What Really Caused Carnival's COVID-19 Stock Drop?

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On May 27, a shareholder lawsuit was filed against Carnival Corp. and its officers under Rule 10b-5 of the Securities Exchange Act in the U.S. District Court for the Southern District of Florida.[1]

According to the Service Lamp Corp. Profit Sharing Plan complaint, the defendants allegedly "made a series of false and misleading statements and concealed material information relating to the Company's adherence to its health and safety protocols in the wake of the COVID-19 pandemic."[2]

The complaint also claims that the "truth emerge[d]" on multiple disclosure dates.[3] The complaint alleges that "when the market became aware of Defendants' prior misrepresentations, the price of Carnival common stock fell sharply, Plaintiff and other members of the Class suffered economic loss, i.e., damages." [4]

Carnival now faces three similar cases: Service Lamp Corporation Profit Sharing Plan v. Carnival Corp., John P. Elmensdorp v. Carnival Corp. and Abraham Atachbarian v. Carnival Corp.

As of October, the lead plaintiffs have not yet been determined by the court. The latest legal development in this matter involves the opposition by two retirement funds against a bid from a solo investor to lead option investors in consolidated suits against Carnival.[5]

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Preliminary Findings

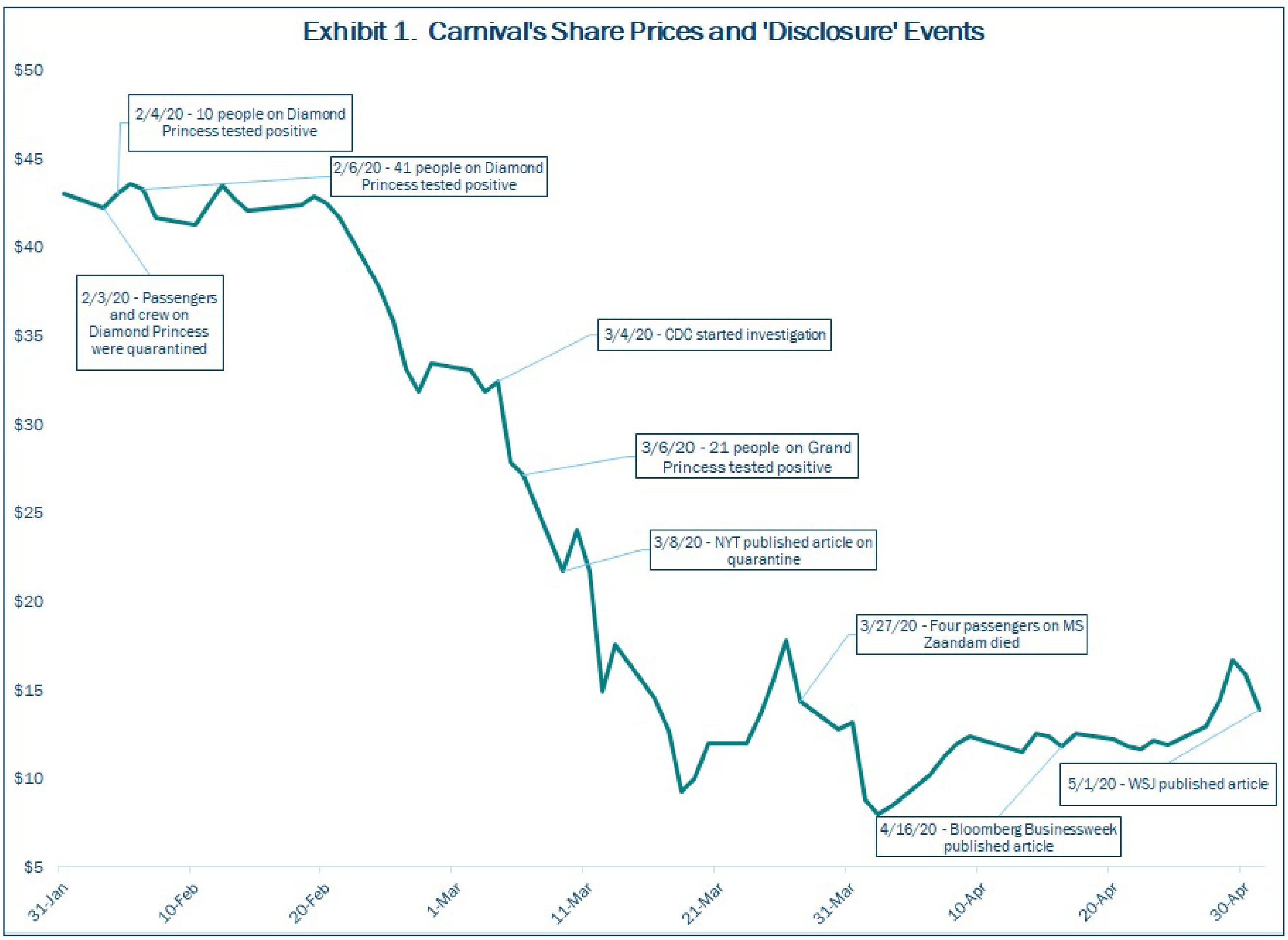
Our analysis shows that while it is true that Carnival's common stock price, or CCL, did fall on some of the alleged disclosure dates, the price drop on each of these dates is fully explained by market and industry factors, and none of the price declines on those dates is statistically significant.

