Dechert LLP

2023 DEVELOPMENTS IN U.S. SECURITIES FRAUD CLASS ACTIONS AGAINST NON-U.S. ISSUERS

Table of Contents

Introduction

In 2023, plaintiffs filed 33 securities class action lawsuits against non-U.S. issuers, down by one from the 34 filings in 2022. This number indicates a continued decline in non-U.S. issuer filings, since a recent high of 88 filings in 2020.[1]

- As was the case in 2022 and 2021, the Second Circuit continues to be the jurisdiction of choice for plaintiffs bringing securities claims against non-U.S. issuers, but this year by a slimmer margin. Roughly 45% of these 33 lawsuits (15) were filed in courts in the Second Circuit. A majority (12) of these lawsuits were filed in the Southern District of New York ("S.D.N.Y."), with the three remaining Second Circuit lawsuits filed in the Eastern District of New York ("E.D.N.Y."). Roughly 27% of the 33 lawsuits were filed in the Ninth Circuit (10), followed by six in the Third Circuit and one each in the Fourth and Fifth Circuits.
- Continuing a trend in 2022 and 2021, most Non-U.S. issuer lawsuits were against companies with headquarters and/or principal places of business in China. Of the 33 non-U.S. issuer lawsuits filed in 2023, 9 were against non-U.S. issuers with headquarters and/or principal places of business in China, followed by a tie for second between the United Kingdom (5) and Israel (5) and a three-way tie for third with Canada (2), Singapore (2), and Switzerland (2).
- The Rosen Law Firm, P.A. reclaimed the top spot with the most first-in-court filings against non-U.S. issuers in 2023 (11), followed closely by Pomerantz LLP (10), and Glancy Prongay & Murray LLP (5). In 2022, the Rosen Law Firm took second place behind Pomerantz, after holding the lead from 2018 through 2021. The Rosen Law Firm was also appointed lead counsel in the most cases in 2023 (5), followed by Pomerantz (3), and Levi & Korsinsky, LLP (3).
- The first and fourth quarters of 2023 proved equally active for filing securities class actions against non-U.S. issuers, with 10 cases filed in both Q1 and Q4. But the first half of 2023—Q1 and Q2—yielded most of the 2023 filings (19 of 33), due to a quiet third quarter with only four filings.
- Although the 33 lawsuits spanned 18 different industries, the largest number of filings involved the software and programming industry (6), and the biotechnology and drugs and money center banks industries (4 each).

An examination of the types of cases filed in 2023 reveals the following substantive trends:

- Six cases involved issues of regulatory compliance and licensure against companies headquartered in China (4), Uruguay (1), and Israel (1).
- Five cases were filed against financial technology ("fintech") companies, with two of those cases concerning the cryptocurrency market's volatility.
- Four cases were filed against biotechnology and pharmaceutical companies, including three companies focused on cancer research.

1 Unless otherwise noted, the figures in this white paper are based on information reported by the *Securities Class Action Clearinghouse* in collaboration with Cornerstone Research, Stanford Univ., Securities Class Action Clearinghouse: Filings Database, Securities Class Action Clearinghouse (last visited Feb. 20, 2024). A company is considered a "non-U.S. issuer" if the company is headquartered and/or has a principal place of business outside of the United States. To the extent a company is listed as having both a non-U.S. headquarters/principal place of business and a U.S. headquarters/principal place of business, that filing was also included as against a non-U.S. issuer.

In 2023, courts rendered 18 decisions dismissing or partially dismissing securities class actions against non-U.S. issuers filed in 2022 and 2021.

- Ten of those decisions were dismissed with prejudice and six were dismissed without prejudice, allowing the plaintiffs leave to amend.
- Seven of these 18 decisions were dispositive, meaning they resulted in the closure of the case with no motion for reconsideration or pending appeal.
- Two of these 18 decisions resulted in partial dismissal, allowing portions of the claims to proceed to discovery.
- Thirteen of these 18 decisions relied on a determination that the plaintiffs failed to allege an actionable misstatement or omission. Eight decisions relied on a determination that the plaintiffs failed to allege a strong inference of scienter. Four of the 18 decisions made both determinations—the plaintiffs both failed to plead an actionable misstatement or omission and also failed to plead a strong inference of scienter.

Non-U.S. Companies Remain Targets for Securities Fraud Litigation

Although the number of securities class actions increased in 2023 (from 197 in 2022 to 215 in 2023), the number of securities class actions against non-U.S. issuers held relatively steady at 33 new cases in 2023, as compared with 34 new cases in 2022.[2]

