

## Southern District of New York: Class Action Dismissed Where Manufacturer Warned of Existing Regulatory Strictures, the Prospect of Heightened Regulation and Attendant Investor Risks (Securities Law Alert)

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On September 30, 2022, the Southern District of New York dismissed with prejudice a putative securities fraud class action against a China-based manufacturer and merchant of e-cigarettes, alleging that it made misstatements and omissions in connection with its U.S. IPO concerning the prospect of stricter e-cigarette regulation in China. [Garnett v. RLX Tech.](#), 2022 WL 4632323 (S.D.N.Y. 2022) (Engelmayer, J.). The court held that plaintiffs failed to plausibly plead that the company made any misleading statement or omission because, on the whole, the company's IPO offering materials fairly alerted investors to existing regulatory strictures, the prospect of heightened regulation, and the attendant risks to investors.

### Background and Procedural History

Soon after the company's IPO, Chinese regulators posted draft regulations stating that e-cigarettes would be subject to stricter regulations, bringing them in line with traditional tobacco products. Thereafter, the company's stock price dropped. Plaintiff purchasers of the company's securities claimed violations of Sections 11 and 12(a)(2) of the Securities Act. Plaintiffs alleged that, among other things, the company's offering materials provided a false and misleading narrative that the company was not facing imminent regulatory changes, characterized "existing regulatory efforts as limited in scope, rather than as harbingers of a forthcoming national standard," misleadingly claimed to be unaware of how government authorities planned to regulate e-vapor products, and inadequately disclosed the likelihood of regulation by using the word "may" to describe the prospect of future regulatory action rather than "will" or "shall." Plaintiffs alleged that Chinese regulators were preparing these stricter regulations at the time of the company's IPO and publicly disclosed that the regulations were certain to be enacted. Defendants moved to dismiss pursuant to Federal Rule of Civil Procedure 12(b)(6).

### Viewed Together and In Context, the Offering Materials Did Not Misrepresent or Omit Material Facts

The court held that plaintiffs failed to plausibly allege a misstatement or omission that was actionable under Sections 11 or 12(a)(2). Citing *In re Morgan Stanley Info. Fund Securities Litigation*, 592 F.3d 347 (2d Cir. 2010), the court explained that "taken together and in context" the

offering materials “did not misleadingly state or omit facts related to the prospect of more stringent regulation of e-cigarettes in China.” The court pointed out that the offering materials “explicitly noted, as a risk factor, that changes in existing laws, regulations and policies and the issuance of new laws, regulations and policies have materially and adversely affected and may further materially and adversely affect our business operations.” The court explained that the offering materials stated that Chinese government authorities “may impose more stringent laws, regulations and policies” on the e-vapor industry. The offering materials also cited strict regulatory measures taken by other countries, including taxes and outright e-cigarette prohibition. The offering materials additionally recited the various regulatory measures that Chinese authorities had already put in place as of the time of the IPO. The court further found that the offering materials alerted investors to the facts of China’s existing national regulations on tobacco products while noting that they did not currently apply to e-cigarettes. The court found that the offering materials warned that there could be “no assurance” that the regulatory regime would be favorable and that the regulatory landscape was uncertain.

As to plaintiffs’ argument that the offering materials should have gone further by disclosing that regulators would “inevitably” bring e-cigarettes under the same regulatory regime as tobacco, the court found that plaintiffs did “not allege facts that made the adoption of such laws a foregone conclusion.”<sup>[1]</sup> The court stated that the factual allegations “depict an environment in which regulation of e-cigarettes in China had gradually tightened and could well continue over time to tighten.” However, the court determined that plaintiffs’ allegations did not plausibly show that regulation of e-cigarettes as tobacco products was inevitable. The court stated that “[c]ompanies subject to government regulation are not required to speculate or foresee coming regulation or its potential effect on the company.”

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<sup>[1]</sup> Examining communications issued by Chinese regulators, the court characterized the approaches under consideration as “preliminary and precatory.” The court noted that even the last regulator statement on the issue before the company’s IPO did not announce that e-cigarettes would be regulated as traditional tobacco products, instead declaring only that the regulator would “actively promote the introduction of control measures for new tobacco products such as Electronic cigarettes.”

Authors and  
Contacts

Cheryl Scarboro

Of Counsel

cscarboro@stblaw.com

+1-202-636-5529

Simona Strauss

Senior Counsel

sstrauss@stblaw.com

+1-650-251-5203

David Elbaum

Senior Counsel

david.elbaum@stblaw.com

+1-212-455-2861



