

[Securities Regulation Daily Wrap Up, FRAUD AND MANIPULATION—N.D. Cal.: Robinhood escapes IPO suit, possibly for good, \(Jan. 25, 2024\)](#)

Securities Regulation Daily Wrap Up

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By [Mark S. Nelson, J.D.](#)

The court will not let the plaintiffs further amend the complaint because the latest allegations of declines in Robinhood's KPIs restated old claims and showed no more than a financial regression to the mean.

A judge in San Francisco has once again dismissed a complaint filed against Robinhood Markets, Inc. that claimed the company's pre-IPO offering documents misled investors about changes in how the company makes money as its core business of facilitating trading by new investors in types of investments, such as crypto assets, that tend to be riskier in nature began to decline just as the company's public offering was about to happen. Much of the case hinged on whether Robinhood's historical financial data was consistent with emerging revenue trends such that out-of-quarter disclosures might be required. In addition to dismissing multiple Securities Act claims, the court also dismissed controlling persons claims for lack of an underlying securities violation. Significantly, the court opted not to grant the plaintiffs another chance to amend the complaint ([Golubowski v. Robinhood Markets, Inc.](#), January 24, 2024, Chen, E.).

Robinhood markets itself as a commission-free broker-dealer who makes the bulk of its revenues from routing orders to other venues via payment for order flow (PFOF). The company has a history of wooing newcomers to invest at trading ETFs, ADRs, and crypto assets. The lawsuit, filed as a putative class action, alleged that eight Robinhood executives and directors and 17 underwriters were liable for false and misleading statements about Robinhood's revenues that appeared in the company's registration statements and prospectus ahead of its IPO, which occurred in July 2021, just months after the well-publicized January 2021 short squeeze of meme stocks. The complaint, like the ones before it, alleged violations of Securities Act Sections 11, 12, and 15, as well as of Items 105 and 303 of Regulation S-K. And just like the prior complaints, it too was dismissed because the plaintiffs failed to plead that the information allegedly omitted from Robinhood's offering documents merited special, out-of-quarter disclosures of extraordinary information.

Securities Act claims. The complaint reasserted claims that Robinhood omitted information from its IPO-related disclosures that would show the company's awareness of declining financial trends in violation of Securities Act Sections 11 and 12(a)(2). The court largely evaluated these claims along a parallel track because of the similarities between Sections 11 and 12(a)(2). Specifically, the court considered several new theories posited by the complaint in light of the judge-made rule that out-of-quarter disclosures of financial metrics is warranted only in extraordinary cases. Previously, the court had dismissed the complaint because the claims were not extraordinary enough and the plaintiff did not allege any unusual crypto trading activity that was unique to Robinhood.

With respect to the plaintiffs' new theories, they alleged that Robinhood should have made disclosures about equity/options trading revenues, certain key performance indicators (KPIs) regarding user data, and changes in crypto trading volume. The court first addressed equity/options trading and concluded that the complaint alleged that Robinhood's revenues from payment for order flow (PFOF) had declined but that the declines were not large and were nevertheless consistent with the company's financial history.

The KPIs cited by the complaint, monthly average users (MAUs) and assets under custody (AUC), represented not worrisome downtrends but were likely instead "historical fluctuations" showing a correction leading back to normal levels, the court explained. Likewise, the court said declines in crypto trading cited by the complaint as more significant than the industry as a whole were more likely "fluctuations back to the mean." Moreover, the court noted that Robinhood had made numerous disclosures that its elevated revenues would eventually decline

and the bespeaks caution doctrine could protect those statements “for failure to predict with exact certainty the level of downturns the company would face.”

With respect to Item 303 of Regulation S-K, which mandates disclosure of known trends and uncertainties, the complaint had alleged that even professional analysts had not predicted the level of declines experienced by Robinhood. However, the court concluded that disclosure was not warranted; said the court: “Unfulfilled predictions of analysts alone do not retrospectively establish historically extraordinary information that mandates out-of-the ordinary disclosures.”

Lastly, the court addressed whether the complaint adequately alleged that Robinhood failed to disclose a shift in its revenues. This theory took two forms. First, the plaintiffs argued that Item 105 of Regulation S-K required Robinhood to disclose the extent to which it depended on “fad trading” related to “meme stocks.” Robinhood countered that it was public knowledge that Robinhood and others had been involved in “fad-trading events.” According to the court, a reasonable investor would have been aware of these events and the significance of crypto asset trading to Robinhood’s business and, thus, the complaint failed to state a Securities Act claim.

Second, the plaintiffs argued that, even so, Robinhood had to disclose its “dependency” on the trading of crypto assets and, in particular, failed to disclose its transaction-based revenue “*by type*” (emphasis in original). The complaint cited Q2 2021 data indicating that Robinhood’s reliance on crypto trading went from 21 percent to 52 percent and that reliance on trading in a single crypto asset, Dogecoin, rose from 34 percent to 62 percent. The complaint posited that even if investors gleaned the larger trend, they would not have understood that Robinhood’s dependence on crypto asset trading (Dogecoin in particular) had risen “exponentially.” Robinhood this time countered that Item 105 requires disclosure of risk factors only and not the disclosure of “present performance indicators.” On this point, the court said it could not discern any change from the prior version of the complaint, which had been dismissed, and went on to note that Robinhood had made disclosures about the rise and expected declines in crypto trading. As a result, the court concluded that the complaint again failed to state a Securities Act claim.

Because the complaint failed to allege an underlying Securities Act claim, related claims that individual Robinhood defendants were controlling persons likewise could not be sustained.

No leave to amend. The court restated the basic rule that leave to amend can be denied where it appears that further amendment would be futile. The court said the plaintiffs had now failed several times to allege a Securities Act claim based on Robinhood’s pre-IPO disclosures and that the court could not envision any additional facts the plaintiffs could allege that would allow the complaint to survive a motion to dismiss. “Yet, the more context that Plaintiffs have added about Robinhood’s business metrics and financials,” said the court, “the less it seems that the complained-of declines were so extraordinary as to warrant disclosure.” As a result, the court denied the plaintiffs the opportunity to further amend the complaint.

The case is [No. 3:21-cv-09767](#).

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Companies: Robinhood Markets, Inc.

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