

PRACTICE POINTS

New COVID-19 Securities Developments: Class Action Omissions Theory and SEC Enforcement Actions

By Gabriel K. Gillett, Katherine M. Funderburg, Paul B. Rietema, and Howard S. Suskin – May 20, 2020

The COVID-19 pandemic has presented publicly held companies and their officers and directors with several legal, business and operational issues. Shareholders have already begun responding to the economic impact of COVID-19 by filing securities class actions related to the pandemic, including lawsuits against Norwegian Cruise Lines (NCL) and Inovio Pharmaceuticals (Inovio) for allegedly misrepresenting the impact of the pandemic on their business operations. We write with an update on a recent COVID-19-related securities class action brought in connection with an initial public offering (IPO) under an omissions theory, filed against Phoenix Tree Holdings Limited (Phoenix) in the US District Court for the Southern District of New York. *Wandel v. Gao et al.*, No. 20-CV-03259 (S.D.N.Y.). Additionally, we note that the SEC Enforcement Division is actively investigating COVID-19-related misrepresentations too, having brought a new enforcement action against a microcap company and its CEO, accusing them of misrepresenting that the company had a large supply of protective masks for sale. *SEC v. Praxsyn Corp.*, No. 20-CV-80706 (S.D. Fla. April 28, 2020).

The class action case involves Phoenix, a Cayman Islands holding company that leases and manages apartments in China. On April 24, 2020, an investor who purchased Phoenix's American Depositary Shares filed a complaint alleging that the offering materials prepared in connection with Phoenix's January 22, 2020 IPO contained several omissions or misrepresentations related to COVID-19. Specifically, the plaintiff alleges that the offering materials omitted key information about the nature and level of renter complaints Phoenix had received before and as of the IPO, as well as demand in the Chinese residential rental market due to the pandemic. Further, the plaintiff asserts that the offering materials omitted material information about Phoenix's exposure to significant adverse developments resulting from the onset of COVID-19 in China—and particularly in Wuhan, one of the cities in which Phoenix operates—at the time of the IPO.

The suit against Phoenix differs from prior COVID-19-related securities class actions in several key ways. First, the nature of the alleged fraud at issue is different. The *NCL* and *Inovio* lawsuits, which assert securities fraud claims under Securities Exchange Act Section 10(b) and Rule 10b-5, allege the companies made public statements misrepresenting how COVID-19 was impacting their business operations. In the *NCL* suit, the shareholder alleges the company made statements that minimized the likely impact of COVID-19 on its operations. In the *Inovio* suit, the shareholder alleges the company misrepresented its progress on the development of a COVID-19 vaccine. The complaint against Phoenix, in contrast, asserts claims under Sections 11, 12(a)(2), and 15 of the Securities Act of 1933 and alleges omissions of material risks in IPO prospectuses and registration statements. As such, the suit against Phoenix appears to be the first case involving alleged omissions of COVID-19-related risks, trends and uncertainties that, according to the plaintiff, should have been disclosed to investors. It is also the first COVID-19-related securities lawsuit against a foreign issuer—which may raise issues related to the extraterritorial

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application of the securities laws, under *Morrison v. National Australia Bank Ltd.*, 561 U.S. 247 (2010). Additionally, the suit against Phoenix is the first COVID-19-related case filed in connection with an IPO, and the first to assert claims under the 1933 act.

On the SEC front, a new enforcement action was announced on April 28 against Praxsyn Corp., a microcap company based in Florida, and its CEO. The SEC charged them under Section 10(b) of the 1934 act with making false and misleading press releases concerning the company's ability to acquire and supply large quantities of protective masks. In fact, according to the SEC's complaint, the company had no masks in its possession, no orders for masks and no contracts to acquire masks. In its press release, the SEC stated that it is "committed to swiftly shutting down COVID-19 investment scams, seeking trading suspensions where appropriate and pursuing fraud charges against both entities and individuals when warranted."

As companies continue to grapple with the economic impact of the pandemic, expect to see an uptick in shareholder litigation stemming from alleged omissions and misrepresentations concerning COVID-19. This may take the form of securities class actions like *NCL*, *Inovio* and *Phoenix*, derivative lawsuits, SEC enforcement actions or combinations of all of these. As the situation presented by the COVID-19 pandemic continues to develop, companies and their officers and directors should carefully consider the contents of public statements made in response to COVID-19, including in SEC filings, and take care to include robust discussions of risk factors presented by the pandemic.

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