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– Chambers USA

Southern District of New York: Loss Causation Not Adequately Alleged Where a Short Seller Report Contained "General Accusations" and Did Not Disclose the Information Described in the Complaint

On July 8, 2021, the Southern District of New York dismissed a putative securities fraud class action alleging that a tech company, certain of its executives and a number of companies involved in underwriting its IPO failed to disclose related-party transactions in the company's registration statement. *Boluka Garment v. Canaan*, 2021 WL 2853284 (S.D.N.Y. 2021) (Oetken, J.). The court held that plaintiffs' Section 10(b) claim failed to adequately allege loss causation because the corrective disclosure, a short seller report, contained "general accusations" and did not disclose the information the complaint described.

Background and Plaintiffs' Allegations

Following the company's 2019 IPO, a short seller report accused the company of deceptive business practices, including failing to disclose related-party transactions. The day the report was published, the company's stock price fell more than 6.8%. Subsequently, plaintiffs commenced this action alleging that the company's registration statement failed to disclose: (i) that a stockholder with 8.8% of the company's total shares (the "8.8% Stockholder") was also a senior executive of the company; and (ii) the related-party nature of its dealings with a business controlled in part by two company directors (the "Director-Controlled Business"), which allegedly purchased nearly $150,000 worth of company products.

Loss Causation Not Adequately Alleged by General Accusations

Defendants argued that plaintiffs' Section 10(b) claim failed to plead loss causation. The court noted that plaintiffs' theory of loss

causation flowed from the short seller report. Plaintiffs claimed that the report exposed the problems arising from the company's related-party transactions. However, the court pointed out that the report said nothing about the 8.8% Stockholder's alleged role as a senior executive and did not include any information about the alleged purchase of company products by the Director-Controlled Business.

Plaintiffs claimed that the wrongdoing described in the report, which "accused [the company] very generally of failing to disclose related-party transactions[,]" was broad enough to encompass their claims. For example, the report stated that "[t]ransactions with related parties and/or sham entities have been a hallmark of . . . fraudulent US-listed Chinese companies," and that the company "used related-party transactions to boost sales prior to its Chinese listing attempts." However, the court disagreed, determining that for purposes of establishing loss causation, "these general accusations fall short." The court stated that "[a]lthough a plaintiff may plead loss causation without alleging a disclosure that precisely mirrors the substance of a prior undisclosed fraud, the disclosure must nevertheless reveal to the market some part of the truth regarding the alleged fraud." The court reasoned that "[b]roadly accusing US-listed Chinese companies of fraudulent behavior reveals nothing about [the company's] alleged failure to disclose [the 8.8% Stockholder's] role in the company or the related-party nature of the company's dealings with [the Director-Controlled Business]." The court found the same to be true of the report's claim that related-party transactions boosted sales prior to the company's previous listing attempts. The court noted that, in context, the report's statement about the related-party transactions specifically referred to the company's relationship with two other entities and did not refer to the 8.8% Stockholder or the Director-Controlled Business.

Southern District of New York: Material Information Not Withheld Where Plaintiff Failed to Allege Defendants Possessed But Withheld More Detailed or More Alarming Information Sufficient to Make Their Prior Disclosures Deficient

On July 19, 2021, the Southern District of New York dismissed a securities fraud class action alleging that a clothing company, certain of its executives and its majority stockholder failed to disclose that the company's retail customers were purchasing products earlier in the year (the so-called "timing shifts"), such that "disproportionately" fewer people would be purchasing products later, and failed to fully disclose the negative financial impact of these timing shifts. *Cheng v. Canada Goose*, 2021 WL 3077469 (S.D.N.Y. 2021) (Broderick, J.). Finding that defendants properly disclosed the information at issue, the court held that "[a]bsent allegations that Defendants possessed but withheld more detailed or more alarming information related to these timing shifts sufficient to make their prior disclosures legally deficient, Plaintiff cannot plausibly allege that Defendants withheld material information about these timing shifts."

The court noted that on several occasions defendants actually did disclose the information at issue, which plaintiff conceded. For example, in an investor and analyst conference call following Q1, the CEO stated that "[o]n the product side . . . people are buying their parkas early." The court also pointed out that after the announcement of the Q3 results, defendants disclosed that investors should "expect a naturally lower rate

of speed in both [the wholesale and retail] channels through the remainder of the fiscal year." Nevertheless, plaintiff alleged that defendants "failed to disclose the full, negative impact" of the timing shifts. In response, the court stated that the legal standard did not necessarily require defendants to disclose the full, negative impact. The court pointed out that the burden was on plaintiff to establish that "any omitted fact was both material and that its omission would be misleading to a reasonable investor."

The court observed that it was difficult to understand what more plaintiff believed that defendants should have disclosed about the timing shifts. The court noted that defendants acknowledged the precise phenomenon at issue, warned that retail growth would be slowed for the rest of the fiscal year, and plainly disclosed that "the timing shift would negatively impact the Company's last two fiscal quarters." To the extent that plaintiff wanted defendants to have disclosed "more granular, empirical, or dire information" about the precise impact the timing shifts would have, the court determined that this argument failed because the complaint did not allege that defendants possessed or had access to any such information. Without allegations that defendants "possessed but withheld more detailed or more alarming information related to these timing shifts sufficient to make their prior disclosures legally deficient," the court held that plaintiff could not plausibly allege that defendants withheld material information about the timing shifts.

