

Circuit Court Decisions Addressing Scierter

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First Circuit: Allegations That a Pharmaceutical Company Was Dependent on Offerings to Fund Its Operations Were Insufficient to Plead Scierter

On April 4, 2018, the First Circuit rejected plaintiffs' efforts to plead scierter by alleging that a pharmaceutical company was "dependent upon offerings to fund its operations" because it was "in a race for FDA approval" and was "generating no significant revenue." [Kader v. Sarepta Therapeutics](#), 887 F.3d 48 (1st Cir. 2018) (Torruella, J.). The court explained that it has "set a high bar for arguments of this sort." To plead scierter based on a motive to boost the company's stock price, plaintiffs must allege "something more than the ever-present desire to improve results, such as allegations that the very survival of the company was on the line."

In the case before it, the First Circuit found the complaint "bereft of allegations that [the company] was financially on the ropes, or that it would shutter its doors unless it padded earnings by deceiving investors." The court recognized that the company's initial public offering may have "generated revenue that proved useful to [the company] in its race for FDA approval, so as to secure the first-mover advantage." However, the First Circuit held that this "alone cannot bear the weight of an inference of scierter that is at least as compelling as any other."

Third Circuit: Affirms Dismissal of a Securities Fraud Class Action Where the Allegations Suggested Mismanagement Rather Than Fraud

On September 20, 2018, the Third Circuit affirmed dismissal of a securities fraud class action against a car rental company brought on the heels of an acknowledgement in an SEC filing that a "sometimes inappropriate tone at the top . . . may have led to inappropriate accounting decisions." [In re Hertz Global Holdings](#), 905 F.3d 106 (3d Cir. 2018) (Jordan, J.). The Third Circuit held the district court did not err in interpreting this statement as "an admission of 'mismanagement,' as opposed to an admission of 'misconduct.'" The Third Circuit found the allegations did not "necessarily suggest" that defendants were "engaged in a systematic fraud." The court determined that it was "[m]ore plausible . . . that the [i]ndividual [d]efendants were just bad leaders."

The Third Circuit found that "any inference of scierter was circumscribed by the fact that the accounting errors were spread across myriad accounting categories." The court also placed no weight on the allegation that the individual defendants certified the accuracy of the company's SEC filings, as plaintiffs did not allege that any defendant "knew he was signing a false SEC filing or recklessly disregarded inaccuracies" in the

filings. The court also determined that the alleged insider trading activity did not support a strong inference of scienter because the individual defendants did not sell their holdings when the stock was trading at its peak. Moreover, the court placed no weight on allegations that the individual defendants “each resigned in close proximity to the public release of bad news.” The court reasoned that “[c]hanges in leadership are only to be expected when leadership fails.”

Ninth Circuit: Generalized Allegations of an IPO-Related Motive to Boost Profitability Are Insufficient to Plead Scienter

On March 8, 2018, the Ninth Circuit held that generalized allegations of a motive to boost a company’s financial performance in the months before and after an IPO are insufficient to meet the high bar for pleading scienter. [Webb v. SolarCity Corp.](#), 884 F.3d 844 (9th Cir. 2018) (Smith, Jr., J.). In the case before it, the Ninth Circuit found that plaintiffs’ IPO-related motive allegations were neither “specific” nor “particularized,” but instead spoke to the type of “routine corporate objectives” that it has rejected in the past. The court explained that “[s]urely every company that goes public wants to maximize its apparent profitability prior to its IPO and to maintain a high share price afterward in order to finance acquisitions and expand.”

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