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Event-Driven Securities Litigation in the Age of COVID-19

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Seyfarth Synopsis: *The COVID-19 pandemic has already spurred several private securities class action lawsuits and Securities and Exchange Commission (“SEC”) enforcement actions. Companies that deal with COVID-19 on a daily basis, as well as companies that have been significantly disrupted (or, conversely, have been positively impacted) as a result of the pandemic must be proactive now to mitigate their risks.*

The last few months have been a time of unprecedented social and economic upheaval due to the ongoing COVID-19 pandemic. Companies on the front lines of fighting the pandemic are facing increased risk of scrutiny and litigation—both from the SEC and from their shareholders—particularly when making forward-looking or other statements in public disclosures, press releases, or media interviews. The same is true for companies with a business model that has been heavily impacted by the pandemic, whether positively (such as video-communication companies) or negatively (such as cruise lines). As we first discussed in our April 21, 2020 [webinar](#), and again in our recent follow-up [webinar](#)^[1] on June 4, 2020, it is vital that companies are mindful of how they treat and disclose news and forecasts related to COVID-19.

Recent COVID-Related Securities Litigation

In the past few months, there have been a number of class action securities cases filed against companies either directly involved with COVID-19 or with a business model heavily impacted by COVID-19. These cases include:

- **Pharmaceutical or Medical Device Companies Accused of Overly-Optimistic**

Statements About Their Business Or Products. In mid-March Inovio Pharmaceuticals became one of the first companies sued for alleged COVID-related securities violations when its CEO allegedly said in an interview that “we were able to fully construct our vaccine within three hours” and planned to start trials “in April of this year.”^[2] The plaintiffs allege this artificially inflated Inovio’s stock price, after which an analyst called for an SEC investigation into the CEO’s “ludicrous and dangerous claim that they designed a [COVID-19] vaccine in 3 hours,” causing Inovio’s stock to drop from \$18.72 to \$5.70 per share over two days.^[3] Inovio responded to the analyst with a statement that it “designed a vaccine construct” and “believed it had a ‘viable approach’ to address the COVID-19 outbreak.”^[4]

- Sorrento Therapeutics, Inc. is facing similar litigation.^[5] The plaintiffs allege Sorrento announced it had discovered an antibody that had “demonstrated 100% inhibition of SARS-CoV-2 virus infection,” which its CEO referred to as a “cure,” that caused a 281.7% increase in its stock price.^[6] They allege that an analyst subsequently issued a report that cast doubt on the validity of Sorrento’s claims, describing them as “sensational” and “nonsense”; Sorrento’s CEO attempted to rebut the analyst on the same day, but the stock price nonetheless decreased 43%.^[7] The plaintiffs further allege Sorrento’s CEO then “insisted that they did not say it was a cure,” causing the stock price to decline another 49.4%.^[8]
- A complaint was also filed against SCWorx Corp., where the plaintiffs allege an announcement that it had “received a committed purchase order of two million COVID-19 rapid testing kits, ‘with provision for additional weekly orders of 2 million units for 23 weeks, valued at \$35M per week’” was “overstated or entirely fabricated” and SCWorx’s “buyer was a small company that was unlikely to adequately support the purported volume of orders for COVID-19 tests.”^[9] The plaintiffs further allege SCWorx omitted that its supplier had previously misrepresented its operations because the manufacturer of the rapid testing kits the supplier claimed to offer published a press release stating the supplier “fraudulently misrepresented themselves” as “sellers of its Covid-19 tests and disavowed any relationship.”^[10]