This finding is particularly pertinent in light of U.S. Supreme Court's landmark decision in Halliburton Co. v. Erica P. John Fund Inc., or Halliburton II.[6] This decision, while reaffirming Basic Inc. v. Levinson's[7] fraud-on-the-market presumption of reliance, held that, prior to the certification of a class in a securities class action matter, the defendants can rebut that presumption by showing a lack of price impact.

Specifically, the Supreme Court ruled "any showing that severs the link" between the alleged misrepresentation and the price decline "will be sufficient to rebut the presumption of reliance."[8]

Qualitative Analysis

Exhibit 1 depicts Carnival's daily stock prices from Jan. 31 through May 1, with all the alleged corrective disclosure events shown in the chart. These nine disclosure dates comprise a comprehensive list that we accumulated from all three complaints.



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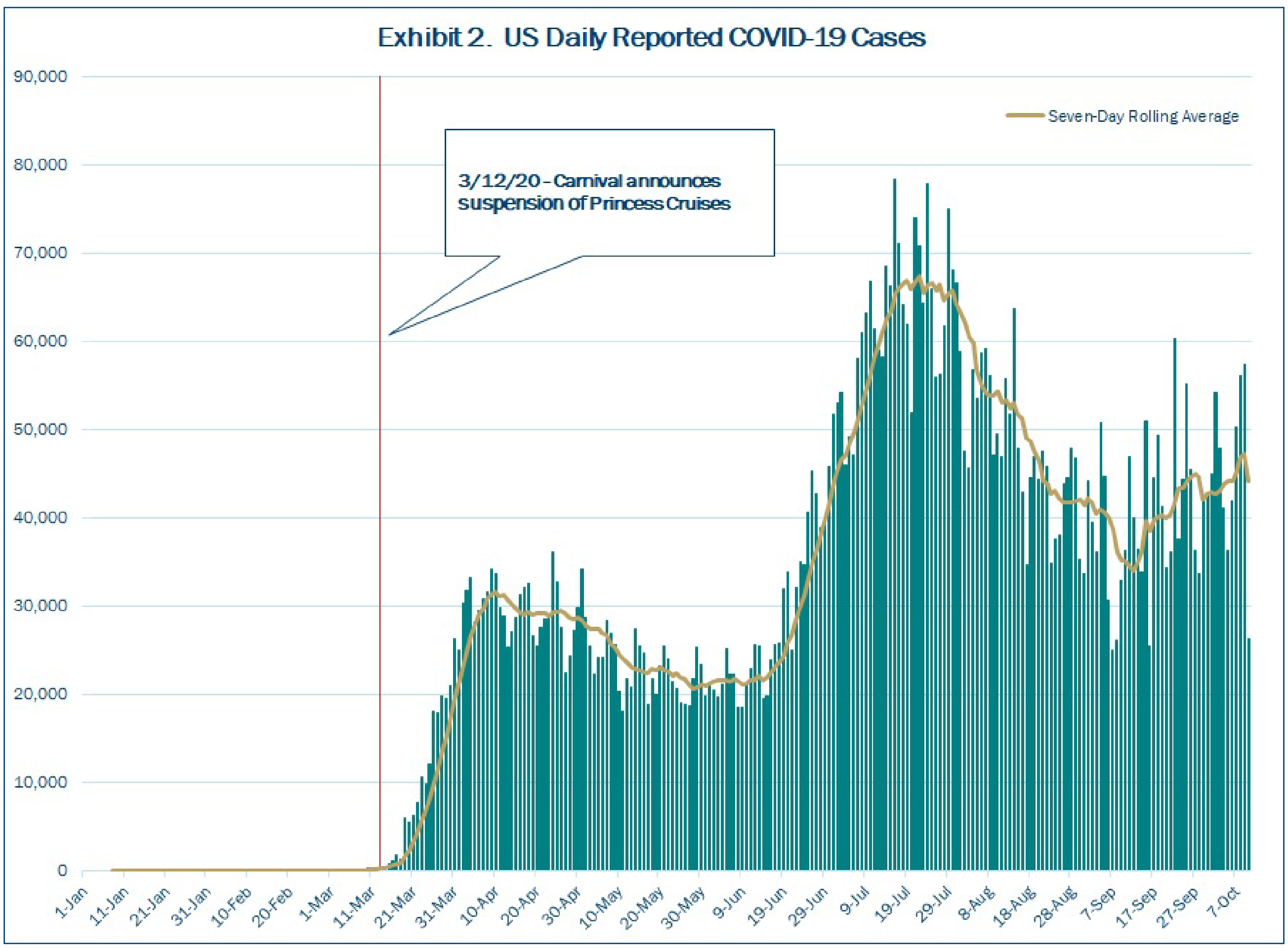
Although not mentioned in any of the three complaints, it is worth noting that on March 12, Carnival announced the suspension of service of Princess Cruises and on the next day, suspension of all operations, due to the COVID-19 pandemic.[9]

To put this date in perspective, consider the data on reported daily new cases of COVID-19 in the U.S., shown in Exhibit 2 below. On March 12, the number of COVID-19 cases was less than 0.3% of the peak number reached in mid-July. Clearly, by mid-March, the severity of the pandemic that was about to unfold in the coming months was unknown and was not foreseen.

For example, in the state of New York, Gov. Andrew Cuomo did not issue an executive order of closing down nonessential services until March 20.[10] Consequently, it is difficult to fathom what Carnival could have disclosed, let alone what duty it had to disclose, prior to its announcement of suspension of operations on March 12.



However, as is evident from Exhibit 1, Carnival's share prices did fall rather sharply during the approximately 30-day period between the third week of February through the third week of March.

Thus, the pertinent question is whether this price drop was caused by the corrective disclosures as alleged in the complaints or whether it was a result of the pandemic-induced demand decimation in the entire cruise line industry.

To answer this question, we turn to an event study analysis.

> While Carnival is one of the first companies in the leisure, travel and hospitality industries to face securities class actions, we believe many other firms in this industry—are likely to face similar lawsuits with claims of inadequate, or absence of timely, disclosures.

A Preliminary Event Study Analysis

We examine Carnival's stock price reaction, after controlling for market and industry factors, on the nine alleged disclosure events. By controlling for industry factors affecting Carnival's stock price, we seek to separate out the impact attributable to Carnival-specific news (i.e., corrective disclosures) from broader industry factors that also affected Carnival's stock price. In what follows, we discuss: industry index construction and event study findings.

