

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

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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.

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