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New York Appellate Court Reverses Denial of Motion to Dismiss Securities Act Claims in Apparent Post-*Cyan* Trend

In the wake of the U.S. Supreme Court's 2018 decision in *Cyan* v. *Beaver County Employees Retirement Fund*,[1] which held that concurrent jurisdiction in state and federal courts exists for violations of the Securities Act of 1933 (the "Securities Act"), the number of Securities Act class actions filed in state courts increased markedly, based on the perception that state courts would be more hospitable forums for plaintiffs. The first two appellate decisions in New York following *Cyan* suggest that this perception may well be inaccurate, and that New York state courts will, like federal courts, hold plaintiffs to their burden of putting forward well-pleaded allegations of falsity that could, if proven, sustain Securities Act claims—and will not hesitate to dismiss complaints that fail to do so.

On March 4, the New York Appellate Division, First Department, unanimously reversed a lower court decision denying defendants' motion to dismiss claims under the Securities Act. The decision in *Labourers' Pension Fund of Central & Eastern Canada* v. *CVS Health Corp.*,[2] appears to be the second decision by a New York State appellate court adjudicating Securities Act claims since *Cyan*. The *Labourers' Pension Fund* decision is consistent with the New York Appellate Division's December 2020 ruling in *Lyu* v. *Ruhnn Holdings Ltd.*,[3] which also unanimously reversed a decision denying defendants' motion to dismiss Securities Act claims. These decisions suggest that New York State courts will rigorously review defendants' offering materials and apply well-established principles of federal securities law to dismiss Securities Act claims at the pleadings stage. These two reversals also send a strong message to the trial courts to more rigorously scrutinize complaints asserting Securities Act claims when deciding motions to dismiss.

The *Labourers' Pension Fund* Decision

In *Labourers' Pension Fund*, a plaintiff shareholder alleged that an issuer misrepresented its goodwill in a registration statement issued in connection with a major acquisition.[4] Shortly after the acquisition closed, the issuer booked a significant goodwill impairment reflecting problems with one of its business units that had allegedly existed for several years, and the issuer's share price declined. Plaintiff filed a putative class

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1 138 S. Ct. 1061 (2018).

2 No. 2020-02890, 2021 WL 816981 (N.Y. 1st Dep't Mar. 4, 2021).

3 137 N.Y.S.3d 322 (N.Y. 1st. Dep't Dec. 3, 2020).

4 *Labourers' Pension Fund of Central & Eastern Canada* v. *CVS Health Corp.*, 2020 WL 2857654, at *1 (N.Y. Sup. Ct. June 1, 2020).

action in state court and asserted claims under Sections 11, 12(a)(2) and 15 of the Securities Act against the issuer and certain of its executives. Defendants moved to dismiss, and the lower court denied defendants' motion in its entirety.[5]

In a two-page order, the New York Appellate Division, First Department, unanimously reversed the lower court and entered judgment for defendants. The court found that the goodwill statements at issue were opinions and therefore not actionable unless they (i) were not actually believed, (ii) contained false embedded statements of fact, or (iii) omitted material facts about the basis of the opinions.[6] No prong was satisfied. *First*, because plaintiff expressly based its Securities Act claims on negligence and strict liability—and disclaimed any claim based on fraud—it could not state a claim for a dishonestly held opinion.[7] *Second*, plaintiff failed to identify any facts embedded in the goodwill opinion.[8] *Third*, plaintiff failed to state an omissions claim because the issuer disclosed the nature of the inquiry forming its goodwill opinion, and plaintiff did not allege that the stated methodology was not followed.[9]

The court also rejected plaintiff's argument that defendants misled investors by disclosing the risk of goodwill impairment as contingent, rather than actual, in the registration statement. The court explained that this did not render the registration statement "as a whole" misleading "in light of the total mix of information."[10] Finally, the court found that plaintiff failed to state a claim against the individual defendants under Section 12(a)(2), and explained that plaintiff's allegations that these defendants "reviewed, approved, and signed the registration statement" were insufficient to establish liability as statutory sellers.[11]

The *Lyu* Decision

Three months earlier, the same appellate court reached a similar conclusion in *Lyu*. There, a plaintiff-shareholder alleged that an issuer, a social media and e-commerce company, failed to disclose in the registration statement accompanying its IPO that it had closed almost 40 percent of its online stores in

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5 *Id.* at *9.

6 *Omnicare, Inc.* v. *Laborers Dist. Council Constr. Indus. Pension Fund*, 575 U.S. 175 (2015).

7 *Labourers' Pension Fund*, 2021 WL 816981, at *1.

8 *Id.*

9 *Id.*

10 *Id.*

11 *Id.*

the quarter preceding the IPO.[12] Plaintiff asserted claims under Sections 11, 12(a)(2) and 15 of the Securities Act, and defendants moved to dismiss. The lower court denied defendants' motion in substantial part.[13]

As in *Labourers' Pension Fund*, the Appellate Division, First Department, unanimously reversed the lower court's denial of defendants' motion to dismiss.[14] In a two-page order, the court held that the alleged omission was immaterial because the offering materials disclosed that the issuer was shifting to a different online sales model.[15] Thus, the omission of certain sales data from the immediately preceding period did not "significantly alter the total mix of information made available to a reasonable investor."[16]

Implications of these New York Appellate Court Decisions

Although these decisions are short, they portend the beginning of a trend towards rigorous application of federal securities law principles to Securities Act claims brought in New York State courts. Both *Labourers' Pension Fund* and *Lyu* instruct courts to review registration statements "as a whole," and dismiss claims based on alleged misstatements or omissions that would be immaterial to a reasonable investor in light of disclosures in the offering materials and the total mix of information. Given the potentially fact-intensive nature of the materiality analysis, the direction to dismiss the complaint in *Lyu* on that ground underscores the rigor of the First Department's approach.

Labourers' Pension Fund also illustrates the paradox plaintiffs face in pursuing opinion-based claims in state court, where they must disclaim allegations of fraud. By doing so, plaintiffs are categorically unable to allege defendants' subjective disbelief in their opinions, making it exceedingly difficult to survive a motion to dismiss. While it remains to be seen how trial courts will interpret and apply these appellate decisions, they send a clear message to the lower courts, and provide a valuable weapon for defendants litigating Securities Act claims in New York State court. Defendants should not hesitate, where appropriate, to attack allegations that fail to satisfy the elements of falsity and materiality, among others.

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12 *Lyu*, No. 655420/2019, 2020 WL 1939668, at *1–2 (N.Y. Sup Ct. Apr. 22, 2020). Claims were also asserted against certain directors and officers of the issuer and the underwriters of the IPO.

13 *Id.* at *5.

14 *Lyu*, 137 N.Y.S.3d at 323.

15 *Id.*

16 *Id.*

We note that many issuers have responded to *Cyan* by adopting bylaw provisions that require Securities Act claims to be asserted only in federal courts, and not in state courts. We have separately addressed the recent trend of state court decisions enforcing such federal forum provisions here.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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