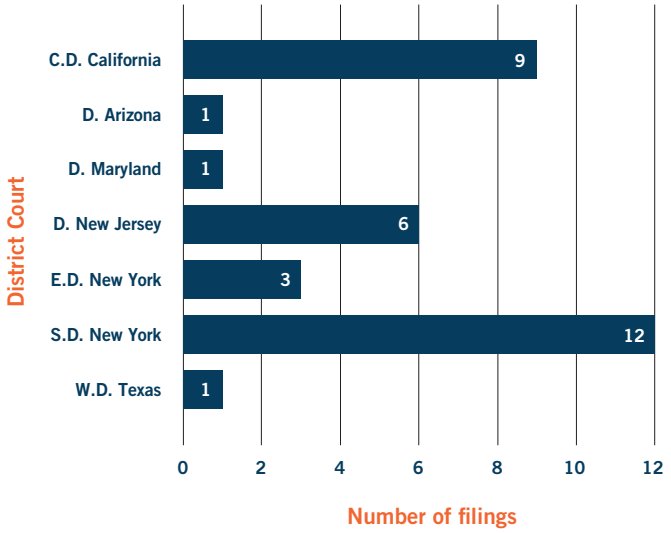
This survey provides an overview of securities lawsuits against non-U.S. issuers in 2023. ***First,*** we analyze the number of cases filed, including trends relating to location filed, the types of companies plaintiffs targeted, and the nature of the underlying claims. ***Next,*** we analyze key decisions rendered on motions to dismiss in 2023 and their impact on the legal landscape of these types of suits. ***Finally,*** we outline issues and best practices non-U.S. issuers should consider implementing to mitigate the risk of such lawsuits.

Filing Trends

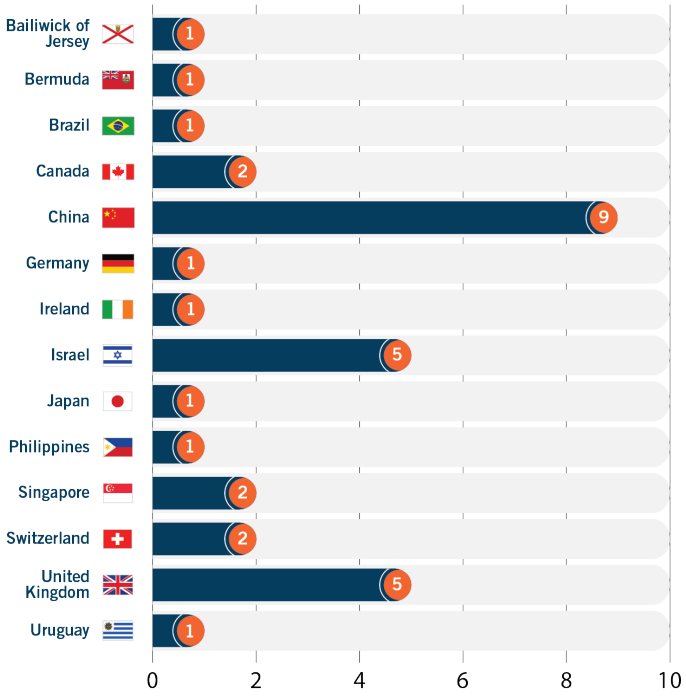
In 2023, the total number of federal securities class actions increased, with 213 cases filed. The percentage of cases filed against non-U.S. issuers held relatively steady. Just under 16% of lawsuits (33 in total) were filed against non-U.S. issuers, a slight drop from 2022 when just over 17% of securities class actions were filed against non-U.S. issuers. As in years past, certain filing trends emerged:

- The Second Circuit, particularly the S.D.N.Y., continued to see the most activity in 2023. With 12 filings in the S.D.N.Y., it was the preferred court for about 36% of all lawsuits brought against non-U.S. issuers in 2023. This share indicates a decrease in S.D.N.Y. filings, down from about 59% in 2022. After the Second Circuit, the Ninth (10), Third (6), Fourth (1), and Fifth (1) Circuits had the next highest numbers of suits filed.
- Most suits were filed against companies headquartered in China (9), the United Kingdom (5), and Israel (5).

Filings by District Court



Filings by Location of Headquarters and/or Principal Place of Business



2 *See* Cornerstone Research, Securities Class Action Filings: 2023 Year in Review, at 1 (2024); Dechert LLP, 2022 Developments in U.S. Securities Fraud Class Actions Against Non-U.S. Issuers, at 2 (2023).

- Of the nine suits filed against Chinese companies, four were filed in the Central District of California ("C.D. Cal."), three were filed in the District of New Jersey ("D.N.J."), one was filed in the S.D.N.Y., and one was filed in the E.D.N.Y.
- Of the five suits filed against United Kingdom-based companies, two were filed in the S.D.N.Y. and one each was filed in the E.D.N.Y., the C.D. Cal., and the District of Maryland.
- Of the five suits filed against Israeli companies, three were filed in the S.D.N.Y. and one each was filed in the D.N.J. and the Western District of Texas.
- Although the suits cover a diverse range of industries, the largest portion of the suits involved (i) the software and programming industry (6)—half of which were filed against Israeli companies; (ii) the biotechnology and drugs industry (4)—all of which were against companies headquartered in different countries; and (iii) the money center banks industry (4) – half of which were filed against companies headquartered in the United Kingdom and half of which were filed against Swiss companies.

