

# #MeToo and Securities Fraud: Lessons From the 'CBS' Case

It is difficult to imagine a stranger juxtaposition than the #MeToo movement and federal securities law. To be sure, the paramount goal of each is to right egregious, albeit different, wrongs, which may explain why they came together in *Construction Laborers Pension Trust for Southern California v. CBS*, \_\_\_ F. Supp. 2d \_\_\_ (S.D.N.Y. Jan. 15, 2020) (CBS), 2020 WL 248729. There, the plaintiffs purported material misrepresentations by the defendants with respect to potential claims of workplace abuse allegedly perpetrated by the corporation's once-legendary CEO. This latest case provides a cogent exposition of the maxims of pleading securities fraud, specifically in the context of supposed misstatements with regard to corporate ethics; as such, is worthy of our attention.

As putative representative for a class of similarly situated shareholders, see generally Fed. R. Civ. P. 23 (class actions), the nominal plaintiff, a pension fund, alleged material misrepresentations and omissions by the defendants relating to the network's former chairman and CEO, Leslie Moonves, an industry titan frequently lauded by CBS as an irreplaceable chief executive. The complaint averred that the media colossus and various of its top executives materially misrepresented in proxy statements and public filings the risk that Moonves might be forced out if his purported ethical lapses were brought to light.

The defendants moved to dismiss the complaint in its entirety, asserting that CBS's business conduct standards and code of ethics were generic, immaterial, and unreliable, and therefore inadequate grounds for meeting the uncompromising standards for pleading securities fraud.

To better appreciate how District Judge Valerie Caproni resolved this controversy, a brief review of

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the fundamentals of federal securities fraud and how to properly plead same is required.

## Six Elements of Securities Fraud

The ultimate weapon in the battle against securities fraud is §10 of the 1934 Securities Exchange Act, and its boon companion, Rule 10b-5 promulgated thereunder. 15 U.S.C. §78j(b) and 17 C.F.R. §240.10b-5,

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respectively. These two admittedly verbose provisos absolutely prohibit all manner of fraud and deceit in connection with the purchase and sale of securities on the national exchanges. See also *Lorenzo v. S.E.C.*, 587 U.S. \_\_\_ (2019).

Over the course of many decades, the Supreme Court has frequently updated an axiomatic six point test describing the irreducible minimum for pleading and later proving securities fraud. See *Amgen v. Connecticut Retirement Plans and Trust Funds*, 568 U.S. 455 (2013). First, there must be a misrepresentation or omission, *Matrixx Initiative v. Siracusano*, 563 U.S. 27 (2011), which is material to a reasonably objective investor. *Basic v. Levinson*, 485 U.S. 224 (1988). Next, one must prove scienter, simply put, evil intent or motive. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976). Third, the misstatements must transpire in connection with the purchase or sale of a security. *S.E.C. v. Zandford*, 535 U.S. 813 (2002).

Proving reliance is the fourth requirement, *Stoneridge Investment*

*Partners v. Scientific-Atlanta*, 552 U.S. 148 (2008), and the fifth element is nothing more than demonstrating economic loss. Finally, the plaintiff must prove loss causation, in other words, the misdeed was the proximate cause of the injury sustained. *Dura Pharmaceuticals v. Broudo*, 544 U.S. 336 (2005).

And, consonant with longstanding traditions for pleading fraud, the allegations must be pled with particularity. Fed. R. Civ. P. 9. Indeed, the 1995 Private Securities Litigation Reform Act emphasized that prerequisite. See 15 U.S.C. §78u-4(b)(2); see also *Tellabs v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007). To be sure, that otherwise harsh mandate is ameliorated somewhat by the allowance that, with regard to the scienter component, stipulating a strong inference of evil motive is sufficient to pass muster at the pleading stage.

The essential elements of pleading securities fraud now known to us, we may better understand how the CBS court addressed the defendants' insistence that the complaint failed to meet those exacting standards.

## Purported Misrepresentations And Omissions

We must first credit District Judge Caproni for neatly sidestepping the more lurid of the underlying allegations. Instead, she deftly proceeded to synthesize the case as undergirded by but a single theory of securities fraud; in the course of expositing the company's ethical standards and code of conduct, and emphasizing the overriding importance of Moonves to CBS's continued prosperity, the defendants materially misspoke in a variety of public pronouncements, thereby lulling investors into the mistaken belief that the company and its star CEO had nothing to fear from the nascent #MeToo campaign.

