Defense Lessons From Freshworks' Win In Post-IPO Case

By **David Friedman, Alison Benedon and Daniel Sinnreich** (July 17, 2025)

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On April 10, the U.S. District Court for the Northern District of California granted summary judgment to the defendants in Sundaram v. Freshworks Inc., a Section 11 lawsuit based on the issuer's evidence that the market absorbed any impact from a disclosure before its stock price dropped below the initial public offering price nearly two weeks later.

The decision helpfully clarifies two important points of law for defendants facing postoffering securities class actions: (1) that Section 11 plaintiffs cannot recover investment losses based on share price declines above the offering price; and (2) that defendants are not required to affirmatively identify the actual cause of a stock price decline to support a negative causation defense.

Section 11 of the Securities Act

Section 11(a) of the Securities Act — Title 15 of the U.S. Code, Section 77k(a) — imposes liability on issuers, underwriters and signatories to a registration statement if, at the time the registration statement becomes effective, it contains an untrue statement of a material fact or omits a material fact required to make it not misleading.

The damages provision in Section 11(e) provides for recovery of damages equal to the difference between the amount a plaintiff paid for the security — "not exceeding the price at which the security was offered to the public" — and the security's value when the lawsuit was brought or when the security was sold.

Unlike claims for securities fraud, Section 11 claims typically do not require a plaintiff to plead or prove loss causation. Rather, Section 11's damages provision provides defendants with an affirmative defense that can limit or eliminate damages if a defendant proves that factors other than the alleged misstatements or omissions caused the plaintiff's losses.

This is commonly called a negative causation defense. Where a defendant makes such a showing, the burden shifts back to the plaintiff to present evidence that the price decline resulted from the alleged misstatement or omission.

The Freshworks IPO and Lawsuit

On Sept. 22, 2021, Freshworks, a software company, held an IPO in which it sold 28.5 million shares of its common stock at $36 per share. The company's share price quickly rose following the IPO on the strength of its strong second-quarter results, which were reported in the IPO disclosures.

On Nov. 2, 2021, the company disclosed relatively weak results for the third quarter, and its share price dropped 14% and 8% on consecutive days, but remained above the IPO price of

$36. Approximately two weeks later, on Nov. 15, 2021, the company's share price first dropped below its IPO price.

In November 2022, a Freshworks shareholder filed a putative class action asserting claims under Section 11 of the Securities Act, alleging that Freshworks' registration statement failed to disclose the company's disappointing interim third-quarter financials at the time of the IPO. The shareholder had purchased shares the day after the IPO at $46 per share, selling them for $14.99 per share on Jan. 13, 2023.

The defendants narrowed the case through two pleadings-stage motions. In ruling on the defendants' motion to dismiss in September 2023, U.S. District Judge Charles Breyer dismissed all Section 11 claims except those arising from Item 303 of Regulation S-K, which requires disclosure of known trends or uncertainties reasonably likely to have a material impact on a registrant's financial condition.

And in ruling on the defendants' motion for judgment on the pleadings, the court held on Oct. 1, 2024, that Section 11 "does not permit plaintiffs to recover for stock price declines above the IPO price." The plaintiff's recoverable losses were therefore limited to those "incurred (1) below the IPO price [and] (2) that were caused by Defendants omitting" known third-quarter financial trends from the registration statement.

The court explained that the question of whether there were recoverable damages was best suited "for summary judgment or trial, likely with the assistance of expert testimony."

The defendants later moved for summary judgment on the grounds that the plaintiff had no recoverable damages, because any share price decline below the IPO price was caused by factors other than the defendants' alleged misstatements and omissions.

The Summary Judgment Decision

Judge Breyer granted the defendants' motion for summary judgment on April 10, and held that no recoverable losses were caused by the defendants' alleged omissions.

First, the court reiterated its prior holding that, under the plain language of Section 11, the plaintiff "can recover only for losses he sustained by Freshworks stock dropping below the IPO price of $36 per share." The court clarified that the fact that the plaintiff purchased shares for $46 per share — above the IPO price — did not affect the calculation because the statutory calculation is capped by the price "at which the security was offered to the public."

Second, the court credited the defendants' uncontested expert evidence that Freshworks stock traded in an efficient market, meaning that all publicly available information was quickly reflected in the stock price — "at most, within a day." Accordingly, the market absorbed any impact from the issuer's Nov. 2, 2021, disclosure of disappointing third-quarter results prior to Nov. 15, 2021, when the company's stock price first dropped below the IPO price, and any subsequent decline below the IPO price was necessarily caused by other factors.

Although the plaintiff relied on an expert who opined that stock prices "may drift downwards for up to three months after negative earnings surprises become public," the expert did not persuade the court because it did not apply the "drift" theory to the facts of the case.

Finally, the court rejected the plaintiff's argument that the negative causation defense required the defendants to "affirmatively identify the actual cause" of the stock drop below the IPO price, explaining, "Nowhere in the statute or the case law is there a requirement that the defendant affirmatively prove what caused the decline; all a defendant must show is that the decline was not caused by the alleged misstatement or omission."

As a result, any dispute of fact as to what caused the stock price to decline below the offering price was not material — and could not prevent summary judgment — because the plaintiff had not offered any evidence to dispute the defendants' expert's conclusion that the decline was not caused by the alleged omissions that were revealed to the market two weeks earlier.

Implications

The decision joins a growing consensus that the plain language of Section 11 prohibits plaintiffs from recovering for investment losses sustained by stock drops above an offering price, even if the plaintiff purchased shares above the offering price and suffered greater investment losses as a result.[1]

The decision also rejects a common argument from plaintiffs that, to establish a negative causation defense, defendants must prove not only that their alleged misrepresentations were not the cause of a stock drop, but also affirmatively prove the cause of the stock drop. Such an argument requires defendants to prove more than is required by statute and, following a negative causation showing by defendants, improperly shifts a plaintiff's burden of establishing the cause of its investment losses.

Defendants facing Section 11 lawsuits following a public offering should carefully review the issuer's stock price movement around the time of the offering and the alleged truthful disclosure to see if the arguments or defenses that persuaded the district court in this case may apply.

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[1] See, e.g., Plichta v. SunPower Corp., 790 F. Supp. 2d 1012, 1023 (N.D. Cal. 2011); In re: WRT Energy Sec. Litig., 2005 WL 2088406, at *3 (S.D.N.Y. Aug. 30, 2005); In re: Initial Pub. Offering Sec. Litig., 241 F. Supp. 2d 281, 348 (S.D.N.Y. 2003).