

<b>Jianming Jyu v Ruhnn Holdings Ltd.</b>
2020 NY Slip Op 31541(U)
April 22, 2020
Supreme Court, New York County
Docket Number: Index No. 655420/2019
Judge: Jennifer G. Schecter
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**SUPREME COURT OF THE STATE OF NEW YORK  
NEW YORK COUNTY**

PRESENT: HON. JENNIFER G. SCHECTER PART IAS MOTION 54EFM

*Justice*

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JIANMING LYU,

Plaintiff,

- V -

RUHNN HOLDINGS LIMITED, MIN FENG, LEI SUN, CHAO SHEN, ZHENBO CHI, KE CHENG, SHEK TING, FENGCHUN JIN, SHANGZHEN LI, ZHENXING SHAO, PEN TUNG, JUNHONG QI, XIAOCAO XU, CITIGROUP GLOBAL MARKETS INC., UBS SECURITIES LLC, TOP CAPITAL PARTNERS LIMITED,

**DECISION & ORDER ON  
MOTION**

Defendants.

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The following e-filed documents, listed by NYSCEF document number (Motion 001) 13, 14, 15, 16, 17, 18, 21, 22, 23, 24, 25, 26, 27, 28

were read on this motion to

DISMISS

Defendants Citigroup Global Markets Inc., UBS Securities LLC (collectively, the Underwriters), and Ruhnn Holding Limited (Ruhnn or the Company) move to dismiss the complaint. Plaintiff Jianming Lyu opposes the motion. The motion is granted in part.

**Background**

The facts drawn from the complaint and the documentary evidence, for purposes of this motion, are accepted as true.

This putative class action under sections 11 and 12(a)(2) of the Securities Act of 1933 (the 1933 Act) is principally based on an omission in the offering materials issued in connection with Ruhnn's initial public offering (the IPO). Ruhnn "describes itself as China's largest key opinion leader ("KOL") facilitator and largest KOL facilitator in

China's e-commerce market" (Complaint ¶ 21).<sup>1</sup> Ruhnn's "KOLs provide marketing services both to Ruhnn-owned-and-operated brands and stores and to Ruhnn's third-party customers" (¶ 22). Plaintiff explains that:

The majority of these online stores are located or hosted on third-party e-commerce platforms and are operated and marketed in the name of Ruhnn's KOLs. **As of December 31, 2018, Ruhnn purportedly owned and operated 91 online stores.** Ruhnn earns revenue from these product sales by taking a percentage of the sales price at the time the product is sold. The Company's full-service model is its largest and most important operating segment, **accounting for over 88% of Ruhnn's total net revenues** for the nine months ended December 31, 2018 (*id.* [emphasis added]).<sup>2</sup>

"The Company also derives revenue from its service business, which Ruhnn refers to as its 'platform model'" (¶ 23). Ruhnn "launched its platform model in 2017 to market its KOLs and KOL services to third parties, such as brands, retailers, designers, and manufacturers. As of December 31, 2018, Ruhnn claimed to have over 500 customers using its platform services. Ruhnn earns fees for these services under a variety of arrangements" (*id.*).

On March 6, 2019, Ruhnn filed a registration statement with the SEC in anticipation of its IPO, which, as amended, was declared effective on April 2, 2019 (¶ 24; *see* Dkt. 17

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<sup>1</sup> "So-called KOLs are essentially social media influencers, i.e., individuals who create content on social media platforms such as Facebook, YouTube, Tik Tok, and Instagram with the hope of garnering a large public following. As a purported KOL facilitator, Ruhnn contracts with social media influencers who are paid to promote, market, and advertise products and services to their fans and followers. Ruhnn claims to recruit, train, and manage KOLs and provide them with analytical support. The Company describes such activities as 'incubating' KOLs. Ruhnn's KOLs primarily market women's apparel, cosmetics, shoes, handbags, and other fashion products on social media platforms popular in China, such as Miaopai, Tik Tok, and Kuaishou" (Complaint ¶ 21).

<sup>2</sup> Ruhnn's fiscal year ends on March 31 (*see* ¶ 22 n 1).

[the Registration Statement]). The following day, on April 3rd, Ruhnn filed its prospectus (see Dkt. 28 [the Prospectus; collectively with the Registration Statement, the Offering Materials]). The IPO occurred that same day (see ¶ 1).