- In addition, the SEC has targeted companies and individuals that made allegedly misleading statements regarding the COVID-19 prevention capabilities of its products. For example, enforcement actions have been commenced against:
 - (i) Praxsyn Corporation, in connection with a press release stating “it was negotiating the sale of millions of masks” and “vetting suppliers to guarantee a dependable supply chain of the masks,” and a follow-up press release claiming it “*had* a large number of N95 masks on hand and had created a ‘direct pipeline from manufacturers and suppliers to buyers’ of the masks” that the SEC alleges were “blatantly false” because Praxsyn “never had either a single order from any buyer to purchase masks, or a single contract with any manufacturer or supplier to obtain masks, let alone any masks actually in its possession”;^[11]
 - (ii) Applied Biosciences Corp., after it claimed in a press release to have begun “Offering Coronavirus Test Kit[s] to the General Public to Combat Spread of COVID-19 . . . to be used for Homes . . . or anyone wanting immediate and private results,” which the SEC alleges was false and misleading because the company “did not offer or intend to sell the test kit for home or private use by the general public, and it had not begun shipping any test kits” but instead intended “only to allow purchases in connection with use by nursing homes, schools, military, and first responders . . . in consultation with a medical professional” and omitted that the “FDA had not approved . . . the sale of any COVID-19 at-home test kits”;^[12]
 - (iii) Turbo Global Partners, for a press release representing another company was the “front facing Partner in the multi-national public-private partnership (PPP) for [an] innovation which simply stated, is the only scanning technology on the planet with non-contact intelligent human temperature screening and facial recognition,” which the SEC alleges is false and misleading because the other company “was not engaged in any public-private partnership or any partnership involving a governmental entity,” and the “scanning equipment in question did not have facial recognition technology . . . only face detection ability (e., it could distinguish a face from a cup of coffee);”^[13] and
 - (iv) James C. Nielsen, an investor who owned approximately 10% of the common stock of Arrayit Corporation, a California biotechnology company, alleging he posted false and misleading statements on an internet forum that Arrayit had developed and received approval for a COVID-19 test, in an attempt to “pump up” the company’s stock.^[14] Nielsen is alleged to have

posted several such misleading messages, without disclosing the extent of his financial stake or that he was selling off shares.[15]

- **Companies Facing Significant Business Disruption.** Perhaps unsurprisingly, the cruise line industry, which has been entirely disrupted by COVID-19, is now facing litigation alleging misstatements regarding its capabilities in weathering the pandemic.
- For example, Norwegian Cruise Line was the subject of class action securities litigation very early in the COVID pandemic—in mid-March—with securities claims alleging that its public filings minimized the impact of COVID-19 and did not disclose sales practices that, allegedly, misled customers into continuing to book tickets.[16] Specifically, the plaintiffs allege Norwegian instructed sales staff “to lie to customers regarding COVID-19 to protect the company’s bookings”—e., one email to a customer read “due to the Coronavirus we have cancelled all of our Asia cruises . . . [t]his has caused a huge surge in demand for all of our other itineraries. I suggest we secure your reservation today to avoid you paying more tomorrow”—when internal emails revealed Norwegian was “hardly selling anything” and sales were at “serious lows.”[17]
- Similarly, Carnival Cruise Lines was sued in May for allegedly false and misleading statements in public filings relating to its adherence to health and safety protocols in the wake of the pandemic.[18] The plaintiffs allege Carnival failed to disclose that its “medics were reporting increasing events of COVID-19 illness on its ships”; that it violated “port of call regulations by concealing the amount and severity of COVID-19 infections on board its ships”; that it failed to follow its own “health and safety protocols developed in the wake of other communicable disease outbreaks”; and that it “spread COVID-19 at various ports throughout the world,” rendering Carnival’s “positive statements about . . . business, operations, and prospects” materially misleading.[19]
- Business disruption cases go beyond cruise lines, and indeed litigation alleging misstatements as to companies’ abilities to handle business disruption have been filed in such diverse industries as animal care[20] and cannabis.[21]
- **Companies Seeing Increased Revenue Due to The Rise of Remote Work.** Conversely, companies offering services that are now in high demand are also facing securities litigation risks. For instance, Zoom Video Communications has seen a dramatic rise in public awareness and use (and stock price) due to the world’s increased need for the use of videoconferencing software in the face of government restrictions on in-person meetings—but was also among the first companies to

face securities litigation, alleging misstatements as to its platform's security capabilities.[22] Specifically, the plaintiffs allege Zoom's public statements were misleading because it failed to disclose that it had inadequate data privacy and security measures; its video communications service was not "end-to-end encrypted"; Zoom's users were at "an increased risk of having their personal information accessed by unauthorized parties"; and Zoom knew usage of its "services were foreseeably likely to decline" when that information became public. [23]

Companies Should Proactively Seek to Mitigate Risk of COVID Securities Suits

While securities litigation may be inevitable in certain circumstances and market conditions, companies that are in the fight against COVID-19, as well as those that have been heavily impacted by COVID-19, should be proactive in mitigating the risk of class action securities lawsuits. Actions to consider include:

- Taking extra care in making public disclosures, press releases, media interviews, and even tweets when discussing COVID-19 matters and including appropriate cautionary language and caveats.
- Becoming familiar with the SEC's guidance as to COVID-19 disclosure, including its March 25, 2020 guidance as to disclosures, as well as the SEC's "COVID-19 Quick Reference Guide for Investors and Market Participants" and its "COVID-19 Related FAQs."
- Ensuring full documentation of all Management analyses and Board deliberations and analyses related to COVID-19 matters.
- Taking reasonable steps to mitigate data security risks arising from remote work.[24]

Key Takeaway

The COVID-19 pandemic has already led to class action securities litigation and SEC enforcement actions. This trend will likely continue. Companies, therefore, need to be proactive now to minimize this risk by, for example, carefully reviewing and revising as necessary its risk factors to account for risks posed to the business by COVID-19 and to be sure to include necessary cautionary language to make clear the uncertainty ahead.

[1] The slides of our April 21, 2020 webinar can be found here: https://www.seyfarth.com/images/content/5/8/v2/58384/COVID-Webinar-LegalExposureforPublicCompanies_042120.pdf; and the slides of our June 4, 2020 webinar can be found here: https://www.seyfarth.com/dir_docs/publications/Slides-Webinar-SecuritiesLitigationandRegulationintheCOVIDEra-06.04.20.pdf.

[2] See *McDermid v. Inovio*, 2:20-cv-01402-GJP (E.D. Pa.), Compl. ¶ 5.

[3] *Id.* ¶ 6.

[4] *Id.*

[5] See *Wasa Medical Holdings v. Sorrento Therapeutics, Inc.*, 3:20-cv-00966-AJB-AGS (S.D. Cal.), Compl. ¶ 3. A second complaint was filed against Sorrento on June 11 in the Southern District of California.

[6] *Id.*

[7] *Id.* ¶¶ 4-7.

[8] *Id.* ¶¶ 8-9.

[9] See *Yannes v. SCWorx Corp.*, 1:20-cv-03349 (S.D.N.Y.) Compl., ¶¶ 3, 8.

[10] *Id.* ¶ 5.

[11] See *Securities and Exchange Commission v. Praxsyn*, 9:20-cv-80706-RAR (S.D. Fla.), Compl. ¶¶ 1-5.

[12] See *Securities and Exchange Commission v. Applied Biosciences Corp.*, 20-cv-03729 (S.D.N.Y.), Compl. ¶ 2.

[13] See *Securities and Exchange Commission v. Turbo Global Partners*, 8:20-cv-01120 (M.D. Fla.), Compl. ¶¶ 19-20.

[14] See *Securities and Exchange Commission v. James C. Nielsen*, 5:20-cv-03788-NC (N.D. Cal.), Compl. ¶¶ 2-3, 13.

[15] *Id.* ¶¶ 17-18.

[16] See *Douglas v. Norwegian Cruise Lines*, 1:20-cv-21107 (S.D. Fla), Compl. ¶¶ 15-28.

[17] *Id.*

[18] See *Service Lamp Corporation Profit Sharing Plan v. Carnival Corporation*, 1:20-cv-22202 (S.D. Fla) Compl., ¶ 3.

[19] *Id.* ¶ 8.

[20] See *Hunter v. Elanco Animal Health Incorporated*, 1:20-cv-01460 (S.D. Ind.), Compl. ¶¶ 17-20 (alleging Elanco rendered positive statements about its business materially misleading by failing to disclose its distributors were not experiencing sufficient demand to sell through their inventory).

[21] See *Riback v. iAnthus Capital Holdings, Inc.*, 1:20-cv-03044 (S.D.N.Y.), Compl. ¶¶ 14-25 (alleging defendant failed to disclose that escrowed funds were unavailable to satisfy interest payment obligation to creditor, triggering a default).

[22] See *Drieu v. Zoom Video Communications*, 5:20-cv-02353 (N.D. Cal.), Compl. ¶ 7.

[23] *Id.*

[24] A helpful resource on this topic can be found on Seyfarth's "Carpe Datum" Blog here: <https://www.carpedatumlaw.com/2020/04/covid-19-remote-workforce-risks-preservation-compliance-privacy-and-data-security-risks/>.

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