Substantive Trends

Misrepresentations and/or Omissions Relating to Regulatory Compliance

In 2023, six cases against non-U.S. issuers alleged misrepresentations relating to regulatory compliance and licensure. Of these cases, one continued a trend from 2022 where the plaintiff alleged that a Chinese company failed to comply with Chinese regulations banning for-profit entities from engaging in after-school tutoring on academic subjects.[3] The complaint asserts that, in July 2021, Chinese authorities issued new regulations commonly referred to as the "Double Reduction."[4]

The Double Reduction prohibits after-school tutoring companies that teach the school curriculum to students from kindergarten through grade nine from making profits, raising capital, or going public.[5]

The complaint, which was filed in the D.N.J. by the Rosen Law Firm, alleges that TAL Education Group ("TAL"), which is incorporated in the Cayman Islands and headquartered in Beijing, misrepresented that it had stopped offering academic courses in compliance with the Double Reduction but, instead, it had just renamed its academic courses to give the impression that they no longer concerned academic subjects.[6] The complaint further alleges that TAL failed to disclose that its revenues depended on violations of the Double Reduction, which posed "a material risk because the Chinese government could put TAL out of business whenever it decided to enforce its laws against TAL."[7] The complaint alleges that on March 14, 2023, a Chinese news outlet published an exposé on TAL's violations, purportedly showing that TAL's "enrichment classes were just academic courses."[8] Following the news report, the complaint alleges that TAL's ADS's, which trade on the New York Stock Exchange, fell 10%.[9]

This lawsuit extends a trend from 2022. In 2022, five complaints, including one against TAL, alleged that the defendant education companies failed to disclose the Double Reduction regulations to investors and had misrepresented the impact of the Double Reduction on their business models.[10]

3 *Lewandowski v. TAL Educ. Grp.*, No. 23-cv-1769, ECF No. 20, ¶ 2 (D.N.J.).

4 *Id.* at ¶¶ 67-68.

5 *Id.* at ¶¶ 4, 70; *see also* Alexandra Stevenson & Cao Li, *China Targets Costly Tutoring Classes. Parents Want to Save Them*, New York Times (Oct. 21, 2021) (discussing China's ban on "private companies that offer after-school tutoring and targeting [of] China's $100 billion for-profit test-prep industry.").

6 *Lewandowski*, ECF No. 20, ¶¶ 23, 145(a).

7 *Id.* at ¶ 145(c).

8 *Id.* at ¶ 14.

9 *Id.* at ¶ 16.

10 *See Dagan Invs. LLC v. First High-Sch. Educ. Grp. Co. Ltd.*, No. 22-cv-3831, ECF No. 52 (S.D.N.Y.); *In re New Oriental Educ. & Tech. Grp. Inc. Sec. Litig.*, No. 22-cv-1014, ECF No. 64 (S.D.N.Y.); *Sun v. Tal Educ. Grp.*, No. 22-cv-1015, ECF No. 82 (S.D.N.Y.); *Haping v. 17 Educ. & Tech. Grp. Inc.*, No. 22-cv-9843, ECF No. 1 (C.D. Cal.); *Zhang v. Gaotu Techedu Inc.*, No. 22-cv-7966, ECF No. 31 (E.D.N.Y.).

On January 19, 2024, TAL moved to dismiss the second amended complaint in the 2022 case, arguing that the plaintiffs failed to allege scienter, an actionable misstatement, or loss causation.[11] On December 15, 2023, TAL moved to dismiss the 2023 action, arguing that the plaintiffs failed to allege scienter or an actionable misstatement.[12] Both motions are scheduled to be fully briefed in March 2024.[13]

Two other cases, both involving issues of regulatory compliance, assert virtually identical claims against two different Chinese companies. The Rosen Law Firm filed both cases eight days apart, with the first against Futu Holdings Ltd. ("Futu") in the D.N.J. and the second against UP Fintech Holding Ltd. ("UP Fintech") in the C.D. Cal.[14] Both companies operate in the financial services industry.[15] Futu is an investment technology company incorporated in the Cayman Islands and based in Hong Kong.[16] It offers digitized financial services, including trade execution, securities lending, and wealth management.[17] Futu trades ADSs on the NASDAQ.[18] UP Fintech is an integrated financial technology company incorporated in the Cayman Islands and based in Beijing.[19] It offers cross-market, multi-product investment experiences for global investors.[20]

The complaints allege that Futu and UP Fintech made materially false and/or misleading statements and/or failed to disclose that: (i) their businesses were illegal insofar as they operated in China because they failed to obtain required securities brokerage licenses; and (ii) they falsely characterized the pertinent licensure laws as ambiguous and uncertain.[21] Specifically, the complaints allege that both companies, despite disclosing in their annual reports that they are *unlicensed* to provide securities brokerage services in China, maintained the licensure requirement was inapplicable to their businesses based on their interpretation of relevant Chinese law.[22] The complaints further allege that Futu and UP Fintech misrepresented the risk of operating their businesses in China without a license.[23]

According to the complaints, the annual reports at issue make clear that Futu and UP Fintech were operating without licenses and could be found in violation of the pertinent licensure requirement, depending on the Chinese government's interpretation and implementation of those laws.[24] For example, UP Fintech's 2019 Annual Report states:

> ***It is possible that authorities in those jurisdictions may take the position that we are required to obtain licenses or otherwise comply with laws and regulations which we believe are not required or applicable to our business activities. If we fail to comply with the regulatory requirements, we may encounter the risk of being disqualified for our existing businesses or being rejected for renewal of our qualifications upon expiry by the regulatory authorities as well as other penalties, fines or sanctions.***[25]