Industry Index Construction for Event Study

We used the S&P 500 index as a proxy for the overall market. We constructed a customized index to control for industry-specific effects. To construct this industry index, we began with publicly traded companies offering consumers goods or services with in-person experience, as is the case for cruise lines.

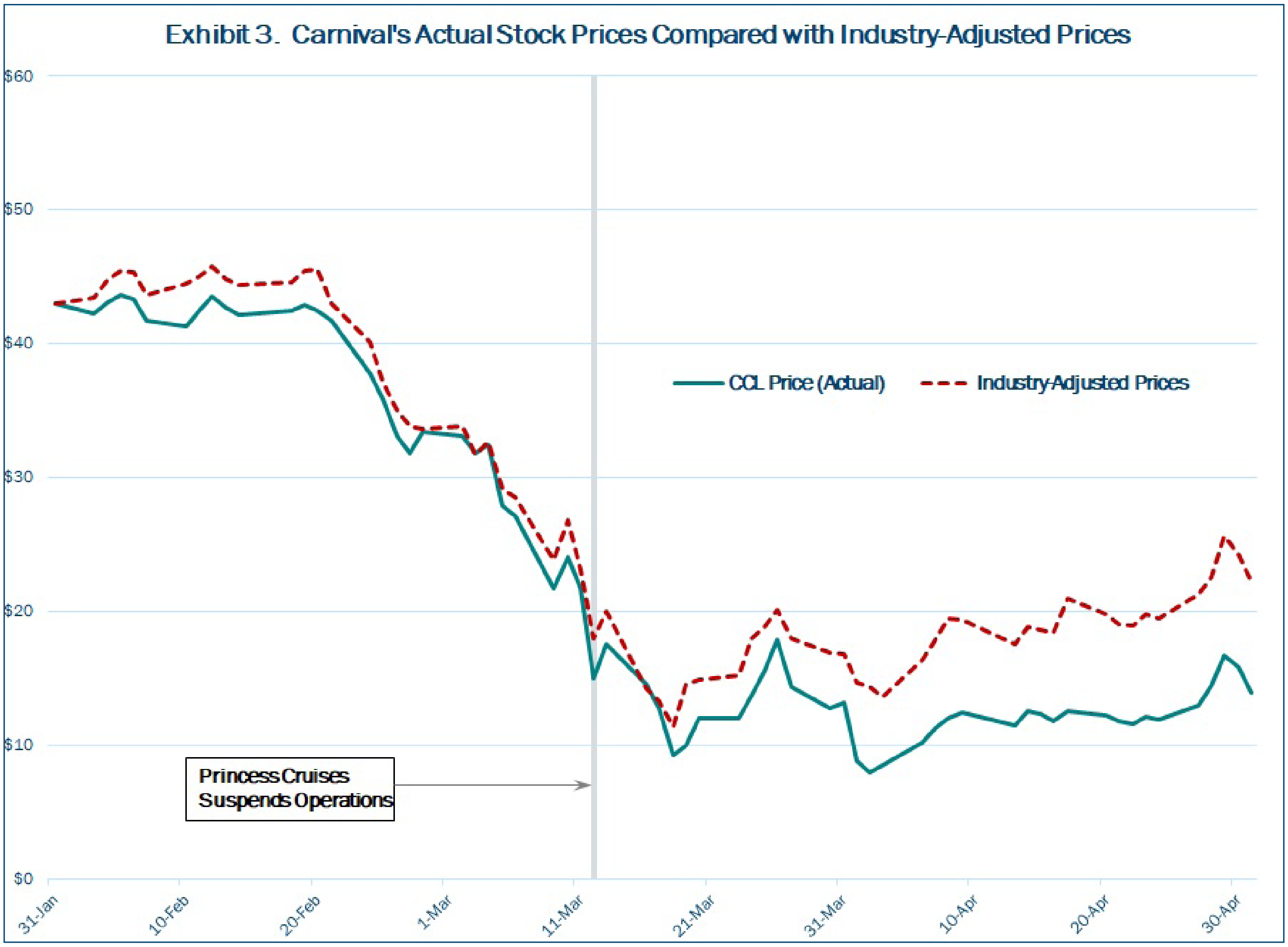
Examples of these industries include movie theaters, theme parks and casinos. Similar to cruise lines, many companies in these industries experienced sharp stock price declines during the February-March period. However, unlike the cruise lines that completely suspended their operations, most companies in these industries continued or resumed operations, at least partially.

