

KIRKLAND ALERT

February 2014

“Holistic” Review of Scienter Allegations in Securities Fraud Class Actions Resulting in Increased Number of Dismissals

Scienter is the intent to defraud, and it is a required element of a securities fraud claim. In 2011, the Supreme Court issued the *Matrixx* decision, which reaffirmed the Court’s *Tellabs* holding that a securities fraud claim is adequately pleaded *only* if “a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged.”¹ In *Matrixx*, the Court also reaffirmed that scienter allegations are to be considered “collectively” or “holistically.”

In analyzing scienter allegations, courts have recognized that “zero plus zero equals zero.”

Some commentators predicted that *Matrixx* and *Tellabs* would make it easier for a plaintiff to plead scienter because a court—having to view a complaint “holistically”—might be dissuaded from dismissing a case even where no single allegation of scienter in the complaint was sufficient to establish scienter. In practice, however, this approach has helped defendants, not plaintiffs.

In the first instance, courts have recognized that “zero plus zero equals zero.”² For example, in one recent decision, a Court of Appeals held that the following allegations, even when viewed holistically, were *insufficient* to establish scienter: (1) internal company documents that were arguably inconsistent with the company’s public statements; (2) individual defendants’ alleged interest in increasing the company’s stock price for the purpose of using the company’s stock in an acquisition; and (3) class period stock sales by the individual defendants.³

Another Court of Appeals determined that the complaint was properly dismissed for lack of scienter where there were a number of independently insufficient allegations, including that the individual defendants would want to maintain the company’s stock price because (1) the company was seeking a partner; (2) the company was planning to raise capital in a stock offering; and (3) the individual defendants supposedly knew they would receive higher salaries, bonuses and stock options if allegedly negative information about the company was not disclosed.⁴

Not only are courts finding that zero plus zero still equals zero, but courts are also considering public records and other factors, which often tend to negate an inference of scienter. These factors include:

- **Stock Trading Activity.** When defendants increase their stock holdings during the class period, this raises a “compelling inference against scienter.”⁵ Lack of stock sales has also been found to negate an inference of scienter.⁶
- **Timely Disclosure of Risks and Difficulties.** Public disclosure regarding the business operations at issue tends to negate an inference that the defendants were intentionally or recklessly misleading investors.⁷

- **Lack of restated financials.** The lack of restated financials tends to negate an inference of scienter.⁸
- **Lack of Contemporaneous Internal Documents.** The failure to identify “a single document, e-mail, meeting, conversation, or statement of any kind that supports the complaint’s allegations” tends to negate an inference of scienter.⁹
- **Size of Potential Loss.** “Because the losses … were extremely modest in relation to revenues …, no such inference [of scienter] exists.”¹⁰

The holistic approach has benefitted defendants because usually the non culpable inferences are more compelling than the inference of fraudulent intent when all relevant factors are considered.

In sum, courts considering scienter allegations after *Matrixx* have continued to require plaintiffs to bear the burden—as is appropriate—of alleging specific facts that give rise to an inference of scienter that is cogent and at least as compelling as any opposing inference one could draw. Viewing the allegations holistically in accordance with *Matrixx* and *Tellabs* encourages courts to consider all relevant factors, including those that negate a compelling inference of scienter. This holistic approach has benefitted defendants because usually the non culpable inferences are more compelling than the inference of fraudulent intent when all relevant factors are considered.

¹ *Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309, 1324 (2011) (citing *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 324, 326 (2007)).

² *City of Roseville Emps.’ Ret. Sys. v. Horizon Lines, Inc.*, 442 F. App’x 672, 675 (3d Cir. 2011).

³ See *In re Level 3 Commc’ns, Inc. Sec. Litig.*, 667 F.3d 1333, 1344 n. 13 (10th Cir. 2012).

⁴ See *In re Rigel Pharm., Inc. Sec. Litig.*, 697 F.3d 869, 884 (9th Cir. 2012).

⁵ *Monk v. Johnson & Johnson*, No. 10 Civ. 4841, 2011 WL 6339824, at *12 n. 12 (D.N.J. Dec. 19, 2011).

⁶ *In re ChinaCast Educ. Corp. Sec. Litig.*, No. 12 Civ. 4621, 2012 WL 6136746, at *8 (C.D. Cal. 2012).

⁷ *Pipefitters Loc. No. 636 Defined Benefit Plan v. Tekelec*, No. 11 Civ. 4-D, 2013 WL 1192004, at *13 (E.D.N.C. Mar. 22, 2013) (quotation omitted).

⁸ *City of Roseville Emps.’ Ret. Sys. v. Sterling Fin. Corp.*, No. 09 Civ. 0368, 2013 WL 3990798, at *42 (E.D. Wash. Aug. 5, 2013).

⁹ *Id.*

¹⁰ *In re Boston Sci. Corp. Sec. Litig.*, 686 F.3d 21, 32 (1st Cir. 2012).

If you have any questions about the matters addressed in this *Kirkland Alert*, please contact the following Kirkland authors or your regular Kirkland contact.

Jay P. Lefkowitz, P.C.
Kirkland & Ellis LLP
601 Lexington Avenue
New York, NY 10022
www.kirkland.com/lefkowitz
+1 (212) 446-4970

Matthew Solum
Kirkland & Ellis LLP
601 Lexington Avenue
New York, NY 10022
www.kirkland.com/msolum
+1 (212) 446-4688

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