Futu's 2019 Annual Report contains similar warnings.[26] The complaints allege that these warnings were misleading because the pertinent licensure requirements were, in fact, clear and unambiguous.[27]

In both instances, third-party media reports allegedly formed the basis of revealing "the truth." The *Futu* complaint alleges that, on December 30, 2022, a *Wall Street Journal* article reported that the China Securities Regulatory Commission had deemed Futu's unlicensed business in China illegal.[28] On this news, the *Futu* complaint alleges, Futu's ADS's declined by as much as 31% in intra-day trading.[29]

11 *See Sun*, ECF No. 86.
12 *See Lewandowski*, ECF No. 29.
13 *See Sun*, ECF No. 80; *Lewandowski*, ECF No. 22.
14 *See Henry v. Futu Hldgs. Ltd.*, No. 23-cv-3222, ECF No. 36 (D.N.J.); *Burns v. UP Fintech Hldgs. Ltd.*, No. 23-cv-4842, ECF No. 1 (C.D. Cal.).
15 *See Henry*, ECF No. 36, ¶ 16; *See Burns*, ECF No. 1, ¶ 7.
16 *See Henry*, ECF No. 36, ¶ 16.
17 *Id.* at ¶¶ 16, 21.
18 *Henry*, ECF No. 36, ¶ 16.
19 *Burns*, ECF No. 1, ¶ 8.
20 *Id.* at ¶ 7.
21 *Henry*, ECF No. 36, ¶¶ 3, 7; *Burns*, ECF No. 1, ¶ 49.
22 *Henry*, ECF No. 36, ¶ 76; *Burns*, ECF No. 1, ¶ 17.
23 *Henry*, ECF No. 36, ¶ 38; *Burns*, ECF No. 1, ¶ 18.
24 *See, e.g.*, *Henry*, ECF No. 36, ¶¶ 46, 48; *Burns*, ECF No. 1, ¶ 17.
25 *Burns*, ECF No. 1, ¶ 17.
26 *See, e.g.*, *Henry*, ECF No. 36, ¶ 46.
27 *See, e.g.*, *Henry*, ECF No. 36, ¶¶ 3-4, 48; *Burns*, ECF No. 1, ¶ 18.
28 *Henry*, ECF No. 36, ¶ 80.
29 *Id.* at ¶ 81.

The *UP Fintech* complaint alleges that UP Fintech faced the same fate on the same date—December 30, 2022—when *Reuters* published an article titled "China regulator asks Futu and UP Fintech to Stop Soliciting Mainland Clients" and the *Wall Street Journal* published an article titled "China Regulator Says Futu, UP Fintech Violated Law."[30] The *UP Fintech* complaint alleges that UP Fintech shares fell 28.5% on the date both articles were published.[31]

Although the plaintiffs filed virtually identical complaints, the D.N.J. litigation is forging ahead at a faster pace. The plaintiffs filed an amended complaint in the *Futu* action on January 16, 2024, and a motion to dismiss that amended complaint will be fully briefed in May 2024.[32] The C.D. Cal. appointed a lead plaintiff and lead counsel in the *UP Fintech* suit on January 30, 2024.[33]

The three remaining regulatory compliance cases assert claims against companies headquartered in Israel, Uruguay, and China. In *City of Omaha Police and Firefighters Retirement System v. Cognyte Software Ltd.,* the amended complaint alleges that Cognyte Software Ltd., an Israeli security analytics software company, made material misrepresentations and failed to disclose that it was noncompliant with various laws in several jurisdictions, which prohibit the sale of cyber surveillance technologies to nations that use them to violate individual and human rights.[34] *In Francis v. DLocal Ltd.,* the complaint alleges that DLocal Ltd., a Cayman-incorporated and Uruguay-based company operating a worldwide payment processing platform, failed to disclose that it was noncompliant with Argentine laws and regulations concerning the exchange of foreign currencies.[35] And in *Fernandez v. DouYu International Holdings Ltd.,* the complaint alleges that DouYu International Holdings Ltd., a Cayman-incorporated, Chinese company operating a livestreaming platform, made material misrepresentations and failed to disclose that it was noncompliant with Chinese laws against organized gambling and pornography.[36] In each case, the complaint alleges that the company failed to disclose the significant risk of increased regulatory scrutiny or penalties associated with noncompliance.[37]

30 *Burns*, ECF No. 1, ¶¶ 54–55.
31 *Id.* ¶ 56.
32 *See Henry,* ECF Nos. 32, 36.
33 *See Burns*, ECF No. 56.
34 No. 23-cv-1769, ECF No. 52, ¶¶ 2, 45 (S.D.N.Y.).
35 No. 23-cv-7501, ECF No. 1, ¶¶ 2, 15 (E.D.N.Y.).
36 No. 23-cv-3161, ECF No. 39, ¶¶ 2, 4–5 (D.N.J.).
37 *See City of Omaha Police & Firefighters Ret. Sys.*, ECF No. 52, ¶ 45; *Fernandez*, ECF No. 39, ¶ 4; *Francis*, ECF No. 1, ¶ 3.

