

[Securities Regulation Daily Wrap Up, FRAUD AND MANIPULATION—S.D.N.Y.: Fraud claims against Longfin offering underwriter dismissed after reconsideration, \(Jul. 30, 2019\)](#)

Securities Regulation Daily Wrap Up

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By Rebecca Kahn, J.D.

On second look, the court found it a more compelling inference that the underwriter was lied to by Longfin about NASDAQ eligibility.

Upon reconsideration, investor claims against an offering underwriter were dismissed by the Southern District of New York for failing to adequately plead scienter. The court found a stronger inference that the underwriter was unaware of its role in the issuer's scheme to defraud investors than the inference that it was a knowing participant (*In re Longfin Corp. Securities Class Action*, July 29, 2019, Cote, D.).

Longfin's IPO. Longfin is a finance and technology corporation providing foreign exchange and finance solutions. Longfin first offered its shares to the public in August 2017 and retained Network 1 Financial Securities Inc. as its lead underwriter for the Regulation A+ offering. On December 13, 2017, Longfin's Class A shares started trading on NASDAQ.

Investigation and class action. In late March through early April 2018, Longfin's stock price plummeted following disclosure of, inter alia, an SEC investigation concerning its IPO. On April 4, 2018, the SEC filed a complaint against defendants Longfin, Network 1, Andy Altahawi, and other Longfin executives and insiders on behalf of investors who purchased Longfin's stock. Plaintiffs alleged that Longfin Corp. "gamed" NASDAQ requirements to get its stock listed, allowing insiders to profit from a market manipulation scheme. On April 6, 2018, the SEC acquired a court order freezing \$27 million in proceeds from sales of Longfin Class A stock. By May 24, 2018, NASDAQ had delisted Longfin.

December 6, 2017 issue. Companies seeking to list its securities on NASDAQ must have at least 1 million publicly held shares. After discovering it had fallen short of the quota, Longfin allegedly issued 409,360 shares to two-dozen individuals for no consideration on December 6, 2017, in a fraudulent effort to meet NASDAQ's listing requirement. Network 1 was provided with bank statements that purportedly showed payment for these stocks.

Motion to dismiss. On April 11, 2019 the U.S. District Court for the Southern District of New York [denied a motion to dismiss](#) the Section 10(b) fraud claims against Network 1, finding that, while a close case, the First Amended Complaint had sufficiently alleged scienter on the underwriter's part. The bank statements provided to Network 1 did not prove that the December 6 Shares were purchased for consideration and also showed that shares were transferred to Longfin insiders in violation of NASDAQ's listing requirements. This, the court said, was sufficient at this stage to show that Network 1 was aware of the fraudulent scheme.

Request for reconsideration. On April 24, 2019, Network 1 filed a motion for reconsideration. According to Plaintiffs' Second Amended Complaint (SAC), Longfin founder Venkata S. Meenavalli wrote a letter to Network 1 on January 2, 2018, responding to the underwriter's request whether the December 6 Shareholders had paid for their shares. Meenavalli "falsely stated" that they had paid for their shares by transferring funds into Longfin's corporate accounts. Meenavalli allegedly controlled those corporate accounts, and the December 6 Shareholders did not pay for their shares by making payments into those accounts. From all of this, the SAC asserted that Network 1 "knew or was reckless in not knowing that the December 6 Shares were not lawfully issued."

Scienter. The question was whether Network 1 knew that the shares issued on December 6 were not validly purchased but still facilitated the offering and NASDAQ listing. Upon re-examination of these allegations,

combined with the additional allegations contained in the SAC, the court found that plaintiffs failed to adequately allege scienter. The allegations were not as cogent or compelling as the inference that Network 1 was lied to by Longfin.

The court had no doubt that Longfin's Reg A+ offering was an essential part of its scheme to defraud investors. Longfin's fraudulent issuance of the December 6 Shares was critical to its reaching the NASDAQ minimum. The court ruled that the SAC failed to plausibly and adequately plead Network 1's knowing participation in the fraud. As such, the court dismissed claims against the underwriter in their entirety.

The case is [No. 18-cv-2933\(DLC\)](#).

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Companies: Longfin Corp.

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