

Southern District of New York: Disclosures Concerning the Possibility That Problems Might Arise Are Insufficient If Those Problems Have Already Occurred

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On March 30, 2020, the Southern District of New York held that plaintiffs adequately alleged claims under Sections 11 and 12(a)(2) of the Securities Act of 1933 based on misstatements concerning the termination of experienced employees and the integration of acquisitions. [City of Omaha Police & Fire Ret. Sys. v. Evoqua Water Techs. Corp., 2020 WL 1529371 \(S.D.N.Y. 2020\) \(Nathan, J.\)](#)^[1] The court found defendants warned of problems that could potentially occur, when in fact the problems had allegedly already occurred.

Plaintiffs alleged that the company had adopted “a policy or practice” of cutting costs by replacing experienced sales employees with “far less experienced (and less qualified and effective) employees.” Plaintiffs contended that the company “strong-armed many employees into retirement by, for example, “setting impossible-to-meet quotas.” Plaintiffs asserted that the loss of experienced employees “had a significant adverse impact on the business.” Defendants responded that the company had disclosed the initiation of a “Voluntary Separation Plan” that “include[d] severance payments to employees as a result of streamlining business operations for efficiency.” The company also warned that the “failure to retain” sales personnel “could materially adversely impact [its] ability to operate or grow [its] business.” The court found these disclosures inadequate because “[d]efendant’s disclosures . . . were hypothetical” yet “the risks disclosed by [d]efendants had *already* materialized.” The court emphasized that “[w]arning of risks that *could* occur at some *future date* does not warn investors that those risks have already come to pass.”

Plaintiffs also alleged that defendants made misstatements “regarding [the company’s] acquisitions and efforts at integrating those companies into its operations.” Plaintiffs asserted that the company failed to disclose that it “terminated the staff members responsible for integration” and “faced serious problems in integrating one of its new acquisitions.” Defendants argued that the company specifically cautioned that it “may have difficulty in operating or integrating any acquired businesses, assets, or product lines profitably.” The court found this warning insufficient because plaintiffs alleged that “*at the time that statement was made*,” the company “had *already* fired integration staff” and the integration of one acquisition “was *already* going poorly.” The court underscored that “[a] hypothetical disclosure about potential future problems is . . . not curative” if the problems had already occurred at the time of the alleged misstatements.

Defendants also argued that certain of its statements were inactionable puffery. For example, defendants pointed to the company’s statement that “[o]ur management team has also expanded our operations to new target markets and geographies and has demonstrated successful acquisition and integration capabilities.” The court recognized that “a representation that something is a ‘success’ can be puffery.” But in the statement at issue, “the word [success] modifies a particular noun—acquisition and integration capabilities.” The court found that when read “in context,” this statement “represents that [the company] *has* demonstrated these capabilities successfully.” The court held that it could not “conclude that *no* reasonable investor would rely on this statement, and thus [the] puffery doctrine cannot defeat [p]laintiffs’ claim at this stage of litigation.”

[1] “Section 11 of the Securities Act imposes liability on issuers and other signatories of a registration statement that ‘contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading.’” *Evoqua*, 2020 WL 1529371 (quoting 15 U.S.C. § 77k(a)). “Section 12(a)(2) provides similar redress where the securities at issue were sold using prospectuses or oral communications that contain material misstatements or omissions.” *Id.*

Authors and
Contacts

Paul Gluckow

Partner and General Counsel

pgluckow@stblaw.com

+1-212-455-2653

Linton Mann III

Partner

lmann@stblaw.com

+1-212-455-2654