Cases Against Other Non-U.S. Issuers Involved a Wide Variety of Misrepresentations and/or Omissions

Among other non-U.S. issuers, shareholders made a variety of claims against businesses in different industries.

Five fintech companies faced suits, two of which concerned the cryptocurrency market's volatility. In *Hawes v. Argo Blockchain, plc,* the complaint alleges that Argo Blockchain, plc ("Argo"), a UK-based cryptocurrency mining company, misrepresented that it could "control and manage the volatility of cryptocurrency pricing" before it "announced desperate strategic initiatives to maintain solvency."[38] The amended complaint alleges that when "[t]he truth began to leak out" that Argo was "severely undercapitalized," its stock first dropped about 4% on June 7, 2022, then 23% on October 7, 2022, and finally 11% on October 11, 2022.[39]

Similarly, in *Mislav Basic v. BProtocol Foundation,* the complaint alleges that BProtocol Foundation ("BProtocol"), an Israeli company operating an automated platform for trading crypto assets, misrepresented material risks and features associated with its "impermanent loss protection" program, which the complaint describes as "insurance against . . . losses incurred by investing crypto assets . . . rather than simply holding them."[40] The complaint alleges that the impermanent loss protection program "generated serious deficits" because the fees generated by the platform were insufficient to cover BProtocol's obligations to its investors.[41] If "a sufficiently large number" of investors withdrew their investments at the same time, the complaint alleges that the platform "would crumble, much like a run on [a] bank."[42] The complaint alleges that on June 19, 2022, BProtocol's "luck ran out: a spike in withdrawals triggered significant payment obligations" to investors and "[i]nstead of making those payments, Defendants unilaterally purported to 'suspend' impermanent loss protection, which meant that withdrawing [investors] incurred 100% of the very losses that Defendants had promised to '100% protect' against."[43]

Pharmaceutical and biotechnology companies based outside the U.S. also faced U.S. securities litigation, with three of those suits concerning companies focused on cancer research. Plaintiffs sued Myovant Sciences Ltd. ("Myovant"), a biopharmaceutical company that developed and commercialized a drug to treat prostate cancer, in relation to its merger with Sumitovant Bipharma Ltd. and its parent company, Sumitomo Pharma Co., Ltd. ("Sumitomo").[44] The complaint alleges that Myovant's proxy statement concerning the merger contained material misrepresentations and omissions.[45] In particular, the complaint alleges that the proxy stated that the special committee formed by Myovant's board of directors had retained a law firm to negotiate the merger because it had no conflicts, but that firm allegedly had multiple conflicts, such as its concurrent representation of other Sumitomo entities.[46] The S.D.N.Y. dismissed the Myovant litigation with prejudice in December 2023 "because it fail[ed] to plausibly allege a materially false or misleading statement or omission."[47] The plaintiffs filed a notice of appeal on January 24, 2024.[48]

In sum, the cases filed against non-U.S. issuers in 2023 demonstrated a broad array of alleged misrepresentations and/or omissions across various industries, underscoring the diverse nature of shareholder claims in this area.

38 No. 23-cv-7305, ECF No. 45, ¶¶ 1, 23, 76–77 (S.D.N.Y.) (quotations omitted).
39 *Id.* ¶¶ 10-16.
40 No. 23-cv-533, ECF No. 37, ¶¶ 6, 8 (W.D. Tex.) (quotations omitted).
41 *Id.* ¶ 7.
42 *Id.*
43 *Id.* ¶ 13.
44 *Zappia v. Myovant Scis. Ltd.*, No. 23-cv-8097, ECF No. 19, ¶¶ 2–3 (S.D.N.Y.).
45 *Id.* ¶ 9.
46 *Id.* ¶¶ 9–10.
47 *Zappia*, ECF No. 36 at 2.
48 *Zappia*, ECF No. 41; *see also Zappia v. Myovant Scis. Ltd.*, No. 24-253 (2d Cir.).

Motion to Dismiss Decisions

In 2023, courts issued decisions resolving 18 motions for dismissal of securities class actions against non-U.S. issuers filed in 2022 and 2021. Of those 18 decisions, 16 granted dismissal of the complaint in its entirety (10 with prejudice and six without prejudice), and two granted dismissal in part, allowing a portion of the claims to continue into discovery. Seven decisions were dispositive, resulting in closing the case with no motion for reconsideration or pending appeal.

Of the 18 decisions in 2023, 12 were issued by the S.D.N.Y., followed by five in the E.D.N.Y. and one in the Eastern District of Virginia. The Rosen Law Firm represents the plaintiffs in both cases that will proceed to discovery in part.[49] The number of dispositive decisions—seven—decreased by two from nine dispositive decisions in 2022.

The courts' reasoning for dismissing these cases is instructive for non-U.S. issuers. In 2023, as in 2022, the primary reason courts dismissed complaints was because the plaintiffs failed to allege an actionable misstatement or omission, though courts also found that the plaintiffs failed to allege a strong inference of scienter. Of the 18 decisions, 12 determined that the plaintiffs had failed to allege an actionable misstatement or omission and seven determined that the plaintiffs had failed to allege a strong inference of scienter. Four courts relied on both determinations to conclude that the plaintiffs had failed to state a claim for relief.