To reflect the effect that is idiosyncratic to industries with in-person experience, we included the following six companies with equal weights: The Walt Disney Co., Las Vegas Sands Corp., MGM Resorts International, Wynn Resorts Ltd., AMC Entertainment Holdings Inc. and Cinemark Holdings Inc., in our custom industry index.

We excluded Carnival's competitors, Royal Caribbean International and Norwegian Cruise Line, since shareholder lawsuits have been filed against them.[11] Inclusion of Disney as a part of the industry index, is conservative, because in addition to cruise ships and theme parks, Disney has several other major lines of business that were far less affected by the pandemic.

Event Study Findings

Exhibit 3 shows Carnival's actual and industry-adjusted stock prices from early February to the end of the purported class period.



The industry-adjusted prices show how Carnival's share price would have behaved without the alleged events if it had tracked the daily movement of the industry index. As is evident from this exhibit, Carnival's share price and the industry index are extremely close to each other up through the relevant disclosure period — that is up through March 12, when Carnival announced the suspension of Princess Cruises.

Exhibit 3 demonstrates that the decline in Carnival's stock prices during this disclosure period is almost fully explained by industry factors.

If the plaintiffs' allegations were true, we would have seen large divergences between Carnival's actual price and the industry index during this relevant disclosure period because the Carnival-specific corrective news would have been reflected in the drops in Carnival's prices but not in the industry index.

The divergence between the industry index and Carnival's prices[12] occurs well after Carnival had already suspended operations, i.e., after March 13.

The specific findings of our preliminary event study analysis are shown in Exhibit 4. It shows that none of the six alleged corrective disclosure events prior to March 13, when Carnival announced suspension of all operations, had a statistically significant negative impact on Carnival's share price at the 95% confidence level.

Exhibit 4. Event Study Estimated Effects on CCL Share Prices

No.	Date	Event Cited in Complaints	Residual CCL Price Change	T-Statistic	Significant?
1	3-Feb	Passengers and crew on Diamond Princess were quarantined	-2.6%	-0.80	No
2	4-Feb	10 people on Diamond Princess tested positive	-1.0%	-0.31	No
3	6-Feb	41 people on Diamond Princess tested positive	-0.8%	-0.23	No
4	4-Mar	CDC started investigation	-0.5%	-0.14	No
5	6-Mar	21 people on Grand Princess tested positive	-0.8%	-0.24	No
6	8-Mar	NYT published article on quarantine	-6.3%	-1.86	No
	12-Mar	**Princess Cruises suspends operations** *	-14.7%	-4.23	Yes
7	27-Mar	Four passengers on MS Zaandam died	-11.0%	-3.33	Yes
8	16-Apr	Bloomberg Businessweek published article	-3.5%	-1.07	No
9	1-May	WSJ published article	-5.5%	-1.65	No

Note: * denotes that this event was not cited in the complaints against Carnival.

The column titled ‘‘Residual CCL Price Change” displays the percent change in Carnival’s price after controlling for market and industry factors; that is, it is CCL’s abnormal or residual return that remains unexplained by the market and industry factors.

As noted earlier, on March 12, Carnival announced suspension of operations of its Princess Cruises and on the next day, all three cruise lines announced suspension of all operations. As seen from Exhibit 4, on this day, the industry-adjusted drop in Carnival stock price is nearly 15% and is statistically highly significant.

