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FEDERAL COURT ISSUES FIRST DECISION DISMISSING PANDEMIC-RELATED SECURITIES CLASS ACTION LAWSUIT

To Our Clients and Friends:

A California federal court issued the first decision in the country in a securities class action arising out of the COVID-19 pandemic, dismissing the case on the ground that the issuer could not have anticipated the extent of the pandemic in early January 2020. The decision, *Berg v. Velocity Financial, Inc.*,[1] offers some hope for issuers that their public statements made before or in the early days of the pandemic will be protected from suit to the extent they failed to predict the COVID-19 crisis and its impact on the issuer's business.

COVID-19 Securities Lawsuits

The COVID-19 pandemic and resulting "Coronavirus Crash" brought on a surge of event-driven securities lawsuits. The initial wave of pandemic-related securities lawsuits began in the Spring of 2020 and targeted primarily businesses in the travel and healthcare industries that were directly impacted by the ongoing public health crisis.[2] Several of these lawsuits centered on allegations that the issuer-defendants had downplayed the impact of COVID-19 on their business and/or concealed incidences of COVID-19 outbreaks at their places of business.

Despite a relatively steady stock market recovery through the Summer and Fall of 2020, pandemic-related securities lawsuits continued to be filed,[3] targeting defendants in a wider range of industries that were less directly impacted by COVID-19, including the software,[4] financial services,[5] and energy industries.[6] These cases alleged that companies failed to disclose the impact of COVID-19 on their financial performance and misstated their ability to weather the storm. Pandemic-related securities lawsuits have now become so numerous that the U.S. Chamber Institute for Legal Reform and the Chamber's Center for Capital Markets Competitiveness filed a petition with the U.S. Securities and Exchange Commission urging the SEC to "act without delay to place reasonable limits on securities litigation arising out of the COVID-19 pandemic."[7]

Berg v. Velocity Financial, Inc.

Berg involves claims against Velocity Financial, Inc. ("Velocity"), a real estate finance company specializing in lending for small commercial and residential properties. After Velocity went public in January 2020, its shares rapidly declined in value. The plaintiff filed a putative securities class action in July 2020, accusing Velocity of misrepresenting or failing to disclose material facts in its offering materials concerning: (i) the company's "disciplined" underwriting process; (ii) the growth of non-performing and short-term, interest-only loans in its investment portfolio; (iii) a "substantial and durable" market for real estate investors; and (iv) risks facing its business, including those relating to the pandemic.

On January 25, 2021, the Court granted Velocity's motion to dismiss, finding that the allegations of fraud were based on information that was either not available at the time of Velocity's initial public offering or contradicted by Velocity's offering materials. Regarding COVID-19, specifically, the Court grounded its decision on the fact that Velocity could not have anticipated the extent of the pandemic in early January 2020. Even so, the Court noted that Velocity's offering materials had cautioned investors that Velocity's business might be affected by "changes in national, regional or local economic conditions or specific industry segments," including those caused by "acts of God," which disclosure the Court found covered the pandemic. Similarly, the Court found that Velocity could not have anticipated that the rate of its nonperforming loans would increase to the extent that it did and, more specifically, that the extent of the increase due to the pandemic was not foreseeable when the company filed its offering materials in January 2020.

Conclusion

The COVID-19 crisis continues to cause disruptions and uncertainty in the economy, and companies can be certain that plaintiffs' lawyers will continue to monitor securities filings and stock price performance for potential claims—groundless or otherwise. Companies can take some comfort that courts, starting with the *Berg* decision and possibly more to follow, will take a sensible and pragmatic approach in recognizing the unprecedented nature of the COVID-19 pandemic and dismissing cases premised on a failure early-on to anticipate the extent of the crisis. The *Berg* decision further shows that seemingly generic risk disclosures that did not call out COVID-19 risks in particular were sufficient in the early days of the COVID-19 pandemic. And public companies will no doubt hope that the decision provides a roadmap for other courts to dismiss similar securities complaints premised on a failure to predict the extent or commercial impact of the COVID-19 crisis.

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[1] No. 20 Civ. 6780, 2021 WL 268250 (C.D. Cal. Jan. 25, 2021).

[2] *See, e.g., Douglas v. Norwegian Cruise Lines*, 20-cv-21107 (S.D. Fla. Mar. 12, 2020); *Service Lamp Corp. Profit Sharing Plan v. Carnival Corp.*, 20-cv-22202 (S.D. Fla. May 27, 2020); *McDermid v. Inovio Pharm. Inc.*, 20-1402 (E.D. Pa. Mar. 12, 2020); *Yannes v. SCWorx Corp.*, 20-cv-03349 (S.D.N.Y. Apr. 29, 2020).

[3] *See, e.g.*, *Tang v. Eastman Kodak Company*, No. 20-cv-10462 (D.N.J. Aug. 13, 2020); *City of Riviera Beach Gen. Emps. Ret. Sys. v. Royal Caribbean Cruises LTD*, No. 20-cv-24111 (S.D. Fla. Oct. 7, 2020).

[4] *See Arbitrage Fund v. ForescoutTechs.*, No. 20-cv-03819 (N.D. Cal. June 10, 2020).

[5] *See SEC v. Wallach*, No. 20-cv-06756 (N.D. Cal. Sept. 29, 2020).

[6] *See Hessel v. Portland Gen. Elec. Co.*, No. 20-cv-01523 (D. Or. Sept. 3, 2020).

[7] Tom Quaadman & Harold Kim, Petition for Rulemaking on COVID-19 Related Litigation, (Oct. 30, 2020), https://instituteforlegalreform.com/petition-for-rulemaking-on-covid-19-related-litigation/.

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