Four Decisions Concerned After-School Tutoring Companies in China

Of the 18 decisions in 2023, four concerned education companies incorporated in the Cayman Islands but operating in China in the after-school tutoring industry.[50] The operative complaints at issue in these decisions alleged that the companies failed to make adequate disclosures and/or made material misstatements with respect to China's regulations on the industry, *i.e.*, the Double Reduction.[51]

49 *See Chen v. Missfresh Ltd.*, No. 23-cv-9836 (S.D.N.Y.); *Hill v. Tenet Fintech Grp. Inc.*, No. 21-cv-6461 (E.D.N.Y.).

50 *See Sun*, ECF No. 78, at 3; *Dagan Invs. LLC*, ECF No. 52, at ¶ 19; *Haping*, ECF No. 69, at 2; *Banerjee v. Zhangmen Educ. Inc.*, No. 21-cv-9634, ECF No. 47, at 2 (S.D.N.Y.).

51 *See Sun*, ECF No. 78, at 12–36; *Dagan Invs. LLC*, ECF No. 62, at 2–4; *Haping,* ECF No. 69, at 4-13; *Banerjee*, ECF No. 47, at 2–8.

Three of these four decisions were dispositive, resulting in closing the case with no motion for reconsideration or pending appeal.[52] All three decisions hinged on a determination that the amended complaint failed to plead an actionable misstatement or omission.[53]

For example, in *Dagan Investments, LLC v. First High-School Education Group Co. Ltd.,* the operative complaint alleged that First High-School Education Group Co., Ltd. ("FHS") made actionable misstatements in its registration statement with respect to relevant Chinese regulations because it "failed to warn investors that the new regulations . . . were far more severe than represented and posed a material adverse threat to the Company and its business."[54] FHS moved to dismiss, arguing that the operative complaint had "not plausibly allege[d] a material misstatement or omission."[55]

In resolving that motion, the S.D.N.Y. noted that "[a] n omission is actionable 'only when the [defendant] is subject to a duty to disclose the omitted facts.'"[56] The court determined that, at the time that the registration statement was published, the defendants "had no duty to disclose the imminent regulations and their effect on the Company's business" because the adverse regulations were announced after the registration statement became effective.[57] The court therefore reasoned that "the defendants cannot be liable for failing to predict with certitude what changes Chinese lawmakers would make to the relevant regulations."[58] Additionally, the court found that "the defendants did, in fact, disclose the risks that were known to them" at the time they published the registration statement.[59] The "Risk Factors" section of the registration statement plainly stated that: "uncertainties exist in relation to new legislation or proposed changes in [China's] regulatory requirements regarding private education, which may materially and adversely affect [FHS's] business, financial condition and results of operation."[60]

The court also determined that, even if the operative complaint had adequately pled a misstatement or omission, those misstatements or omissions were immaterial "because the information was readily available in the public domain."[61] The court stated that "[a] misstatement or omission qualifies as material where there is a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available."[62] The operative complaint specifically alleged that before the defendants published the registration statement, various public, widely accessible news outlets were reporting on the imminent adverse regulations in English.[63]

Finally, the court held that the plaintiffs' claims were barred by the statute of limitations because the news reports, which should have put the plaintiffs on notice of the alleged violations underlying their securities claims, were published before the registration statement became effective and before the initial public offering.[64] Therefore, "the plaintiffs knew or should have known of their claims as soon as the Registration Statement become [sic] effective," not over one year after that date when plaintiffs initiated the action.[65] For all of these reasons, the court dismissed the operative complaint with prejudice and closed the case.[66]

One decision—*Sun v. Tal Education Group*—turned on the issue of scienter and resulted in dismissal *without* prejudice.[67] There, the plaintiffs alleged that TAL made more than 50 materially false and misleading statements and omissions regarding, inter alia, TAL's adherence to Chinese regulations governing the after-school tutoring industry, its ability to comply with Chinese regulations, and the impact of those regulations on its business.[68]

52 *See Dagan Invs. LLC*, ECF No. 62; *Haping,* ECF No. 74; *Banerjee*, ECF No. 48.
53 *Dagan Invs. LLC*, ECF No. 62, at 14; *Haping,* ECF No. 69, at 19; *Banerjee*, ECF No. 47, at 19, 23–24.
54 *Dagan Invs. LLC*, ECF No. 62, at 8 (quotation omitted).
55 *Id.* at 7.
56 *Id.* (quoting *In re Time Warner Inc. Sec. Litig.*, 9 F.3d 259, 267 (2d Cir. 1993)).
57 *Id.* at 8-9.
58 *Id.* at 9.
59 *Id.*
60 *Id.* (quotation omitted).
61 *Id.* at 13.
62 *Id.* (quotations and citations omitted).
63 *Id.* at 13-14.
64 *Id.* at 15-16.
65 *Id.* at 15-16.
66 *Id.* at 16.
67 *Sun*, ECF No. 78, at 54, 57.
68 *Id.* at 17.

