PAUL HASTINGS

Stay Current

December 2020

Follow @Paul_Hastings

New York Appellate Division Wades into Cyan's *Waters with Two New Decisions*

By Kevin Broughel, Anthony Antonelli, John Nowak, Molly Wolfe & Michael Fisher

We have previously written about the impact of the 2018 U.S. Supreme Court decision in *Cyan Inc. v. Beaver County Emps. Ret. Fund*, which held that state courts have concurrent subject matter jurisdiction over class actions that exclusively allege claims under the Securities Act of 1933 (the "Securities Act").[1] A subsequent rise in state court securities filings followed, with New York eclipsing California as the top jurisdiction for plaintiffs to file Securities Act lawsuits.[2]

One unsettled issue arising out of *Cyan* was how New York state courts would address Securities Act claims that had also been asserted in federal court actions. Would state courts issue stays in favor of the federal actions, or would defendants potentially face state and federal lawsuits asserting Securities Act claims simultaneously? Practitioners have also been closely watching to see how New York courts might apply federal securities law precedents, and whether New York courts would dismiss cases at the pleading stage. Early New York Supreme Court decisions addressed these issues, but at times with inconsistent results. Recently, the New York Appellate Division, First Department issued two post-*Cyan* rulings in *Lyu v. Ruhnn Holdings Limited* and *In re Qudian Securities Litigation* that provide valuable insights as to how New York state courts will address Securities Act cases.[3]

LYU V. RUHNN HOLDINGS LIMITED

The *Lyu* decision marks an early New York Appellate Division decision on the merits of a Securities Act claim post-*Cyan*. The putative class action complaint alleged violations of Sections 11, 12(a)(2), and 15 of the Securities Act based primarily upon an alleged omission in the offering materials that the issuer, a social media and e-commerce company, had closed almost 40 percent of its full-service online stores in the fiscal quarter immediately preceding its initial public offering. The lower court denied defendant's motion to dismiss plaintiff's Section 11 and 15 claims, only dismissing the Section 12(a)(2) claim on the basis that defendant was not liable as a "statutory seller" under the Securities Act.[4]

The Appellate Division unanimously reversed the lower court's denial of the motion to dismiss plaintiff's Section 11 and 15 claims, directing dismissal of the complaint in its entirety. Under Second Circuit precedent, the court found that the issuer's disclosures were not material and adequately apprised a reasonable investor about the store closures:

> Given defendants' disclosure that defendant … was shifting to a "platform" model for its online sales and away from the self-owned, "full service" model, the omission of data from the period immediately preceding the issuance of the final prospectus showing that there had already been a reduction in the full service segment of the company did not

> "significantly alter[] the 'total mix' of information made available" to a reasonable investor.[5]

The court further noted that, even focusing on the issuer's "full-service model" alone, disclosure of the issuer's total number of stores "would not have given a more accurate picture of the status of the business."[6] Accordingly, dismissal was appropriate.

IN RE QUDIAN SECURITIES LITIGATION

Defendants facing concurrent state and federal Securities Act lawsuits have often sought a stay of the state court proceedings. In determining whether to grant the stay, courts generally evaluate several different factors including, among others, which forum would offer a more complete disposition of the issues presented, which action was commenced first, the stage of the proceedings, and whether there was substantial overlap of the issues asserted in both actions. As discussed in our previous Client Alerts, decisions on these motions broke both ways, with stays of the state lawsuits often granted when the federal action was filed first.[7]

In *Qudian*, the state court action was filed ***after*** five similar federal court class actions had been filed and consolidated. The state court action was brought on behalf of the same putative class as the federal action; was filed by counsel that had filed one of the federal actions (but had not been selected as lead plaintiffs' counsel);[8] and, with certain differences in the underlying alleged misrepresentations, asserted the same violations of Sections 11, 12(a)(2), and 15 of the Securities Act against a subset of the same defendants. Defendants successfully moved for a stay of the state court action.[9]

Subsequently, the federal court dismissed the consolidated complaint with the exception of one allegation premised on a purported failure to disclose the issuer's planned launch of an auto loan business.[10] Thereafter, Plaintiffs in the state court action filed a motion to vacate the stay on the ground that the proposed state court complaint asserted Securities Act violations based on a ***different*** misrepresentation—one that was not alleged in the federal complaint and, arguably, could not be added because the one-year statute of limitations had expired. The Supreme Court of New York declined plaintiffs' motion to vacate, reasoning that "a stay is justified where there is another already commenced action pending in federal court, and there is a 'substantial relationship' between the parties, issues, and relief sought."[11]

On appeal, the Appellate Division reversed and granted plaintiffs' motion to vacate the stay. The court held that a decision in the federal action would not determine all of the questions in the state court action ***because the actions related to different alleged misrepresentations,*** and there was no risk of inconsistent rulings because the alleged misrepresentation in state court was never at issue in the federal lawsuit. The court also rejected the contention that the plaintiffs in the state court action were somehow related to the plaintiff in the federal action or that the plaintiffs in both actions were "mere tools or puppets" of plaintiffs' counsel.[12]

RAMIFICATIONS

The *Lyu* decision is helpful in that it illustrates the application by the Appellate Division of a bedrock principle of federal securities law—that allegations of misleading or omitted material information will fail where those allegations are contradicted by disclosures that were, in fact, made. *Lyu*, therefore, serves as an important reminder that defendants in New York state courts can still succeed in dismissing Securities Act claims at the pleading stage based on well-established federal securities law principles.[13]

We expect more of these substantive securities rulings at the appellate level as additional New York state Securities Act cases move forward.

