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Post-Cyan Update – New York State Decisions Shed Light on Approach to Securities Act Claims

By [Kevin Broughel](#), [Anthony Antonelli](#) & [Amanda Pober](#)

The U.S. Supreme Court in its 2018 landmark decision in *Cyan, Inc. v. Beaver County Employees Retirement Fund*¹ unanimously held that state courts have concurrent subject matter jurisdiction over class actions that exclusively allege claims under the Securities Act of 1933 (“Securities Act”). Predictably, plaintiffs have responded by bringing more Securities Act claims in state courts around the country, and practitioners have been closely following the impacts of this shift to see what precedents, if any, would be disrupted as state court procedure intermixes with substantive federal securities law principles. As we noted in a prior Client Alert, in May a Connecticut trial court in *City of Livonia Retiree Health and Disability Benefits Plan v. Pitney Bowes Inc.*² held that the PSLRA’s automatic discovery stay would still apply to Securities Act lawsuits commenced in Connecticut state court, a decision that may radiate to other jurisdictions. Now, two recent decisions from the New York Supreme Court provide several other important insights into how New York and perhaps other state courts will approach Securities Act claims brought in state forums.

In re Netshoes Securities Litigation

In *Netshoes*, the plaintiffs brought Section 11, 12(a)(2), and 15 claims relating to allegedly false and misleading statements contained in Netshoes’ Registration Statement and Prospectus in connection with its IPO. Plaintiffs alleged that Netshoes, a Brazilian e-commerce company, overstated its competitive market position vis-à-vis other retailers, misled investors about the performance of its business-to-business supplements and vitamins distribution business (“B2B Business”), misrepresented its future growth prospects, and inaccurately disclosed its accounts receivables and financial statements in non-compliance with International Accounting Standards.³ The court, in rejecting plaintiffs’ claims, applied several different federal securities law principles worth noting.

Omnicare Bars Claims for Opinion Statements Sincerely Believed. Under the U.S. Supreme Court’s decision in *Omnicare*, a statement of opinion is not actionable, even if the belief is ultimately wrong, if it was honestly believed when made, and does not incorporate an untrue underlying fact or omit material facts about the issuer’s inquiry or knowledge concerning the opinion statement, “if those facts conflict with what a reasonable investor would take from the statement itself.”⁴ Plaintiffs alleged several opinion statements that the court deemed protected from liability under *Omnicare*. As one example, the court ruled that Netshoes’ statements that it did not believe it had a relevant direct competitor in a certain region and industry, and that it did believe it was “a clear contender for the market leader in Brazil,” were not false or misleading. Likewise, claims that Netshoes’ financial statements were inflated at the time of the offering because there were subsequent increases in



allowances for “doubtful accounts” related to the B2B Business were insufficiently pled because they involved subjective accounting judgments which plaintiffs failed to allege were not sincerely believed when made or were otherwise actionable.⁵

Corporate Optimism and Puffery Will Not Suffice. Allegations concerning Netshoes’ future market positioning and business potential, as well as statements touting customer loyalty and repeat purchasing expectations, were held to be expressions of puffery and optimism that could not sustain a Securities Act claim.⁶

The Bespeaks Caution Doctrine Protects Forward-Looking Statements. Separately, the court found that alleged misstatements about the future performance of the online retail industry, planned growth strategies, and other projected outcomes were protected forward-looking statements that were accompanied by sufficient meaningful cautionary language warning investors that actual results could differ from the statements. This cautionary language included that if “markets for [Netshoes’] Internet-based services ... fail to grow as anticipated, such a lack of growth may have a material impact on [Netshoes’] ... financial condition” and that Netshoes “[s]ince ... inception ... ha[s] never recorded profits or positive operating cash flows in a fiscal year” and that it “may not be able to record profits or positive operating cash flow on a consolidated basis in the near future or at all.”⁷

Alleged Item 303 Omissions Were Immaterial and Disclosed. Item 303 required Netshoes in its SEC 10-K and 10-Q filings to “[d]escribe any known trends or uncertainties that have had or that the registrant reasonably expects will have a material ... impact on net sales or revenues or income from continuing operations.” Plaintiffs alleged that declines in Netshoes’ B2B Business were not adequately disclosed. In ruling for Netshoes, the court observed that the B2B Business was only 4.3% of Netshoes’ net sales and the Offering Documents disclosed various financial metrics that defeated Plaintiffs’ claims, including but not limited to the fact that Netshoes’ “[c]ustomer ‘credit risk’ from overdue B2B accounts receivable had nearly quadrupled; and that its allowance for doubtful accounts had more than tripled.”⁸

Based on these and other principles, the court dismissed the complaint in its entirety. Notably, the court dismissed the complaint even though a heightened pleading standard under CPLR 3016(b) for misrepresentation or fraud claims did not apply, as it found the allegations in the complaint were based on negligence and strict liability.⁹

In re PPD AI Group Securities Litigation

Like *Netshoes*, plaintiffs in *PPDAI* brought Section 11, 12(a)(2), and 15 claims relating to alleged misstatements and omissions associated with an IPO for PPD AI, an online consumer marketplace. Defendants moved to stay the case based, in part, on a similar action filed in the Eastern District of New York several months later. Defendants also sought an order staying discovery in the state court action until the resolution of any motions to dismiss.¹⁰

The court denied the defendants’ requests. In considering *Cyan*, and applying the New York *Asher*¹¹ factors in determining whether to issue a stay, the court held the state court matter should proceed. Several important facts drove the court’s analysis.