The S.D.N.Y. determined that the amended complaint failed to allege a strong inference of scienter based on either (1) a motive and opportunity to commit fraud, or (2) circumstantial evidence of conscious misbehavior or recklessness.[69]

The plaintiffs argued that the individual defendants were motivated to issue false statements to sell their common stock at artificially inflated prices.[70] But the court determined that the alleged trading was not inherently suspicious because it occurred more than a month prior to the corrective disclosures.[71] Additionally, the court noted that the plaintiffs failed to allege either what portion or percentage of the defendants' stockholdings were sold or the defendants' net profits from those sales, and, as such, they failed to allege suspicious or unusual trading.[72]

The plaintiffs also attempted to plead scienter based on the alleged disclosures of a confidential witness.[73] According to the amended complaint, the confidential witness, "a deputy head and deputy general manager responsible for government relations," disclosed that TAL's senior executives were aware that stringent regulations were forthcoming months before the Chinese government formally issued the regulations in July 2021.[74] The court determined, however, that the complaint failed to allege with sufficient particularity that "a person in the position occupied by the source would possess the information alleged" because the confidential source was "not alleged to have had any personal interaction with TAL's top executives."[75] The court noted that, "[i]n the absence of direct personal contact between the confidential witness[] and the Individual Defendants, Plaintiffs must demonstrate scienter by other means."[76]

Finally, the plaintiffs argued that the amended complaint adequately pled scienter based on the "core-operations doctrine."[77] "Under the 'core operations' doctrine, a court may infer that a company and its senior executives have knowledge of information concerning the core operations of a business,' such as 'events affecting a significant source of income."[78] But the court noted that courts in the Second Circuit "generally treat core operations allegations as providing supplementary but not independently sufficient means to plead scienter."[79] The court therefore held that the core operations doctrine could not save the plaintiffs' claims, where they had failed to allege facts independently sufficient to plead scienter.[80] Accordingly, the court dismissed the operative complaint without prejudice.[81] TAL's success on this motion will likely inform its approach in moving to dismiss the plaintiff's second amended complaint.

Two Decisions Resulted in Partial Dismissals

Two decisions granted in part and denied in part a motion to dismiss by a non-U.S. issuer, therefore allowing a portion of the claims to proceed to discovery.[82]
In *Chen v. Missfresh Ltd.,* Missfresh Ltd. ("Missfresh"), a Chinese technology company that sold groceries in China through its mobile application, moved to dismiss the amended complaint against it in its entirety.[83]
The operative complaint alleged that Missfresh (1) overstated its net revenues and sales through its online platforms for the quarter immediately preceding its initial public offering ("IPO") by approximately 10%, (2) failed to disclose certain internal control deficiencies in its accounting processes, and (3) failed to disclose that Missfresh's business model was fundamentally unsustainable at the time of the offering.[84] Because of the alleged instability, over a year after the IPO, "Missfresh was forced to shut down its distributed mini warehouse delivery business and next-day delivery business, which collectively accounted for over 90% of the company's revenue."[85]

The S.D.N.Y. denied Missfresh's motion to dismiss

69 *Id.* at 54.
70 *Id.* at 44.
71 *Id.* at 46.
72 *Id.* 46–47.
73 *Id.* at 48, 52.
74 *Id.* at 48.
75 *Id.* at 49.
76 *Id.* at 50 (quotation omitted).
77 *Id.* at 53.
78 *Id.* (quotation omitted).
79 *Id.* (quotation omitted).
80 *Id.*
81 *Id.* at 57.
82 *See Chen v. Missfresh Ltd.*, No. 22-cv-9836, ECF No. 79 (S.D.N.Y.); *Handal v. Tenet Fintech Grp. Inc.*, No. 21-cv-6461, ECF No. 40 (E.D.N.Y.).
83 *Chen*, ECF No. 79, at 2.
84 *Id.* at 1-2.
85 *Id.* at 2.

with respect to the first set of claims, but granted the motion with respect to the second and third sets of claims.[86] With respect to the first set of claims, the court noted that Missfresh acknowledged that it overstated the company's net revenues and sales through online platforms for the first quarter of 2021 by over 11% each.[87] Despite this acknowledgement, Missfresh argued that its misstatements were not actionable because (1) "the overstatement of revenue was not material because it was offset by misstated costs of equal amount"; (2) "the offering documents disclosed that Missfresh's internal controls might be deficient such that an accounting restatement could be required"; and (3) the plaintiffs failed to allege "loss causation because the company's stock price had already declined precipitately after the IPO for unrelated reasons."[88] The court rejected all three of these arguments.[89]

First, the court determined that, based on SEC Staff Account Bulletin 99, if a registrant's revenues "are materially overstated, the financial statements taken as a whole will be materially misleading even if the effect on earnings is completely offset by an equivalent overstatement of expenses."[90] Second, the court noted that, to the extent Missfresh was seeking to rely on the "bespeaks caution" doctrine based on its warnings with respect to its internal controls, the argument must fail because "[t]he bespeaks caution doctrine only applies to forward-looking statements, not historical financial results."[91] The court further noted that Missfresh had "an affirmative duty to accurately report its financial results" and it could not "avoid that affirmative duty by warning that the information they were providing may be inaccurate."[92] Third, the court noted that to obtain dismissal based on the absence of loss causation, Missfresh would have to prove that the alleged misrepresentation had no price impact at all, and the court found that this defense could not be resolved on a motion to dismiss.[93]

