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Stitch Fix Faces Stockholder Suit Over Direct Sale Losses

By **Leslie A. Pappas**

Law360 (March 23, 2023, 6:26 PM EDT) -- A shareholder of online fashion retailer Stitch Fix Inc. has sued the company in Delaware's Court of Chancery, alleging that from December 2020 through March 2022, the company misled the public about the effect that a direct-buy option was having on its subscription business.

In a verified stockholder derivative complaint filed March 17 and unsealed late Wednesday, shareholder Keith Horton alleges that for almost a year and a half, the company's officers and directors made "false and misleading statements and material omissions" about the company's "Freestyle" program, which allowed customers to buy directly from the website instead of through its subscription service.

The defendants "breached their fiduciary duties by personally making and/or causing Stitch Fix to make to the investing public a series of materially false and misleading statements and omissions about the Freestyle direct buy, including its cannibalization of the company's legacy Fix business," the complaint says.

The Delaware lawsuit comes a few months after Stitch Fix founder Katrina Lake announced on Jan. 5, 2023, that Elizabeth Spaulding would step down as CEO and the company would cut its salaried workforce by about 20%.

San Francisco-based Stitch Fix traditionally sold items through its "Fix" subscription service. The subscription service regularly delivered boxes filled with stylist-selected items that allowed customers to try on and buy what they liked, then return the rest.

But beginning in July 2019, the company started to let customers buy certain items directly from the Stitch Fix website in between their box deliveries, without having to rely on a stylist's suggestions first, the complaint says.

In early 2021, Spaulding dismissed concerns that giving customers a direct-buy option might cannibalize sales and revenue from the company's traditional business, telling analysts on a conference call that the new experience was "additive," the complaint says.

"In truth, throughout the relevant period, Stitch Fix concealed the fact that the new Freestyle program was not complementary or additive to the company's legacy business and that, instead, the Freestyle program would cannibalize the company's Fix service," the complaint says.

The company officially launched the "Freestyle" program in September 2021, allowing customers for the first time to purchase items directly from the Stitch Fix website without ordering a Fix subscription first, according to the complaint.

The company admitted in December 2021 that the Freestyle program had caused some "short term" cannibalization of its subscription business. In March 2022, Spaulding said that Freestyle had "inadvertently created friction" for its customers — news that triggered a 6% drop in the company's stock price.

Horton filed the lawsuit derivatively on behalf of Stitch Fix, naming Spaulding, Lake, and seven other company directors as defendants.

The four-count complaint seeks damages for breaches of fiduciary duty, aiding and abetting breaches of fiduciary duty, unjust enrichment, and waste of corporate assets.

Horton alleges that the directors breached their fiduciary duties by not being forthcoming about how the Freestyle program was affecting the company's legacy business, and failing "to correct these false and misleading statements and omissions of material fact to the investing public."

He also alleges that the company failed to put internal controls in place that could have corrected some of the company's disclosure failures.

Horton built his case in part on a demand he made on the company in October 2022 for access to its corporate books and records, the complaint said. Under Section 220 of Delaware General Corporation Law, a shareholder may demand access to a company's books and records if there is a reasonable suspicion of corporate wrongdoing.

Stitch Fix did not immediately respond Thursday to Law360's request for comment. Counsel for Horton did not respond to a request for comment.

Keith Horton is represented by Joshua H. Grabar of Grabar Law Office and Seth D. Rigrotsky, Gina M. Serra and Herbert Mondros of Rigrotsky Law PA.

Counsel information for Stitch Fix was not immediately available on Thursday.

The case is Keith Horton v. Katrina Lake, et al., case number 2023-0337, in the Court of Chancery of the State of Delaware.

--Editing by Emily Kokoll.