Plaintiff purchased Ruhnn's American Depository Shares (the ADS) in or traceable to the IPO (¶ 5). Plaintiff complains that the ADS traded at 73% below the IPO price after Ruhnn disclosed, on June 14, 2019, that it had closed nearly 40% of its stores prior to the IPO in the fiscal quarter ending March 31, 2019, with only 56 of the 91 stores remaining open as of the IPO date (see ¶ 34). Ruhnn further revealed poor financial results:

product sales had **fallen** 46% sequentially and grown by a meager 1.4% year over year. At the same time, the results the Company reported in its service platform business were entirely eclipsed by the meager growth in the full-service product sales business. Revenue from platform services was \$7.5 million and \$22 million for the quarter and fiscal year, respectively, versus \$28 million and \$140 million in product sales for the quarter and year. Gross margin across the Company's revenue streams had also **declined** 80 basis points year over year, reflecting the Company's failure to approach profitability, as its most important operating segment, its full-service segment, had suffered a significant contraction prior to the IPO (*id.*).

In September 2019, plaintiff commenced this putative class action asserting claims based on violations of sections 11 and 12(a)(2) of the 1933 Act against all defendants and section 15 (control-person liability) against the individual defendants.<sup>3</sup> Ruhnn and the Underwriters move to dismiss urging that the alleged omission about the store closures is immaterial based on disclosures in the Offering Materials expressing a shift away from the full-service model to the platform model as the primary generator of revenue. They argue

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<sup>3</sup> Plaintiff also claims violations of SEC regulations, specifically items 105 and 303 of Regulation S-K (see ¶ 33).

that the store closures were part of that shift and that the revenue decline resulted from other factors such as a known holiday seasonal shopping slowdown and the trade war between the United States and China. Ruhnn further contends that it is not a statutory seller and is therefore not subject to liability under § 12(a)(2).

### **Discussion**

#### Legal Standard

On a motion to dismiss, the court must accept as true the facts alleged in the complaint and all reasonable inferences that may be gleaned from them (*Amaro v Gani Realty Corp.*, 60 AD3d 491 [1st Dept 2009]). The court cannot assess the merits of the complaint or any of its factual allegations, but may only determine if, assuming the truth of the facts alleged and the inferences that can be drawn from them, the complaint states the elements of a legally cognizable cause of action (*Skillgames, LLC v Brody*, 1 AD3d 247, 250 [1st Dept 2003], citing *Guggenheimer v Ginzburg*, 43 NY2d 268, 275 [1977]). If dismissal is sought based on documentary evidence, the motion will succeed only if that “evidence utterly refutes plaintiff’s factual allegations, conclusively establishing a defense as a matter of law” (*Goshen v Mutual Life Ins. Co. of N.Y.*, 98 NY2d 314, 326 [2002]; *Leon v Martinez*, 84 NY2d 83, 88 [1994]).

#### 1933 Act Claims

“Section 11 of the (1933 Act) imposes liability on issuers and other signatories of a registration statement that, upon becoming effective, contains an untrue statement of a material fact or omit[s] to state a material fact required to be stated therein or necessary to make the statements therein not misleading” (*Litwin v Blackstone Group, L.P.*, 634 F3d

706, 715 [2d Cir 2011]; *see* 15 USC § 77k[a]). An omission is material if 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” (*Basic Inc. v Levinson*, 485 US 224, 231-32 [1988]). Materiality is ordinarily a question of fact that cannot be determined on a motion to dismiss (*In re Morgan Stanley Info. Fund Sec. Litig.*, 592 F3d 347, 359 [2d Cir 2010]).

These same principles apply pursuant to section 12 of the 1933 Act to the liability of an offeror or seller of securities in connection with statements in a prospectus.

In moving to dismiss because there was no material omission, defendants rely on statements in the Offering Materials that purport to fully disclose the shift away from the full-service to the platform model. In reality, however, the disclosures communicate the expectation that the platform model would grow and perhaps overshadow the full-service model (*see* Dkt. 28 at 7 [“This new model allows us to operate in a more asset-light manner and collaborate with a greater number and variety of KOLs and brands”], 88 [“we expect our service revenues under our platform model to increase in absolute amount and as a percentage of our total revenues in the near future”], 98 [“We ceased sales of *certain brands* of apparel and cosmetic products in the full-service model in fiscal year 2019 and transformed *such business* into the platform model”] [emphasis added]).

