

Yiqing Zhang v RYB Educ., Inc
2020 NY Slip Op 32207(U)
July 2, 2020
Supreme Court, Queens County
Docket Number: 717923/2018
Judge: Joseph Risi
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Short Form Order

NEW YORK SUPREME COURT - QUEENS COUNTY

Present: HONORABLE JOSEPH RISI
A. J. S. C.

IA Part 3

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YIQING ZHANG, Individually and on Behalf of
All Others Similarly Situated,

Index
Number 717923/2018

Plaintiffs,
-against-

DECISION/ORDER

RYB EDUCATION, INC., CHIMIN CAO,
YANLAI SHI, PING WEI, CREDIT SUISSE
SECURITIES (USA), MORGAN STANLEY &
CO. INTERNATIONAL PLC, CHINA
INTERNATIONAL CAPITAL CORPORATION
HONG KONG SECURITIES LIMITED, and BNP
PARIBAS SECURITIES CORP.,

Sequence Number 1

FILED

**7/7/2020
02:55 PM**

Defendants.
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**COUNTY CLERK
QUEENS COUNTY**

The following numbered papers read on this motion by defendants RYB Education, Inc. ("RYB") and Liang Meng ("Meng") to dismiss the amended complaint pursuant to CPLR §3211(a)(1) and (a)(7).

Papers
Numbered

Notice of Motion - Affidavits - Exhibits EF 14 - 32
Answering Affidavits - Exhibits EF 33 - 34
Reply Affidavits EF 35, 37

Upon the foregoing papers, it is ordered that the motion is determined as follows:

The Court notes that by letter dated August 29, 2019, counsel for Mr. Meng informed the Court that plaintiffs attempted to serve Mr. Meng in Hong Kong under the Hague Convention, he accepted service and under the Rules of the Hong Kong High Court, service was effectuated on or about August 10, 2019. The Court further notes that Liang Meng is listed as an individual defendant

in the amended complaint dated March 1, 2019, although he is not listed in the caption. As he had notice of the action and is not contesting service and has appeared in the action, under these circumstances and given the absence of prejudice, the Court will treat the fact that Mr. Meng was omitted from the caption as an error, and under CPLR §2001, permit an amendment to the caption to include his name. Furthermore, by letter e-filed under Document 37, Mr. Meng seeks to join in fully in RYB's motion to dismiss which was not opposed by any party. Accordingly, Mr. Meng is permitted to join in this motion.

Plaintiffs bring this class action against defendants alleging violations of Sections 11, 12(a)(2) and 15 of the Securities Act of 1933. RYB is a provider of early childhood education with approximately 1,000 facilities in 300 cities. Mr. Liang Meng is one of the directors of RYB. Following an incident in November 2017 involving the mistreatment of students at an RYB facility, it is claimed that various statements about teacher training, qualifications, and student safety contained in RYB's initial public offering ("IPO") documents were false and misleading. The Registration Statement was filed on August 30, 2017, and the Prospectus was filed on September 27, 2017.

Initially, the Court will address the issue of whether plaintiffs' claims under Sections 11, 12(a)(2), and 15 are subject to the heightened pleading standard under CPLR §3016(b), as RYB argues. CPLR §3016(b) provides that "[w]here a cause of action or defense is based upon misrepresentation, fraud, mistake, wilful default, breach of trust or undue influence, the circumstances constituting the wrong shall be stated in detail." Here, plaintiffs allege that the Offering Documents are materially false and misleading, that is, contain misrepresentations. Therefore, CPLR §3016(b) applies and plaintiffs must state the circumstances constituting the misrepresentations in detail (*see Berardino v Ochlan*, 2 AD3d 556, 557 [2d Dept 2003]).

RYB's argument that plaintiffs failed to sufficiently allege standing under Section 12(a)(2) is insufficient. A plaintiff may assert Section 12(a)(2) claims "where the securities at issue were sold using prospectuses or oral communications that contain material misstatements or omissions" (*In re Morgan Stanley Information Fund Sec. Litig.*, 592 F.3d 347, 359 [2d Cir. 2010]). Therefore, Section 12(a)(2) permits claims against those deemed to be a "statutory seller," which is a defendant that either "(1) passed title, or other interest in the security, to the buyer for value, or (2) successfully solicit[ed] the purchase [of a security], motivated at least in part by a desire to serve his own financial interest or those of the securities['] owner" (*id.*). Here, plaintiffs state in the amended complaint that they "purchased the Company's securities pursuant to and traceable to the IPO." Contrary to RYB's contention, "it is sufficient to allege that [Plaintiffs] purchased [ADSs] in connection with the IPO" and plaintiffs need not "identify the specific defendant from whom they purchased the ADSs" (*In re iDreamSky Technology Ltd. Sec. Litig.*, 236 F. Supp. 3d 824, 832 [S.D.N.Y. 2017]). Thus, plaintiffs statement in the amended complaint that they purchased shares in connection with the IPO and pursuant and/or traceable to the IPO is sufficient for standing purposes under Section 12(a)(2).

