Securities Regulation Daily Wrap Up, FRAUD AND MANIPULATION —S.D.N.Y.: Judge certifies securities fraud class against Signet Jewelers, (Jul. 12, 2019)

Securities Regulation Daily Wrap Up

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By Rebecca Kahn, J.D.

Defendants argued dual nature of the case (securities fraud and sexual harassment), precluded class certification. Judge dismissed this argument as a "red herring."

A New York federal judge certified a class of investors claiming that Signet Jewelers Ltd. artificially inflated its stock price by making materially misleading statements and omissions about its culture of sexual harassment and the strength of its in-house customer financing credit portfolio. Adjudicating the suit's core allegation would not require, as Signet argued, trying the particulars of multiple discrimination claims. Rather, this case can be adjudicated like any other ordinary securities class action: by analyzing whether the belated disclosure of the scope of the legal challenge facing Signet caused the company's stock to fall through the floor (*In re Signet Jewelers Ltd Securities Litigation*, Jul. 10, 2019, McMahon, C.J.).

Investors in Signet Jewelers Ltd brought this action claiming violations of Exchange Act Sections 10(b) and 20(a) for fraudulent conduct that artificially inflated the price of Signet common stock from August 29, 2013, through March 13, 2018 (the proposed "Class Period"). Throughout this period, the complaint alleges, Signet repeatedly represented that its credit portfolio was a key strategic advantage, very "conservatively managed," with had "stringent" underwriting practice. Unknown to investors, 45 percent of its portfolio—approximately $800 million—was subprime.

Former Signet employees reported that the company employed strict quotas forcing salespeople to press credit on high-risk borrowers. These employees characterized Signet's underwriting as "ridiculous," "garbage," and a "running joke." Applicants' jobs were not verified, facially false information was ignored, incomplete and unsigned applications were approved, and borrowers' poor credit scores and multiple bankruptcies were disregarded. Central to their fraud, the plaintiff submits, was the company's decision to use a less common method for aging accounts receivable called the "recency" method. According to Plaintiff, using the recency method enabled the defendants to disguise the risk associated with Signet's credit portfolio.

Corrective disclosures. Signet began making "corrective disclosures" starting in November 2015 and in mid-2016, disclosed that it had begun a strategic review of its credit portfolio, and solicited offers to sell the entire credit book. In May 2017, Signet disclosed the subprime loans and, in March 2018, announced that it would sell them at a substantial discount, resulting in losses from $165 million to $175 million in losses. After each of these disclosures, the price of Signet stock plummeted, allegedly causing substantial investor losses.

Sexual harassment action. Separately, since 2008 Signet has been a defendant in a class action arbitration ("Jock") alleging that Signet was rife with systemic sexual harassment pervading Signet at all levels, as exemplified by the behavior of its former CEO, who personally participated in harassing and discriminatory activities. When supporting documents for these "salacious" allegations became public in February 2017 and were reported by *The Washington Post*, Signet's stock plummeted. Within months there was a shakeup at the top and Signet's announced sweeping reforms.

Lead plaintiff, The Public Employees Retirement System of Mississippi, filed its Fifth Amended Complaint against Signet and five of its corporate officers on March 22, 2018. After subsequent motions to dismiss were denied, the plaintiff moved to certify the class.

Rule 23(b)(3). The court found that all class member claims arose from the same wrongful conduct and will be resolved based on similar legal arguments. Ascertaining Class members will be easily administrable by reference to investor records, the court noted.

Reliance and economic loss. The defendants argued that common issues of law and fact did not predominate with respect to reliance and economic loss. The court disagreed. As for reliance, the Supreme Court in *Basic v. Levinson* ruled that such reliance may be presumed where the alleged misrepresentations were publicly known, the stock traded in an efficient market, and the plaintiff traded the stock between the time that misrepresentations were made and when the truth was revealed. But if defendants show no price impact resulting from the allegations, *Basic*'s fraud-on-the-market theory does not apply, common reliance cannot be presumed, and the action cannot be certified as a class action. Once the plaintiffs establish that *Basic's* presumption of reliance applies, the burden shifts to the defendants to show, by a preponderance of the evidence, that the misrepresentations did not affect the company's stock's price. As the defendants did not dispute that plaintiff has satisfied the publicity, market timing, and market efficiency prerequisites, plaintiff is entitled to *Basic*'s presumption of reliance.

Signet's rebuttal attempt fails. The defendants presented expert reports attempting to show no correlation between the corrective disclosures and the stock price drops. Their first expert offered no opinion about whether there was an absence of price impact as a result of Signet's credit-related corrective disclosures. Nor did he conduct any type of statistical analysis or event study assessing whether Signet's stock price declines were unrelated to those revelations.

A second expert testified that the defendants' alleged misstatements pertaining to the allegations raised in Jock had no price impact because "the substance" of the Jock declarations, and the risks that disclosure of the declarations posed to Signet, were already known to the market as a result of prior releases of information. Rather than illustrating price impact, the second expert's report claimed that Signet's stock drop after publication of the *Washington Post* article was simply "consistent with bad publicity." But the Jock disclosures had been kept confidential until February 26, 2017. As a second expert acknowledged, the article contained information that had not previously been disclosed. "How, then," the court asked, "does he also take the position that there was an absence of price impact arising from publication of the *Washington Post* article?"

The second expert asserted that the market was fully aware of the extent to which Signet was facing credible and voluminous allegations of rampant sexual misconduct. The court disagreed as the "generalized summaries" of the Jock evidence did not establish that the substance of Jock was fully known (or knowable) by the market. A March 28, 2014, *New York Times* article only reported a handful of alleged instances of harassment, and "did not fully convey the severity of the allegations facing Signet." The *New York Times* article also quoted a Signet spokesperson denying the Jock allegations as "without merit"—a denial alleged by the plaintiff to be false. As such, the court wrote, it was no "disclosure" at all, since such a denial is counteractive, misleading, and can cause investors to doubt the contents of the purported disclosure. The court concluded that neither expert's report demonstrated an absence of price impact by a preponderance of the evidence.

Class period modified. The court agreed with Signet that the requested class period be shortened, since any non-disclosure had been fully cured by May 25, 2017, the day that Signet announced its plan to sell the prime portion of its portfolio. This announcement fully informed the market about the "extent of the risky loans [that] Signet supposedly concealed." The Class Period must end there, the court ruled, because invoking the *Basic* presumption, requires proof that investors traded the stock between the time the misrepresentations were made and when the truth was revealed. The court was bound by the plaintiff's allegation in the FAC that the May 2017 disclosure "corrected" Defendants' fraud. The plaintiff cannot avail itself of the *Basic* presumption of reliance for subsequent corrective disclosures if, by its own admission, the truth was fully revealed prior to the end of the class period, the court ruled.

As to the remaining corrective disclosures, the court ruled, the plaintiff established that common issues of law and fact concerning "reliance" predominated and ordered certification of the class.

The case is No. 1:16-cv-06728-CM.

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Companies: Public Employees Retirement System of Mississippi; Signet Jewelers Ltd

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