**Reuters** Legal News

# Gaming the system: corporate disclosures and 'information bundling'

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**SEPTEMBER 9, 2021**

Investors, judges and regulators are on high alert to an increasingly popular disclosure tactic — referred to as "information bundling" — used by corporate executives against defrauded shareholders seeking a full and fair recovery in lawsuits that allege violations of the federal securities laws.

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On Sept. 3, 2021, SEC Commissioner Caroline Crenshaw issued a "Statement Regarding Information Bundling and Corporate Penalties," in which she expressed "concern[] about corporate issuers benefitting from information bundling." She urged the SEC to crack down on corporate executives' misuse of information bundling, including by setting penalties that are not constrained by the amount of a company's stock price decline following its issuance of a corrective disclosure.

Executives engage in "information bundling" when they combine required disclosures of facts indicating that they violated the securities laws with a simultaneous announcement about wholly unrelated matters. As SEC Commissioner Crenshaw described it, by using information bundling, "[c]orporate defendants strategically release bad news in ways that dampen or obscure the market's reaction." The tactic is intended to make it more challenging for shareholders to prove the necessary elements of a violation of the securities laws and to recover full damages in court.

For example, an executive employing this disclosure tactic might deliberately delay announcing a company's need to restate their past financials due to material errors until it can bundle the announcement alongside a disclosure about a range of different topics such as an exciting new product or business venture, or a company stock buyback program. Rather than make a stand-alone disclosure of their need to restate their past financials — which is likely to trigger a significant stock price decline and potential shareholder lawsuits — these executives try to bury the disclosure in a sea of other announcements on different matters.

By bundling their disclosures in this way, these corporate executives hope to make it more difficult for investors to demonstrate "loss causation" — a required element of most claims under the securities laws. They also hope that, by bundling their corrective disclosure with "positive" unrelated news likely to increase the company's stock price, they can reduce or eliminate investors' recoverable damages in securities fraud lawsuits

This bundling disclosure tactic is drawing the ire of regulators, legal scholars, and judges, and is likely to backfire against the corporate executives who attempt to use it.

Commissioner Crenshaw's observations are backed by academic studies highlighting concerns about executives' increased use of information bundling to try to game the legal system. Earlier this year, Professor Charles Korsmo published an illuminating article in the Boston College Law Review documenting the various ways corporate executives use information bundling to try to obscure the effect of their misstatements.

Professor Korsmo's article built upon prior academic studies showing that, in at least 33% of the cases analyzed, corporations bundled their public announcements of material errors in their past financial statements with unrelated disclosures. Charles R. Korsmo, *Information Bundling, Disclosure, and Judicial Deference to Market Valuations*, 62 Boston College Law Review 571 (2021), https://bit.ly/3yVIO2Y.

Fortunately, investor-plaintiffs and their damage experts have well-recognized tools to combat this bundling tactic in the courtroom and ensure that shareholders obtain a full and fair recovery for securities law violations. Among other things, damage experts can use "event studies" to disaggregate bundled information. Event studies are empirical analyses used to demonstrate a stock price's reaction to publicly reported news. Such analyses can isolate the amount of a stock price decline caused by disclosures related to the fraud (for which the corporate executives are liable) and filter out the stock price impact from the unrelated, bundled news.

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Damage experts can also use event studies to measure the full impact of a defendant's securities law violations, notwithstanding corporations' use of bundled disclosures. To do that, damage experts can construct an event study that assesses how much the corporation's stock price would have declined if the executives had not bundled their disclosure. Specifically, the damage expert can empirically show how much the company's stock price would have declined had the corporation made each of its disclosures on a stand-alone basis. Such analyses can help ensure that investors recover for the total harm caused by defendants' fraud, which should not be offset or limited by their deliberate bundling of unrelated "positive" news with their corrective disclosure.

*SEC Commissioner Crenshaw's statement about information bundling — in which she emphasized that "paying a penalty cannot be just a cost of doing business" — points to further regulatory scrutiny in the months and years to come.*

Courts are increasingly wary of corporations' use of bundled disclosures. For example, in February 2017, the drug company Endo International announced that it needed to take a massive goodwill impairment charge in the future as a result of its previously undisclosed, anti-competitive drug pricing practices. The Endo executives bundled their impairment announcement with unrelated positive news that Endo beat analysts' earnings estimates for the quarter. But three years later, when Endo's lawyers cited Endo's positive stock price movement on the disclosure date as a shield against liability, the court saw through its bundling tactic.

The Eastern District of Pennsylvania judge hearing the case, Judge Michael M. Baylson, issued a scathing May 2021 decision finding that Endo's executives should not benefit from "waiting to announce corrective information until it had offsetting good news," rejected Endo's damages arguments, and certified a class of defrauded investors. *Alexandre Pelletier et al. v. Endo International PLC et al*. case number 2:17-cv-05114, (U.S. District Court for the Eastern District of Pennsylvania).

Judges are likely to continue to reject corporations' attempts to avoid liability through bundled disclosures. When presented with evidence of such disclosure tactics, courts have authority to relieve investors of their normal evidentiary burdens or, alternatively, shift the burden of proof onto the defendant-corporation to disprove loss causation and to demonstrate what portion of the stock price decline was attributable to their release of the unrelated bundled news, as opposed to their required disclosures correcting their prior misstatements. A strong argument could be made that burden-shifting is appropriate in such circumstances to ensure that defendants are not rewarded for deliberately manipulating their disclosures to obscure the impact of their fraud.

Executives' bundling tactics are also likely to backfire in the jury room, in the event that any such cases proceed to trial before a settlement. Defendants' clear attempt at gamesmanship will rightly appear to jurors like market manipulation and suggest an active intent to deceive investors in the face of corporate fraud.

The SEC has the power to punish corporate executives who engage in information bundling, and it can institute additional rules that make clear that such gamesmanship will not be tolerated. After all, the federal securities laws are designed to provide investors robust disclosures and to compensate investors harmed by violations of the disclosure rules. Those twin goals are threatened if companies were able to avoid legal liability for violations of the securities laws simply by engaging in information bundling.

SEC Commissioner Crenshaw's statement about information bundling — in which she emphasized that "paying a penalty cannot be just a cost of doing business" — points to further regulatory scrutiny in the months and years to come. Swift and meaningful regulatory action would serve as a useful backstop to help put an end to this troubling disclosure tactic and ensure that defrauded investors receive a full and fair recovery.

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**This article was first published on Reuters Legal News and Westlaw Today on September 9, 2021.**

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