On a motion to dismiss pursuant to CPLR §3211, the Court must accept the facts alleged by

the plaintiff as true and liberally construe the complaint, according it the benefit of every possible favorable inference (*see Sokoloff v Harriman Estates Dev. Corp.*, 96 NY2d 409, 414 [2001]). The role of the court is to “determine only whether the facts as alleged fit within any cognizable legal theory” (*id.*). Where, as here, evidence is submitted by the movant in support of a CPLR §3211(a)(7) motion, the court must determine whether the proponent of the pleading has a cause of action, not whether he or she has stated one (*see Hartman v Morganstern*, 28 AD3d 423 [2d Dept 2006]; *Steiner v Lazzaro & Gregory*, 271 AD2d 596 [2d Dept 2000]). Where documentary evidence definitively contradicts the plaintiff’s factual allegations and conclusively disposes of the plaintiff’s claim, dismissal pursuant to CPLR §3211(a)(1) is warranted (*see DiGiacomo v Levine*, 76 AD3d 946, 949 [2d Dept 2010]).

Applying these principles to the case at bar, the Court concludes that the amended complaint failed to sufficiently state causes of action alleging violations of Sections 11 and 12(a)(2) of the Securities Act of 1933. Section 11 provides recourse to any person acquiring a security if “any part of the registration statement . . . contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading” (15 USC §77k[a]). “The truth of a statement made in the registration statement is judged by the facts as they existed when the registration statement became effective” (*In re Initial Pub. Offering Sec. Litig.*, 358 F. Supp. 2d 189, 205 [S.D.N.Y. 2004]). Section 12(a)(2) imposes liability under similar circumstances against “a person who offers or sells a security . . . by means of a prospectus or oral communication” (15 USC §77l[a][2]). Therefore, while Section 11 covers registration statements and Section 12(a)(2) covers prospectuses, to state a cause of action under either, a plaintiff must allege that the Offering Documents contained: (1) a material misrepresentation; (2) a material “omission in contravention of an affirmative legal disclosure obligation;” or (3) a material “omission of information that is necessary to prevent existing disclosures from being misleading” (*In re Morgan Stanley Info. Fund Sec. Litig.*, 592 F.3d 347, 360 [2d Cir. 2010]).

Here, plaintiffs allege in the amended complaint that RYB’s statements in the Registration Statement and Prospectus regarding its teacher qualifications, teacher training, and safety and security protocols were false and misleading. Plaintiffs cite to the following statements in the Offering Documents alleged to be false and misleading:

- (1) “Our professional and high-quality teachers and principals and, more importantly, our established system to effectively train, grow and retain teaching staff and management talents underpin our high-quality education services.”
- (2) “Candidates must also go through our stringent selection, training and certification process before they can teach in our network.”
- (3) “Despite our constant emphasis on service quality, our continuous training of our teachers as well as our close supervision on daily basis, we cannot assure that our teachers will completely follow our service manual and standards all the time.”

(4) “[A] video footage that allegedly depicts improper behavior of a teacher at one of our then directly operated kindergartens was released online in April 2017. It soon led to broad distribution and caused negative publicity on our operations and harmed our brand.”

(5) “We maintain high standards in selecting, certifying and training our teaching staff to ensure consistent educational quality. Almost all of our teachers have received professional training from colleges or other institutions in education, arts and language before joining us. Each candidate has to go through our stringent selection, orientation training and certification process before he or she can become one of our certified teachers. In addition, before joining us, a number of our teachers have gone through RYB co-sponsored programs with selected teachers’ colleges where they studied. Through these cosponsored programs, we provide these candidates with early exposure to our culture and teaching philosophy.”