For these reasons, the court denied the motion to dismiss with respect to the alleged overstatement of the company's revenues and sales. The court, however, granted the motion to dismiss as to the second and third sets of claims because "the company disclosed the internal control deficiencies it had identified to date, the possibility it would identify more, and the negative impact

86 *Id.*
87 *Id.* at 11.
88 *Id.*
89 *Id.*
90 *Id.* at 15 (quotation omitted).
91 *Id.* at 16 (citation omitted).
92 *Id.* at 17.
93 *Id.* at 20.

those deficiencies could have on the company."[94] The court therefore concluded that the voluntary disclosures concerning Missfresh's internal controls and instability were not misleading.[95] Although those claims were dismissed, the claims related to an overstatement of revenues and sales continue to discovery.[96]

In *Handal v. Tenet Fintech Group Inc.*, the E.D.N.Y. granted in part and denied in part a motion to dismiss by Tenet Fintech Group Inc. ("Tenet"), a Canadian company operating primarily in China in the IT portfolio-management industry.[97] There, the operative complaint alleged that Tenet, its CEO, and its CFO materially misstated in Tenet's registration statement that it was in the process of acquiring, had acquired, or would acquire ownership stakes in three entities, including a Chinese company operating a popular financial lending application and a Chinese company operating an insurance product management and brokerage platform.[98] A short seller report formed the basis of the plaintiffs' operative complaint.[99]

The court denied Tenet's motion to dismiss count one of the amended complaint, alleging a violation of Section 11 of the Securities Act, which prohibits materially misleading statements or omissions in registration statements filed with the SEC.[100] The court also denied in part Tenet's motion to dismiss count two of the amended complaint, alleging a violation of Section 15 of the Securities Act, which establishes control person liability for violations of Section 11.[101] The court found that the amended complaint adequately pled control for the CEO, who had signed the registration statement, but it had not adequately pled control for the CFO, who had not signed the registration statement, because the amended complaint included only "boilerplate allegations to establish that the [CFO] was a control person of Tenet."[102] The court found that those boilerplate allegations were insufficient to allege Section 15 control.[103]

The court granted the motion to dismiss in all other respects, finding that the operative complaint had failed to plead scienter for all but one of the misstatements and, for the one remaining misstatement, the operative complaint failed to allege that the plaintiffs relied upon it in purchasing Tenet's shares because the lead plaintiffs purchased their shares *before* that one actionable misstatement.[104] The court also noted that courts in the Second Circuit do not assume that OTC markets are efficient for purposes of demonstrating reliance.[105] For these reasons, the court granted Tenet's motion to dismiss the plaintiffs' claims under 10(b) of the Exchange Act, Rule 10b-5, and Section 20(a) of the Exchange Act.[106]

These two cases proceeding to discovery show that material misstatements related to revenues, sales, and business ownership may survive a motion to dismiss in the Second Circuit.

94 *Id.* at 34.
95 *Id.* at 29.
96 *Id.* at 2.
97 *Handal*, ECF No. 40, at 2.
98 *Id.* at 1, 5–6.
99 *Id.* at 4–5.
100 *Id.* at 10, 19–20.
101 *Id.* at 21–22.
102 *Id.* at 21.
103 *Id.*
104 *Id.* at 35-37.
105 *Id.* at 37.
106 *Id.* at 38.

Conclusion

Although the overall number of securities class actions increased in 2023, the proportion of cases against non-U.S. issuers has remained relatively unchanged. The filings make clear that a company does not need to be based in the United States to face potential securities class action liability in U.S. federal courts. Accordingly, it is imperative that non-U.S. issuers take steps to mitigate their risks in not only their home jurisdictions but also in the United States.

Non-U.S. issuers should be particularly cognizant when making disclosures or statements to:

- ensure compliance with regulatory requirements;
- speak truthfully and disclose both positive and negative results;
- ensure that a disclosure regimen and processes are well-documented and consistently followed;
- work with counsel to ensure that a disclosure plan is adopted that covers disclosures made in press releases, SEC filings, and by executives; and
- understand that companies are not immune to issues that may cut across all industries.

Non-U.S. issuers should work with the company's insurers and hire experienced counsel who specialize in and defend securities class action litigation on a full-time basis. Finally, to the extent that a non-U.S. issuer finds itself the subject of a securities class action lawsuit, the bases upon which courts have dismissed similar complaints in the past can be instructive.

Key Contacts

Joni S. Jacobsen
Partner | Chicago | New York
+1 312 646 5813 | +1 212 698 3500
joni.jacobsen@dechert.com

David H. Kistenbroker
Partner | Chicago | New York
+1 312 646 5811 | +1 212 698 3500
david.kistenbroker@dechert.com

Angela M. Liu
Partner | Chicago | New York
+1 312 646 5816
angela.liu@dechert.com

Christopher J. Merken
Associate | Philadelphia
+1 215 994 2380
christopher.merken@dechert.com

Julia M. Curley
Associate | Philadelphia
+1 215 994 2402
julia.curley@dechert.com

03.11.24