jr., Commissioner, U.S. Securities and Exchange Commission (2018 – 2020).

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