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Dis-Honest: Judge Allows Lawsuit against Jessica Alba Company to Move Forward

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A judge in the United States District Court for the Central District of California has allowed a lawsuit against actress Jessica Alba's child and personal care company Honest to move forward. The case is the latest in a series of investor-led actions against companies that shareholders claim have used COVID-19 and associated disruptions to mislead the public about the financial health of their businesses.

The litigation against Alba's company, *Cody Dixon v. the Honest Company Inc. et al. (In re The Honest Company Securities Litigation*), centers on Honest's statements about its business at the time of its IPO in May 2021. At the time, Honest submitted registration and prospectus documents to the SEC that contained optimistic – and the plaintiffs allege, misleading – projections for its business. Honest allegedly did not disclose that some of its products, including the "Clean Conscious Diaper," had been panned by customers, and that consumers' behavior had already shifted markedly due to the COVID-19 pandemic, negatively impacting Honest's sales. When Honest subsequently disclosed disappointing revenue figures, its stock value tumbled, leading to the present investor action.

Honest moved to dismiss the claims against it, arguing that their optimistic projections were mere "puffery," and that it could not have known about negative feedback to their products or how the COVID-19 pandemic would affect their business. For example, Honest asserted that they could not predict what "no one else, including government and world health authorities" would do in response to the pandemic, or foresee the effect of worldwide disruptions on their business.

Judge Mark Scarsi was not entirely convinced. He found that the plaintiffs had pled that, by the time of the IPO in May 2021, Honest already knew about the negative customer reception to its products and had already experienced a downturn in sales as consumer buying habits shifted. As such, Judge Scarsi ruled that the plaintiffs could show that Honest had omitted material facts affecting their business outlook. Judge Scarsi did agree with Honest's arguments, however, that the investor plaintiffs could not show that Honest knew its "omnichannel" retail strategy would struggle as the world emerged from the worst of the pandemic and consumer shopping habits shifted once again, finding that such knowledge could not be reasonably inferred from the sales data that Honest had at the time of the IPO.

The order in *In re The Honest Company Securities Litigation* underscores the importance of complying with all relevant regulations of Section 11 of the Securities Act in connection with an IPO. Particularly at issue in this case are Items 105 and 303 of Regulation S-K, which require, among other things, the disclosure of material facts that could make an investment risky, as well as any "significant economic changes" that could affect a business's sales or revenue. These requirements have been particularly important to adhere to as the global economy experiences ongoing shifts, including continuing issues in the supply chain caused by COVID-19 to disruptions caused by Russia's war with Ukraine.

The action against Honest is also noteworthy as it is the latest in a series of actions targeting companies for failing to disclose material information related to a business's response to COVID-19. It appears courts may be less understanding, especially as time goes on, to issuers claiming that they did not know the effects that the ongoing pandemic could have on their business. To that end, it is important for companies and their counsel to stay informed about developments in securities disclosure laws, particularly as courts continue to assess what level of disclosure is required in response to current events. Engaging with outside counsel is often essential to avoiding or mitigating these litigation risks, especially given the ever-changing nature of jurisprudence in this developing area of the law.

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