

Fourth Circuit: Allegations Sufficient to Raise an Inference of the Speaker's Knowledge of a Statement's Falsity Do Not, Standing Alone, Satisfy the Scierter Pleading Requirement

12.18.17



(Article from *Securities Law Alert*, November/December 2017)

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On November 15, 2017, the Fourth Circuit held that allegations raising an inference of a CEO's knowledge of a statement's falsity were not "sufficient to show that [the CEO] acted intentionally or recklessly to deceive, manipulate, or defraud." [Maguire Financial v. PowerSecure Int'l](#), No. 16-2163 (4th Cir. 2017) (Duncan, J.). The Fourth Circuit reasoned that "scierter and knowledge with respect to misrepresentation are distinct components of the requisite analytical framework." The court stated that "[t]o conflate the two ... would read the scierter element out of the analysis in contravention of the ... exacting pleading standard" established by the Private Securities Litigation Reform Act ("PSLRA").

At issue in the case before the Fourth Circuit was a CEO's alleged misrepresentation that the company had obtained a contract "renewal and expansion" when the company had instead secured a new contract that allegedly turned out to be less profitable than the original contract. The Fourth Circuit recognized that "[a] reasonable investor might well expect a seasoned executive like [the company's CEO] to know the difference between a contract renewal" and a new contract, "and intend to make the distinction." However, the court explained that "the reasonable investor's view of a factual statement" is relevant to the "material misrepresentation inquiry," rather than the scierter inquiry.

The Fourth Circuit determined that it could not "infer" scierter from allegations suggesting that the CEO "knew his statement was false." The court found plaintiffs were attempting to "fuse[] an inference that [the CEO] knew enough to realize that his characterization was technically incorrect with an inference that he intended to deceive." The court stated that "stacking inference upon inference in this manner violates the [PSLRA's] mandate that the strong inference of scierter be supported by facts, not other inferences."

Here, the Fourth Circuit declined "to find intent to deceive investors" based on the CEO's onetime use of the "possibly ambiguous" word "renewal" to describe "an agreement that had historically accounted for approximately 4.1% of the company's annual revenue." The court reasoned that "[i]f [the CEO] wanted to deceive investors, [one] would expect that he would discuss the new contract at length, in greater detail, or multiple times, not that he would briefly and ambiguously characterize it as a 'renewal and expansion' once."

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