

## Southern District of New York: Disclosing Some Inexperience Does Not Create a Duty to Disclose All Inexperience (Securities Law Alert)

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On May 3, 2022, the Southern District of New York denied dismissal of all claims in a putative securities fraud class action alleging that an investment company, its subsidiaries, and its president/co-founder failed to disclose material information about the company's investment opportunities in violation of Section 10(b), among other claims.<sup>[1]</sup> *Tecku v. Yieldstreet*, 2022 WL 1322231 (S.D.N.Y. 2022) (Marrero, J.). Notably, while the court determined that some allegations survived the motion to dismiss, the court was not persuaded that highlighting inexperience in some areas created a duty to disclose all inexperience.

The defendant investment company offered investment products mainly consisting of debt instruments, such as the company's "Marine Finance" line of investment products. This line of products involved the company loaning investor funds to a borrower who would purchase a marine vessel to deconstruct and sell for scrap. Plaintiffs commenced this action alleging that \$90 million in five vessel deconstruction loans were in default. Plaintiffs alleged that the company's Form ADV disclosed its team's lack of experience in some areas but failed to disclose that its "Marine Finance" team had never been involved in a marine deconstruction deal.

The court determined that the company's alleged inexperience in marine deconstruction deals was merely information that plaintiffs would have liked to know and was not an actionable omission. The court stated that it was "not persuaded by an argument that if a company chooses to highlight its inexperience in some areas, the company has a duty to disclose all its inexperience, theoretically including inexperience that has no relevance to the parties' dispute." The court explained that the undisclosed inexperience did not render the included statements misleading, pointing out that plaintiffs did not allege that the company said these were the only areas of inexperience. The court reasoned that if it concluded otherwise then companies would choose not to disclose any inexperience to protect against needing to disclose all.

By contrast, the court denied dismissal of plaintiffs' allegations concerning actions by the company's president/co-founder that deviated<sup>[2]</sup> from the diligence process promised in the offering documents for the five post-October 2018 vessel deconstruction deal offerings. Plaintiffs argued that defendants had a duty to update the offering documents to accurately represent the diligence process, or at least disclose the intervening events. The court determined that plaintiffs' allegations created "a strong inference of a duty" to disclose this information to potential investors because the president/co-founder's actions rendered the diligence process in the offering documents misleading or false. The court stated that even if the offering document "statements were accurate when published, the intervening events of October 2018

rendered the statements false, requiring Defendants to at least update investors that the diligence process differed from the process outlined in the document.”

- [1] In addition to alleging Section 10(b) violations, plaintiffs also alleged fraudulent inducement, aiding and abetting fraud, Section 20(a) violations, common law breach of fiduciary duty, aiding and abetting breach of fiduciary duty, and negligent misrepresentation.
- [2] Plaintiffs alleged the president/co-founder deviated by identifying and vetting a deal on his own for future investments with one borrower using a short-term lending model. Plaintiffs alleged that under the company’s promised diligence process, the company was supposed to rely on an industry expert to both identify potential vessel-deconstruction opportunities and vet whether these transactions fit into the expert’s lending methodology. Second, the deals that survived the expert’s vetting were supposed to receive an independent analysis by the company in which a multi-party credit committee with veto powers would review the transaction.

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