(6) “Our teachers receive systematic, regular training from our early childhood education experts. Our franchisees and their facility principals must complete an intensive, three-week initial training at our headquarters, as well as continued annual training hosted by us. Under our partnership with Erikson Institute, or Erikson, a renowned U.S. graduate school in early childhood education, Erikson provides us with regular on-site and online teacher training; we also send selected teachers and principals to overseas training programs hosted by Erikson. In addition to formal training, we convene annual conferences for teachers to share their best practices, organize open classroom sessions to showcase star teachers’ classes and regularly hold nationwide teaching contests to foster healthy competition and communication among teachers.”

(7) “We strictly enforce our rigorous service standards across our network. Our standardized operations and management guidelines set forth service standards to be followed by teachers, principals, staff, franchisees, vendors and other participants in our network. The local presence of over 20 of our regional offices, combined with the work of our dedicated product and franchisee support teams and supervisory teams, helps ensure consistency in service quality across our network. As of June 30, 2017, we had a team of 59 franchise supervisors, who regularly visit and follow up with our franchisees in order to ensure that our quality requirements are complied with and offer support in improving teaching quality when needed.”

(8) “Our strong technology infrastructure provides the backbone to maintain consistency in our service quality.”

(9) “Training is an integral part of our operations and supports our long term growth. After joining us or our franchisees, all candidate teachers must go through our stringent three-week orientation, training and certification process before being certified and qualified to teach in our network. After this three-week initial training, our teachers continue to receive systematic and regular training. Teachers also get the chance to improve and learn from their peers in our annual teacher conferences, open classrooms showcasing star teachers’ classes and teaching contests. In addition, the Erikson Institute, a renowned U.S. premier graduate school in early childhood education, provides our teachers with regular on-site and online training, and we also send selected teachers and principals

to overseas training programs hosted by the Erikson Institute.”

(10) “We have established and strictly implemented security and safety protocols.”

With respect to the aforementioned statements pertaining to teacher training and qualifications, plaintiffs allege in the amended complaint that such statements are materially false and misleading because the training that RYB provided to its teaching staff regarding issues of safety and security was not effective and was “materially deficient.” It is alleged that, although defendants fostered the impression that RYB’s teacher training program provided comprehensive guidance from “early childhood education experts” in educating and managing a classroom, the “training” teachers actually received consisted of largely symbolic gestures and instructions to engage in self study. Plaintiffs further allege that former RYB employees confirmed that no detailed or targeted training was provided to teachers regarding issues of discipline or punishment. Furthermore, plaintiffs allege that, although defendants’ statements fostered the impression that all of RYB’s teachers have completed all necessary requirements for certification or licensure and were fully qualified to teach, RYB employed individuals who had not yet actually obtained their licenses, were interns employed by partnership schools and were working at RYB schools in connection with their internships, and/or were still studying for their teacher qualification licenses. Plaintiffs allege that by omitting any mention of the scant disciplinary guidance RYB provided to its teacher trainees and that some of its staff were not licensed or certified, defendants misled the market regarding a core aspect of its business.

With respect to the statements regarding service standards, technology infrastructure, and safety and security protocols, plaintiffs allege that, although defendants’ statements fostered the impression that services and operations were standardized throughout RYB’s network of facilities, service standards were not uniformly maintained throughout the network. The amended complaint references disparities among RYB facilities regarding the existence, use, and management of surveillance cameras and staff to monitor the premises, inadequate safety and security protocols and training on safety and security issues, and the employment of teachers who did not possess all necessary licenses or certifications.

It is alleged in the amended complaint that the inadequacies in RYB’s teaching staff, teacher training, and safety and security protocols remained as of the time of the IPO. It is further alleged that, in November 2017, it was reported that the Chinese police were investigating claims of sexual molestation and needle marks on children at an RYB kindergarten in Beijing, and over the next thirteen months, more details emerged regarding RYB’s shortcomings with respect to these issues.

In support of its motion, RYB primarily contends, among other things, that plaintiffs failed to identify a materially false or misleading statement or omission in the Offering Documents and that RYB provided adequate risk disclosures. Based on the context of the alleged misrepresentations and omissions, their general nature, and their placement amongst robust risk disclosures, this Court finds that, although plaintiffs’ claims were stated in detail, RYB presented sufficient documentary evidence, namely, the Registration Statement and Prospectus, which conclusively disposes of

plaintiffs' first and second causes of action for violations of Section 11 and Section 12(a)(2).

