

# Daily Journal

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MONDAY, APRIL 14, 2025

## Newfound appreciation for private securities-fraud rights of action to protect the public

**Despite the Supreme Court's long-standing recognition of private securities litigation as a vital supplement to public enforcement, cases like *Under Armour* and *Hertz* reveal how stringent pleading standards and procedural hurdles can undermine investors' ability to hold wrongdoers accountable often leaving justice to the luck of timing rather than the merits of the claim.**

By Robert R. Henssler, Jr.  
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For five decades, the U.S. Supreme Court has described private securities litigation as a “necessary supplement” to public enforcement led by the U.S. Securities and Exchange Commission. The unstated premise here is that government action is the primary tool for enforcing securities laws and that private suits play an important but complementary role in protecting the public.

But Congress never intended for investors to depend entirely on government action to vindicate their rights. By design, investors are needed to combat securities fraud because “[e]nforcement resources [at the SEC] are stretched thin, and the SEC alone cannot ensure a level playing field for honest market participants,” according to a recent amicus brief filed by leading former SEC officials.

The recently settled case *In re Under Armour Securities Litigation*, No. 1:17-cv-00388-RDB (D. Md.), provides a useful illustration.

*Under Armour* was the subject of both SEC enforcement proceedings and private securities class action litigation. In 2016, Morgan Stanley published a damning report revealing slowing growth in the company's business, and early the next year, the company reported disappointing



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revenue growth, falling below 20% growth for the first time in 26 consecutive quarters. The stock fell sharply, and investors filed suit, alleging that *Under Armour* had fraudulently concealed that its rapid growth had actually been declining for over a year.

Despite *Under Armour's* alleged misconduct, the plaintiffs - hampered by the Private Securities Litigation Reform Act's discovery stay and demanding pleading standard - twice had their case dismissed. The court held that while the plaintiffs ade-

quately pleaded the falsity of the defendants' statements both times, the law's “strong inference” of scienter requirement was not satisfied - although it was a close call.

While the appeal was pending, another shoe dropped. *The Wall Street Journal* revealed that *Under Armour* was under federal investigation for improper revenue recognition. Based on these new facts, the plaintiffs were able to execute a rare procedural maneuver to bring the case back from the appellate court,

set aside the judgment in the district court, and file a third amended complaint. The third time truly was a charm. The district court denied the defendants' motion to dismiss the third amended complaint in full, finally allowing the case to proceed to discovery.

But here's the rub - the SEC found that *Under Armour's* conduct violated the securities laws and fined the company \$9 million. But investors persisted with their private suit and recovered \$434 million and significant corporate governance reforms as part of their settlement with the company. This result - recovering more than 48 times the recovery achieved by the SEC and the second-largest securities recovery ever in the Fourth Circuit - underscores the importance of investors' private right of action for securities fraud.

While the *Under Armour* case was revived through an extraordinary procedure and the auspicious timing of the revelation of the SEC's investigation, the plaintiffs in *In re Hertz Global Holdings, Inc. Sec. Litig.*, No. 2:13-cv-07050 (D.N.J.), were not so fortunate. There, despite the plaintiffs' allegations in their fourth amended complaint citing *Hertz's* own financial restatement - which acknowledged “inappropriate accounting decisions” - the court dismissed

the case with prejudice for failure to meet the PSLRA's stringent standard for pleading scienter.

Similar to *Under Armour*, a parallel SEC investigation of the *Hertz* defendants' conduct resulted in a \$16 million penalty and findings of fact that were inconsistent with the defendants' non-culpable explanation of the events set out in *Hertz's* restatement. The difference was timing: while in *Under Armour* the WSJ revealed an SEC investigation while the case was still on appeal, in *Hertz*, the SEC order was not published until more than a year after the case was dismissed, and Federal Rule of Civil Procedure 60(b) prevented

the plaintiffs from reinstating their case and adding the facts revealed by the SEC.

The enforcement of the federal securities laws should not depend on such happenstance. Nor should alleged fraudsters be given a roadmap such that delaying disclosure of their misconduct equates to justice denied. But, as the *Under Armour* and *Hertz* cases show, such has been the result of the PSLRA's demanding pleading standard. Thus, an unduly harsh application of the pleading standard may well continue to interfere with the ability of private securities-fraud actions to complement public enforcement of the securities laws.

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