

Eleventh Circuit: District Court Failed to Consider Whether Partial Corrective Disclosures Cumulatively Disclosed the Alleged Fraud

05.28.20



(Article from *Securities Law Alert*, May 2020)

For more information, please visit the [Securities Law Alert Resource Center](#)

On May 4, 2020, the Eleventh Circuit reversed the dismissal of a securities fraud action alleging that a beverage company made misleading statements regarding two sales metrics that the company cited as measures of its growth and sales. *Luczak v. National Beverage Corp.*, 2020 WL 2111947 (11th Cir. 2020) (per curiam). The Eleventh Circuit held that the district court erred in its loss causation analysis by “fail[ing] to analyze [the] complaint as alleging a series of partial disclosures” that, when taken together, revealed the alleged fraud.

The Eleventh Circuit explained that in order “[t]o show loss causation, a plaintiff must offer proof of a causal connection between the misrepresentation and the investment’s subsequent decline in value.” The court noted that while “loss causation can be difficult to prove in fraud-on-the-market cases . . . a plaintiff can demonstrate loss causation circumstantially by: (1) identifying a ‘corrective disclosure’ (a release of information that reveals to the market the pertinent truth that was previously concealed or obscured by the company’s fraud); (2) showing that the stock price dropped soon after the corrective disclosure; and (3) eliminating other possible explanations for this price drop.”

The plaintiff alleged that the company made misrepresentations concerning two purportedly proprietary sales metrics—velocity per outlet (“VPO”) and velocity per capita (“VPC”)—in three press releases issued in 2017. According to the plaintiff, a March 23, 2018 letter from the SEC and a June 26, 2018 article in *The Wall Street Journal* were both partial corrective disclosures of the alleged fraud. The plaintiff alleged that “the March 23 letter was the first time the market learned that the company issued conflicting statements regarding its VPO and VPC metrics” and “was failing to cooperate with the SEC” in explaining these metrics. The plaintiff further alleged that “the June 26 article provided the market with a full realization that [d]efendants’ claims about the VPO and VPC metrics were misleading.”

The Eleventh Circuit held that the district court “erred in finding the March 23 letter could not serve as a corrective disclosure because it does not constitute either proof of fraud or proof of liability.” The court explained that because the plaintiff “alleges the March 23 letter and the June 26 article cumulatively disclosed [the company’s] allegedly fraudulent practices,” the plaintiff did not “need to allege the March 23 letter alone shows proof of fraud.”

The Eleventh Circuit held that “[t]he district court also erred in its separate analysis of both documents.” The Eleventh Circuit determined that “it was improper for the court to reject [the plaintiff’s] reading of the [March 23] letter and find that the SEC never accused [the

company] of failing to cooperate.” The Eleventh Circuit stated that “[w]hile a court is not bound to accept the truth of general allegations in a complaint where they are contradicted by specific factual details in attached exhibits, no contradiction exists here” between the plaintiff’s allegations and the SEC’s letter. The Eleventh Circuit further found the district court’s characterization of the June 26 article as “a mere summary of the earlier correspondence between the [c]ompany and the SEC staff” was “not a fair reading of the article, nor of [the plaintiff’s] allegations.” The Eleventh Circuit noted that the article did not “specify that [the] information [in the article] was gleaned only from the March 23 letter, so the district court should not have drawn this conclusion.”

The Eleventh Circuit concluded that the complaint adequately “alleges the defendants’ fraudulent behavior leaked out through a series of partial disclosures, causing a drop in the stock price.” Because the court found these allegations satisfied “the heightened pleading standards of Rule 9(b) and the [Private Securities Litigation Reform Act (“PSLRA”)], the Eleventh Circuit found that it “need not resolve” the question of “whether the PSLRA’s heightened pleading standards apply to allegations of loss causation.”

Authors and
Contacts

Peter Kazanoff

Partner

pkazanoff@stblaw.com

+1-212-455-3525

George Wang

Partner

gwang@stblaw.com

+1-212-455-2228

Cheryl Scarboro

Of Counsel

cscarboro@stblaw.com

+1-202-636-5529