The crux of plaintiffs' amended complaint is that defendants failed to accurately describe and/or omitted significant information regarding RYB's teacher training program, teacher qualifications, and safety and security protocols, which were core aspects of its business, thereby misleading the public. However, the exact type of risks of which plaintiffs complain were disclosed in the Offering Documents themselves (*see Securities Act. I. Meyer Pincus & Assocs., P.C. v Oppenheimer & Co.*, 936 F.2d 759, 762 [2d Cir. 1991]). In the section entitled "Risk Factors," it is stated that,

"Despite our constant emphasis on service quality, our continuous training of our teachers as well as our close supervision on daily basis, we cannot assure that our teachers will completely follow our service manual and standards all the time. Any misbehavior or unsatisfactory performance of our teachers will hurt our reputation and potentially our operation results and financial performance. For example, a video footage that allegedly depicts improper behavior of a teacher at one of our then directly operated kindergartens was released online in April 2017. It soon led to broad distribution and caused negative publicity on our operations and harmed our brand."

Notably, the Offering Documents address the possibility of teachers not uniformly following RYB's service standards and, in fact, mentions the April 2017 incident involving the mistreatment of a student by an intern and trainee in an RYB facility in violation of RYB's policies and training program. In view of the foregoing, RYB specifically cautioned investors about the relevant risks associated with its service standards, teacher training, and the nature of its business.

With respect to plaintiffs' allegations regarding teacher qualifications and the use of interns and/or trainees, the Offering Documents state,

"Additional requirements on permits and licenses may also apply to our operations, including . . . to have all teaching staff obtain teachers' licenses and work permits, among others. [W]e cannot assure you that we will be able to receive or renew all required licenses, permits or certificates in a timely manner. If we fail to receive or renew required licenses, permits or certificates in a timely manner, or at all, we may be subject to fines, confiscation of the gains derived from our noncompliant operations, suspension of our noncompliant teaching facilities or liability to indemnify economic loss suffered by our students, which may materially and adversely affect our business, financial conditions and results of operations."

The Offering Documents show that RYB cautioned investors that it may not be able to timely obtain licenses and certifications for all teachers and the consequences of that risk. Moreover, the use of interns or trainees in addition to certified or licensed teachers is not inconsistent with the disclosures in the Offering Documents. It is also not stated anywhere in the Offering Documents that every

employee has a teaching license or certification. In addition, plaintiffs do not allege in the amended complaint that RYB had an insufficient number or no certified or licensed teachers at any of its facilities.

As to plaintiffs' allegation that the Offering Documents failed to disclose the deficiencies in RYB's teacher training program regarding issues of student safety, security, and discipline, the Court finds that no such material misstatements or omissions were made. The Offering Documents, coupled with the RYB training materials, adequately describe the content of RYB's teacher training program and included risk disclosures which describe the limitations of the training program. In particular, the training materials submitted on the motion as well as those portions cited to in the amended complaint, RYB delineate conduct that would violate the code of professional ethics for its teachers, including "corporal punishment" and its equivalent, and expressly stated that teachers are prohibited from "scolding, insulting, discriminating against, cursing at, or . . . physically punishing children." Moreover, in the Offering Documents, RYB warned of the risks associated with the training program, explaining that it cannot assure that every teacher in its network would uniformly follow RYB's service manual and standards at all times and that the lack of supervision of its teachers and other employees could cause harm to students. RYB also highlighted the April 2017 incident, which involved the proclaimed risk of teachers not following the guidelines about discipline and safety. As such, the documentary evidence is sufficient to refute plaintiffs' allegations that the Offering Documents would mislead a reasonable investor regarding the content of RYB's teacher training program.

Section 15 of Securities Act makes "control persons," or persons who "control" defendants liable under Sections 11 and 12. The purpose of this section is to help investors collect damages in cases where the defendant is insolvent or does not have enough money to pay the investor. Here, since the Court has concluded that plaintiffs failed to adequately state claims under Section 11 or Section 12(a)(2), the third cause of action for violation of Section 15 of the Securities Act is dismissed as moot.

Accordingly, the motion is granted in its entirety as against RYB Education Inc. and Liang Meng.

This is the decision and order of the Court.

Date: July 2, 2020



Hon. Joseph Risi, A.J.S.C.

FILED

**7/7/2020
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**COUNTY CLERK
QUEENS COUNTY**