Lack of Complete Identity of Parties and Issues. Several defendants in the state court action were not named as defendants in the federal action. Moreover, plaintiffs argued that the Securities Act claims in the later-filed federal action were untimely and would be time-barred, meaning that only the state court forum could adjudicate the Securities Act claims.¹²



First to File. The fact that the state court action was filed two and a half months before the Eastern District of New York action was deemed to “significantly favor” denying the stay.¹³

Expertise. The court held that any perceived greater experience and familiarity of federal courts with federal securities claims was not persuasive because under *Cyan* state courts now have jurisdiction to adjudicate Securities Act violations.¹⁴

Duplication of Effort. The court ruled that any duplication of effort was “tempered” by the purported untimeliness of the Securities Act claims in the Eastern District of New York. Additionally, the court found any pre-*Cyan* authority on the issue unavailing, observing that “there are no decisions by the New York appellate courts addressing a motion to stay a ‘33 Act claim in favor of a later filed federal court action in a post-*Cyan* universe.”¹⁵

On the separate motion to stay discovery, the defendants argued that the PSLRA mandatory stay of discovery should apply to all private actions, whether brought in state or federal court. After noting there were no New York cases discussing the issue,¹⁶ the court denied the stay, finding that “[a]pplication of the federal PSLRA automatic discovery stay would undermine *Cyan’s* holding that ‘33 Act cases may be heard in state courts.”¹⁷

Ramifications

As more state trial courts grapple with Securities Act claims, both plaintiffs and defendants will be searching decisions for insights and potential trends. The *Netshoes* decision is most noteworthy because it is believed to be the first New York state court case that has applied *Omnicare* to a Securities Act claim. Particularly where many of the plaintiffs’ allegations were based on statements framed as opinions or were paired with cautionary language, *Netshoes* serves as an important reminder that defendants can still succeed in dismissing Securities Act claims at the pleading stage based on well-established federal securities law precedents like *Omnicare*, even if more stringent federal pleading standards are not applied.

The impact of the *PPDAI* decision also bears watching. In many respects, it may be limited to the facts of that case in that there was a lack of commonality among the parties, a much later filed federal action, and potential statute of limitations issues that would bar plaintiffs’ Securities Act claims from ever being heard in federal court. Nevertheless, it remains to be seen whether its holding that the PSLRA’s automatic discovery stay is not applicable, which is in direct contrast with the Connecticut *Livonia* decision, will be followed by other courts within and outside of New York. Regardless, both decisions highlight why parties must carefully monitor and research state court post-*Cyan* Securities Act rulings in the relevant jurisdiction to best understand how those courts are analyzing Securities Act claims.





If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings New York lawyers:

Anthony Antonelli
1.212.318.6730
anthonyantonelli@paulhastings.com

Kevin P. Broughel
1.212.318.6483
kevinbroughel@paulhastings.com

Amanda L. Pober
1.212.318.6221
amandapober@paulhastings.com

¹ 138 S. Ct. 1061 (2018).

² 2019 WL 2293924 (Conn. Super. Ct. May 15, 2019).

³ *In re Netshoes Securities Litigation*, No. 157435/2018, at p. 4, 8-9 (Sup. Ct. N.Y. Cty. July 16, 2019).

⁴ *Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund*, 135 S. Ct. 1318, 1326-1329 (2015).

⁵ *In re Netshoes*, at p. 8-12.

⁶ *Id.* at 13.

⁷ *Id.* at 13-15.

⁸ *Id.* at 17-18.

⁹ *Id.* at 7.

¹⁰ *In re PPDAI Group Securities Litigation*, 2019 WL 2902150, at *2-3 (Sup. Ct. N.Y. Cty. July 5, 2019).

¹¹ *Asher v. Abbott Laboratories*, 307 A.D.2d 211, 211-12 (1st Dep't 2003).

¹² *In re PPDAI*, at *4.

¹³ *Id.* at *4-5.

¹⁴ *Id.* at *5.

¹⁵ *Id.*

¹⁶ In *Hoffman v. AT&T Inc.*, No. 650797/2019, 2019 WL 2578360, at *2 (Sup. Ct. N.Y. Cty. June 24, 2019), the court similarly denied a motion to stay in light of a subsequently filed federal action, but the parties ultimately agreed to stipulate to a stay of discovery pending a decision on defendants' motion to dismiss.

¹⁷ *Id.* at *6.

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