This is clearly not a corrective disclosure day as it is not even mentioned in the complaints against Carnival. However, with the announcements of the suspension of operations of all three cruise lines, the market learned about the severity of the pandemic’s effects on the cruise industry as it became clear that the future revenues of the firms in this industry would be adversely impacted in a material way.

Thus, it is difficult to fathom how any day after March 13 could be viewed as a corrective disclosure date. Indeed, of all nine corrective disclosure dates, only a single one, March 27, is statistically significant; but it is after two weeks had passed since the announcement of suspension of operations.

Concluding Comments

The economic evidence presented in Exhibits 3 and 4 does not support a causal link between the emergence of truth as claimed by the plaintiffs and the decline in Carnival’s share prices. Our analysis finds no evidence of statistically significant share price reaction on any of the alleged corrective disclosures dates prior to Carnival’s announcement of suspension of operations.

While Carnival is one of the first companies in the leisure, travel and hospitality industries to face securities class actions, we believe many other firms in this industry—particularly those that experienced severe price drops—are likely to face similar lawsuits with claims of inadequate, or absence of timely, disclosures. While each case is unique and requires individualized analysis, we hope our approach can be used to examine the veracity of plaintiffs in these matters as well.

About the Authors

Dr Atanu Saha, a Partner with StoneTurn, has over 25 years of experience in the application of economics and finance to complex business issues. He has served as an expert witness in numerous securities matters, and provided testimony in disputes related to antitrust, patent infringement, valuation of investment portfolios and commercial damages.

Dr. Yong Xu, a Managing Director with StoneTurn, brings over 20 years of experience in the application of economics, finance, and statistics to complex business issues. He has provided expert witness support in numerous commercial litigation matters and provided insights in disputes related to securities fraud, antitrust, patent infringement, trademark and trade dress infringement, and class actions.

[1] Service Lamp Corporation Profit Sharing Plan et al., v. Carnival Corporation et al., C. A. 1:20-cv-22202-KMM-JB (S.D. Fl. May 27, 2020) (the "Service Lamp Action"). There are two related cases against Carnival, John P. Elmensdorp et al., v. Carnival Corporation, et al., C. A. 1:20-cv-22319-KMM-DG (S.D. Fl. June 3, 2020) (the "Elmensdorp Action"); and Abraham Atachbarian et al., v. Carnival Corporation, et al., C.A. 1:20-cv-23011-RNS-EGT (S.D. Fl. July 21, 2020) (the "Atachbarian Action").

[2] Complaint, Service Lamp Corporation Profit Sharing Plan et al., v. Carnival Corporation et al., p. 2.

[3] Ibid, pp. 13 – 20.

[4] Ibid, p. 20.

[5] Law360 Article, "Fight Heats up to Lead Carnival Investors' Suit Over Virus," Oct. 6, 2020.

[6] Halliburton II , 134 S. Ct. 2398 (2014).

[7] Basic , 485 U.S. 224 (1988).

[8] Halliburton II, 134 S. Ct. at 2408 (quoting Basic, 485 U.S. at 248).

[9] https://www.usatoday.com/story/travel/2020/03/13/coronavirus-concerns-cruise-cancellations-port-closures/5037173002/. See also the Class Action Complaint, City of Riviera Beach General Employees Retirement v. Royal Caribbean Cruises et al., C. A. 1:20-cv-24111-KMW, (S.D. Fl. Oct. 7, 2020).

[10] https://www.governor.ny.gov/news/governor-cuomo-signs-new-york-state-pause-executive-order.

[11] Douglas et al., v. Norwegian Cruise Lines et al., C. A. 1:20-cv-21107 (S.D. Fl. March 12, 2020). City of Riviera Beach General Employees Retirement v. Royal Caribbean Cruises et al., C. A. 1:20-cv-24111-KMW, (S.D. Fl. Oct. 7, 2020).

[12] Importantly, the average CCL prices in the period between March 12 and the end of the purported class period (May 1) is $12.67. However, the average price in the 90-day period (per PSLRA 90-day look-back rule) after the end of purported class period, that is between May 4 and the end of July 2020, is $16.06.