Parsing her holdings with a series of bold and substantive headings, Caproni first addressed whether the media giant's disclosures of its ethical standards, as set forth in public documents, were materially false. The

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# #MeToo

« Continued from page 4

court pointedly declared that such declarations of policy are typically generic and insubstantial. Notably, CBS employed terms such as “standards,” “commitment,” and “general obligation” in postulating its code of conduct. Such statements were merely aspirational, found the court; “no reasonable investor would have relied” upon them as assurance that the company “was immune to losing key executives due to accusations of sexual misconduct.”

Interestingly, Caproni refused to declare that all corporate statements of ethics were categorically immaterial. Certainly, while acknowledging it is a rare case indeed for such utterances to rise above the level of mere puffery, the court was circumspect enough to allow that a declaration of ethical policy interwoven with facts and intended to assure investors might, in the right circumstances, satisfy the venerable

norms for pleading materiality and reliance.

Next was the allegation that CBS misled investors in its “Risk Disclosures,” wherein the company warned that Moonves’s unexpected departure might have a materially adverse impact upon the company’s value. The plaintiff contended that such statements were materially false, for reason that CBS did not discuss the particulars of its own then-ongoing inquiries as to Moonves’ behavior, let alone reveal the soon-to-be embattled chief’s personal knowledge.

Again, the court held the allegations deficient in light of the demanding standards for pleading §10 violations. Among other things, these risk disclosures “never quantified the likelihood that Moonves would depart, whether under a cloud or voluntarily,” merely “stated simply that he was important to CBS,” and never suggested Moonves’s behavior was beyond reproach. The court found it would have been “strange—and irresponsible” for the network to predict the outcome of the internal inves-

tigation before it was complete. As to the last, Judge Caproni made a most telling point; it is not materially misleading to fail to predict a problem which later materializes.

The dismissal of the bulk of the complaint now a certainty, the

no indication of his own involvement in such matters. Yet this was directly contradictory to the fact that Moonves already knew he was under investigation by law enforcement in Los Angeles for a purported sexual assault.

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court reviewed a very distinct subset of allegations, ones pertaining to statements made by Moonves himself at a major industry event held not long before his alleged misconduct was revealed. Speaking at this well publicized summit, and at a time when the #MeToo movement was gaining traction, the network czar implied no personal knowledge of sexual harassment at CBS, and most certainly gave

Given such, Caproni now reached a markedly different conclusion with respect to these specific claims. The court decreed that Moonves’s words “could be construed as a representation that he had personally engaged in no sexual misconduct.” Proffered at a significant industry conclave, his statements were both material and capable of inducing reasonable reliance by investors. More-

over, the plaintiff had fulfilled its obligation to pled scienter, crafted as Moonves’s “conscious [ ] reckless[ness]” for the truth. Lastly, as the network’s top executive, his evil intent could be imputed to CBS. Accordingly, these allegations would survive.

Finally turning to the element of loss causation, Caproni, while admittedly skeptical, nevertheless ruled the mere fact that the value of CBS stock had declined after exposure of Moonves’s alleged discretions provided “a plausible causal link” sufficient to meet the comparatively light burden imposed on the plaintiff at the pleading stage. And so, while the majority of the plaintiff’s complaint was dismissed, its allegations of securities fraud as against Moonves, and as imputed to the corporation, lived to fight on.

While we await the ultimate outcome of this litigation, we find much to commend in the CBS opinion. First, it amply demonstrates that pleading a claim of federal securities fraud is a daunting task. The six maxims of the prevailing standard are unforgiving,

along with the further burden of pleading with particularity. Yet its rigors serve the salutary purpose of assuring that only substantial claims survive the pleading stage, and more speculative adventures are turned aside at an early juncture.

Specific to the matter at hand, the case at bar perpetuates the sensible view that declarations of corporate ethics are largely aspirational. Typically lacking materiality, reliability, and the taint of scienter, they are inappropriate grounds for alleging securities fraud. Yet we compliment the foresight of Judge Caproni in her allowance that, in the right circumstances, such allegations might yet prove viable.

## Conclusion

The #MeToo movement and securities fraud do have a commonality; both seek to eradicate deceit and the abuse of power. While at first blush seemingly disparate, the CBS case indicates their shared goals may join them in a courtroom yet again.