Ruhnn did *not* state that it expected to substantially reduce existing full-service business or, much more importantly, that at the effective date of the Offering Materials, it had already closed nearly 40% of its stores. Nor did Ruhnn speak about the immediate or potential financial impact of that decision. Instead, in April 2019, it chose to disclose that

it had 91 stores as of December 31, 2018 (*see id.* at 4)--highlighting that the amount of stores could be a factor important to an investor--without revealing that the number had already decreased to 56 prior to the IPO, was trending downward and was not simply being reduced relatively by the growing platform model.<sup>4</sup> Ruhnn certainly stated that there was a “slower growth” of product sales due to a decrease in “the number of KOLs serving the full-service model” and that “the number of orders . . . fulfilled decreased” (*see id.* at 98). This speaks to the percentage of KOLs using the full-service model, but not a decrease in the number of overall stores or store sales. Indeed, Ruhnn touted that “sales of . . . self-designed products on our online stores **continued to grow** as a result of the booming internet KOL e-commerce economy in China,” which does not in any way suggest massive store closures even if the Company ceased sales of certain products (*see* Dkt. 28 at 98 [emphasis added]). Disclosure of the existence of 91 online stores at the end of 2018 is arguably misleading under the circumstances because investors are entitled to accurate material information at the time of the IPO and there were much fewer stores--only 56--operating then.<sup>5</sup>

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<sup>4</sup> Even if Ruhnn did not have the affirmative obligation to disclose the number of stores, once it chose to do so, it had the obligation not to do in a misleading manner (*Meyer v Jinkosolar Holdings Co.*, 761 F3d 245, 250 [2d Cir 2014] [“Even when there is no existing independent duty to disclose information, once a company speaks on an issue or topic, **there is a duty to tell the whole truth**”] [emphasis added]; *see Morgan Stanley*, 592 F3d at 366 [“The literal truth of an isolated statement is insufficient; the proper inquiry requires an examination of defendants’ representations, taken together and in context. Thus, when an offering participant makes a disclosure about a particular topic, whether voluntary or required, the representation must be complete and accurate”]).

<sup>5</sup> To be sure, a reasonable investor may have been put on notice that, in the long run, stores were going to account for less revenue than the nearly 90% they had in the past. But that does not indicate that many online stores were closing or had been already closed. In any event, it is not the case that only long-term concerns are material. The whole point of the 1933 Act’s disclosure

Here, plaintiff has plausibly alleged that a reasonable investor would care about Ruhnn's significant store closures in deciding whether to invest. Whether Ruhnn had other problems after June 2019 that led to its stock price's decline requires analysis of loss causation and is not subject to resolution at this early pleadings stage (*see In re Facebook, Inc. IPO Sec. & Derivative Litig.*, 986 F Supp 2d 487, 523 [SDNY 2013]; *In re Fuwei Films Sec. Litig.*, 634 F Supp 2d 419, 444 [SDNY 2009]). All that matters now is whether the omitted information definitively would not have significantly altered the total mix of information. Based on the pleadings and the documentary evidence, the court is not convinced (*see ECA, Local 134 IBEW Joint Pension Trust of Chicago v JP Morgan Chase Co.*, 553 F3d 187, 197 [2d Cir 2009] [“a complaint may not properly be dismissed ... on the ground that the alleged misstatements or omissions are not material unless they are so obviously unimportant to a reasonable investor that reasonable minds could not differ on the question of their importance”]). All inferences must be drawn in plaintiff's favor at this point and the court cannot conclude, as a matter of law, that the store closures didn't matter (*see* Dkt. 14 at 8-9, 12-17; *Kolchins v Evolution Markets, Inc.*, 31 NY3d 100, 106 [2018]).<sup>6</sup>

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requirements is to ensure that investors are aware of all material facts when they invest so that they can make an informed decision about investing long or short term.

<sup>6</sup> Defendants' argument that plaintiff has not alleged a violation of Regulation S-K, which is based on their contention that disclosures were adequate, is rejected. Additionally, there is no basis for dismissal based on a heightened pleading standard. Even if CPLR 3016(b) applied--and New York courts have recently concluded that it does not (*see Matter of Netshoes Sec. Litig.*, 64 Misc 3d 926, 930-31 [Sup Ct, NY County 2019]; *Matter of PPDAI Group Sec. Litig.*, 66 Misc 3d 1226[A] [Sup Ct, NY County 2020])--plaintiff does not allege fraud and there is nothing conclusory about the misrepresentation allegations. Defendants' motion itself makes plain that they have been clearly

### Section 12 Claims Against Ruhnn

Section 12 of the 1933 Act only imposes liability on one who “offers or sells a security” (15 USC § 77l[a][2]). It requires that a defendant be more than a mere participant in a securities transaction. A defendant must be a “statutory seller”—one who either actually passes title to the purchaser for value or who successfully solicits the purchase of securities “motivated at least in part by a desire to serve his own financial interests or those of the securities owner” (*Pinter v Dahl*, 486 US 622, 642, 647 [1988]).