The *Qudian* case underscores the real risk defendants face in simultaneously contending with parallel state and federal securities lawsuits. While prior trial court rulings suggested New York state courts would normally look to and, in many cases, defer to the first-filed Securities Act proceeding, the appellate court in *Qudian* did not reference this factor. Rather, the decision analyzed whether the misstatements and omissions underpinning the Securities Act claims were the same in determining whether a stay was warranted.

Additionally, the court focused on the individual representative plaintiffs being different in the state and federal actions, rather than on the fact that it was the same proposed class in both proceedings. In at least one prior Supreme Court of New York decision, the Court refused to vacate a stay where there were different alleged misstatements among the actions, but the same proposed classes.[14] *Qudian* could embolden class plaintiffs to lodge more "second-filed" state court Securities Act cases with distinct factual allegations from their federal predecessors so as to avoid a stay and increase the likelihood of parallel state and federal actions proceeding.

✧ ✧ ✧

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

John P. Nowak
1.212.318.6493
johnnowak@paulhastings.com

Molly Wolfe
1.212.318.6765
mollywolfe@paulhastings.com

Kevin P. Broughel
1.212.318.6483
kevinbroughel@paulhastings.com

Michael Fisher
1.212.318.6044
michaelfisher@paulhastings.com

---

[1] 138 S. Ct. 1061 (2018).

[2] *Cornerstone Research, Securities Class Action Filings: 2019 Year in Review*, 1, 19 (2020), https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2019-Year-in-Review.

[3] *Lyu v. Ruhnn Holdings Ltd.*, No. 12553, 2020 WL 7062118, (N.Y. App. Div. Dec. 3, 2020); *In re Qudian Sec. Litig.*, No. 12537N, 2020 WL 7061890, (N.Y. App. Div. Dec. 3, 2020).

[4] *Lyu v. Ruhnn Holdings Ltd*., No. 19-cv-655420, 2020 N.Y. Misc. LEXIS 2250 (Sup. Ct. N.Y. Cty. Apr. 22, 2020).

[5] *Lyu*, 2020 WL 7062118.

[6] *Id.*

[7] *See, e.g.*, *In re NIO Inc. Sec. Litig.*, No. 0653422/2019 (N.Y. Sup. Ct. Dec. 13, 2019) (NYSCEF Doc. No. 86) (Ostrager, J.) (stay granted when federal action first-filed); *Mahar v. Gen. Elec. Co.*, 65 Misc. 3d 1121, (N.Y. Sup. Ct. 2019), *reargument denied*, (N.Y. Sup. Ct. 2020), and *aff'd*, 188 A.D.3d 534 (N.Y. App. Div. 2020) (same); *Matter of PPDAI Grp. Sec. Litig*., 64 Misc. 3d 1208(A), (N.Y. Sup. Ct. 2019) (stay denied when federal action filed second); *In Re Dentsply Sirona, Inc. v. XXX*, No. 155393/2018, 2019 WL 3526142 (N.Y. Sup. Ct. Aug. 02, 2019) (same). In some instances, however, stays have been denied even when the federal action was filed first. *See, e.g., Convery v. Jumia Technologies Ag*, No. 656021/2019, 2020 WL 4586301 (N.Y. Sup. Ct. Aug. 07, 2020) (denying stay of later filed state court action in part because it was not "first in time" with respect to the asserted Securities Act claims, which were added to the federal complaint after the state court action had commenced).

[8] A second state court complaint was filed by a different plaintiff in June 2018 and thereafter consolidated with the first state court action.

[9] *In re Qudian Sec. Litig.*, No. 651804/2018, 2020 WL 2106837 (N.Y. Sup. Ct. Apr. 28, 2020).

[10] *In re Qudian Inc. Sec. Litig.*, No. 17-CV-9741 (JMF), 2019 WL 4735376 (S.D.N.Y. Sept. 27, 2019), *reconsideration denied*, No. 17-CV-9741 (JMF), 2020 WL 3893294 (S.D.N.Y. July 10, 2020)

[11] *In re Qudian Sec. Litig.*, 2020 WL 2106837, at *1 (quoting *Alter v Oppenheimer & Co. Inc.*, No. 121188/03, 2005 WL 1539251, at *2 (N.Y. Sup. Ct. June 30, 2005)).

[12] *In re Qudian Sec. Litig.*, 2020 WL 7061890, at *7.

[13] *See, e.g.*, *Netshoes Sec. Litig. v. XXX*, 64 Misc. 3d 926, (N.Y. Sup. Ct. 2019) (dismissing Securities Act claims premised on opinion statements based on *Omnicare* and other federal securities law principles).

[14] *In re Nio Inc. Sec. Litig.*, No. 653422/19, 2020 WL 4932073, at *1 (N.Y. Sup. Ct. Aug. 21, 2020) (holding that "plaintiffs … failed to show that the legal strategy by the lead counsel in the Federal Action, relating to which alleged misstatements in the registration statement to challenge, would prejudice the interests of the purported class.").