

Eastern District of New York: Dismisses a Class Action Against an Airline Calling the Securities Fraud Allegations “Speculative” (Securities Law Alert)

06.01.22



(Article from *Securities Law Alert*, May 2022)

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On April 12, 2022, the Eastern District of New York dismissed a putative securities fraud class action against an airline and certain of its officers and directors alleging that they made misleading upbeat statements in a May 2020 earnings report, and violated Section 10(b) by failing to disclose certain auditor findings later disclosed in June. *In re GOL Linhas Aéreas Inteligentes Sec. Litig.*, 2022 WL 1093215 (E.D.N.Y. 2022) (Kovner, J.). The court held that plaintiffs “failed to adequately plead that the May 2020 earnings report contained material misstatements or omissions of fact . . . because they have not adequately pleaded that defendants knew of the auditor findings at the time of the May report.”

In May 2020, the airline issued its earnings report for Q1 of 2020, which discussed falling customer demand, plans to cut capacity, and an expected revenue decline due to the pandemic. However, the report also noted the airline’s experience navigating times of stress, the airline’s “effective and structured liquidity management,” and that while reporting a loss for Q1, the airline still reported a profit for its loyalty program. Subsequently, in June 2020 the airline disclosed that its auditor had substantial doubt about the airline’s ability to continue as a going concern and identified material weaknesses in its internal control over financial reporting (“ICFR”). Plaintiffs alleged that defendants were liable under Section 10(b) on an omissions theory because the May 2020 earnings report, with its upbeat financial statements, did not disclose the auditor’s negative findings that were later revealed. Plaintiffs contended that defendants must have known of the findings when the earnings report was issued.

Concluding that plaintiffs failed to adequately plead an actionable omission, the court explained that defendants could only be liable on plaintiffs’ theory if they actually knew of the auditor’s conclusions at the time that the earnings report was issued. While the complaint asserted that defendants learned of their auditor’s concerns “at least as early as February 2020 and/or no later than May 3, 2020,” the court determined, as in *San Leandro Emergency Med. Grp. Profit Sharing Plan v. Philip Morris*, 75 F.3d 801 (2d Cir. 1996), that “such an unsupported general claim is insufficient to survive a motion to dismiss.” The court pointed out that plaintiffs did not point to specific internal reports from the auditor advising defendants of the auditor’s anticipated findings before the May earnings report, and also failed to specify who prepared such reports, when they were prepared, and who reviewed them.

The court also concluded that plaintiffs fell short of adequately pleading an omissions-based claim based on circumstantial evidence. As to the

ICFR deficiencies, plaintiffs argued that the auditors must have informed defendants about the deficiencies by May 2020 because of an auditing industry standard requiring auditors to disclose significant deficiencies and material weaknesses “in a timely manner” and “prior to the issuance of the auditor’s report.” However, the court concluded that plaintiffs’ inference rested on little more than speculation and that an auditing standard requiring “timely” disclosures did not support plaintiffs’ inference. The court also found that plaintiffs failed to support their assertions that the auditor would have: (i) concentrated on ICFR at the outset; (ii) finished examining ICFR early in the audit; or (iii) reached tentative conclusions, and informed the airline’s audit committee of such tentative conclusions, by the time of the May 2020 earnings report. Similarly, the court found that only speculation supported the allegation that the auditor reached its going-concern conclusion by May 2020, rather than reaching this conclusion in the following month when the airline disclosed it.

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