It is undisputed that this was a firm-commitment underwriting. Ruhnn did not pass title to plaintiff; the Underwriters did. Plaintiff, moreover, does not even allege how Ruhnn may have actually solicited the purchase (Complaint ¶ 55 [“the defendants named herein promoted and sold Ruhnn ADSs to plaintiff”]; *see In Re Violin Memory Sec. Litig.*, 2014 WL 5525946, at \*19 [ND Cal Oct. 31, 2014], accord *Baker v Seaworld Entertainment, Inc.*, 2016 WL 2993481, at \*17 [SD Cal Mar. 31, 2016]; *see also Greenfield Children’s Partnership v FriendFinder Networks, Inc.*, 2014 WL 12205997, at \*4 [SD Fla Mar. 18, 2014] [“threadbare assertion” that defendant “‘actively solicited the securities’ is insufficient to establish seller status under *Pinter*”], *affd* 590 F Appx 854 [11th Cir 2014]). Signing the registration statement alone is not enough (*Hawaii Structural Ironworkers Pension Trust Fund v AMC Entertainment Holdings, Inc.*, 422 F Supp 3d 821, 857 [SDNY

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informed of the complained-of incidents and that they well know the substance and source of the allegations.

2019]; *Yi Xiang v Inovalon Holdings, Inc.*, 254 F Supp 3d 635, 646 [SDNY 2017].<sup>7</sup>

Because a buyer cannot assert a section 12 claim against its seller's seller, the cause of action is dismissed as against Ruhnn (*see Pinter*, 486 US at 644 n 21; *In re Deutsche Telekom AG Sec. Litig.*, 2002 WL 244597, at \*4 [SDNY Feb. 20, 2002]; *see also Matlick v AmTrust Fin. Servs. Inc.*, 2020 NY Slip Op 50357[U] at \*8 [Sup Ct, NY County 2020]).<sup>8</sup>

Accordingly, it is ORDERED that defendants' motion to dismiss the complaint is granted only to the extent that the section 12(a)(2) claim is dismissed against Ruhnn and the motion is otherwise denied; and it is further

ORDERED that a preliminary conference will be held telephonically on June 3, 2020 at 3:00 p.m., and the parties shall submit their joint letter at least one week before.



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4/22/2020  
DATE

CHECK ONE:

CASE DISPOSED  
 GRANTED

DENIED

NON-FINAL DISPOSITION  
 GRANTED IN PART

OTHER

JENNIFER G. SCHECTER, J.S.C.

<sup>7</sup> Every federal “Court of Appeals to have considered the issue … has held that an individual’s signing a registration statement does not itself suffice as solicitation under Section 12(a)(2)” (*Emerson v Mutual Fund Series Trust*, 393 F Supp 3d 220, 259 [EDNY 2019], quoting *Citiline Holdings, Inc. v iStar Fin. Inc.*, 701 F Supp 2d 506, 512 [SDNY 2010] [collecting cases]).

<sup>8</sup> The Second Circuit did not hold to the contrary in *Federal Housing Finance Agency v Nomura Holding Am., Inc.* (873 F3d 85, 139-140 [2d Cir 2017]), which addressed whether depositors are statutory sellers. Plaintiff’s reliance on SEC Rule 159A is misplaced because the regulation does not displace *Pinter*’s requirement that absent title passing between the parties there must be solicitation (*see In re Kosmos Energy Ltd. Sec. Litig.*, 955 F Supp 2d 658, 670-673 [ND Tex 2013]; *In re Countrywide Fin. Corp. Mortg.-Backed Sec. Litig.*, 932 F Supp 2d 1095, 1118 [CD Cal 2013]; *Massachusetts Mut. Life Ins. Co. v Residential Funding Co.*, 843 F Supp 2d 191, 207 [D Mass 2012]; *Maine State Retirement Sys. v Countrywide Fin. Corp.*, 2011 WL 4389689, at \*10 [CD Cal 2011]; *but see Citiline Holdings, Inc.*, 701 F Supp 2d at 512).