District of Nevada: Denies Dismissal of Claims That Company and its Founder Made Misrepresentations in the Wake of Sexual Misconduct Allegations

On July 28, 2021, the District of Nevada denied in part the dismissal of a securities fraud class action alleging that a casino resort company, its founder/former CEO and certain officers and directors concealed alleged misconduct by the founder and made material misrepresentations or omissions in concealing the alleged misconduct. *Ferris v. Wynn Resorts*, 2021 WL 3216462 (D. Nev. 2021) (Gordon, J.). The court held that plaintiffs adequately alleged that two sets of statements were actionable: (i) the founder's and the company's responses to a *Wall Street Journal* article revealing allegations against the founder of a decades-long pattern of sexual misconduct and sexual harassment; and (ii) company press releases responding to a cross claim made by the founder's ex-wife in a separate litigation alleging that the founder engaged in serious misconduct and misused company resources to support his lifestyle without effective board oversight.

Founder Statement Calling Allegations "Preposterous" Sufficiently Pleaded as False Where Complaint Alleged Multiple Instances of Misconduct

In response to the WSJ article, the founder stated that, "The idea that I ever assaulted any woman is preposterous." The founder argued that his statement was not false because he is not required to admit wrongdoing and none of the accusations against him have been proven true. The court disagreed, determining that "the statement would give a reasonable investor the impression that the allegations against [the founder] were preposterous, when the [complaint] alleges several instances of sexual assault by [the founder]." The court held that plaintiffs sufficiently alleged the falsity of the statement at this stage and denied the founder's motion to dismiss on this basis.

Response Casting Allegations as Fabricated Sufficiently Pleaded as False Where Company Received Multiple Misconduct Complaints

The company's response to the WSJ article cast the allegations as part of a "negative public relations campaign" against the founder by his ex-wife.[1] Defendants argued that the statement was puffery, not capable

1. The statement read, "The recent allegations about [the founder] reflect allegations made in court hearings by [the founder's] ex-wife [] in her legal battle with him and the company. It is clear that [the founder's] ex-wife has sought to use a negative public relations campaign to achieve what she has been unable to do in the courtroom: tarnish the reputation of [the founder] in an attempt to pressure a revised divorce settlement from him."

of objective verification, and that it was not false because it did not deny the misconduct described in the WSJ article. The court disagreed, denying the motion to dismiss and determining that plaintiffs sufficiently alleged the falsity of this statement because "a reasonable investor would get the impression that the allegations are false and fabricated by [the founder's ex-wife] as part of her negative public relations campaign to tarnish [the founder]" and force a revised divorce settlement. The court noted that the complaint alleged that "a materially different state of affairs existed because the Company had received multiple complaints about [the founder's] sexual misconduct by that point and various Company executives were aware of that."

Responses to the Cross Claim Allegations Sufficiently Pleaded as False Where Court Interpreted Statements as Broad Denials and Company Received Multiple Misconduct Complaints

Plaintiffs alleged that defendants made material misrepresentations in response to a cross claim by the founder's ex-wife in a separate litigation and her press release regarding the same. The court characterized defendants' statements[2] as including "broad denials" of the cross claim allegations. Defendants contended that the statements were too vague to be false and did not explicitly address the founder's misconduct. However, the court denied dismissal with respect to these statements and held that plaintiffs sufficiently pleaded the falsity of these statements. The court explained that while the statements did not explicitly refer to the alleged sexual misconduct, they referred generally to the ex-wife's allegations regarding the board, of which the founder was the chairman. The court determined that these "statements would give a reasonable investor the impression that the Company denied all of [the] allegations, which addressed [the founder's] serious misconduct against an employee and a resultant multi-million dollar settlement." The court noted that plaintiffs alleged that by the time this statement was made, the company had received multiple sexual misconduct complaints and that multiple executives were aware.

2. For example, "[The ex-wife's] allegations regarding our Board, its composition and its independence are simply not true and are rehashed from her previous, unfounded statements made during her proxy campaign." And, "Neither her nor the company's recent filings contain any new facts or revelations, as she so passionately claims. [The ex-wife's] comments regarding our Board of Directors, their independence and their actions in this matter are false."

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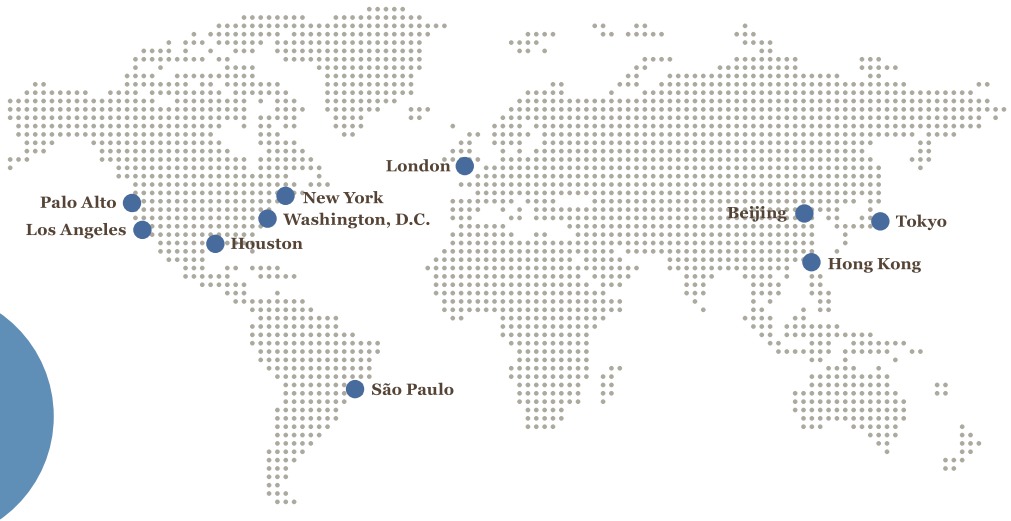

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