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Sixth Circuit Affirms Dismissal on Scierter Grounds in *Doshi v. Gen'l Cable Corp.* (May 24, 2016)

Securities Litigation Legal Update

In *Doshi v. Gen'l Cable Corp.*, ___ F.3d ___, 2016 WL 2991006 (6th Cir. May 24, 2016), the Sixth Circuit affirmed a district court order dismissing a securities fraud class action against a company and two of its executives, on the grounds that the complaint failed to plead facts sufficient to create a strong inference of scierter on the part of either the company or the individual defendants. In its holding, the Sixth Circuit refused to impute the state of mind of a senior non-defendant executive to the company for the purposes of scierter, because that executive had not made any false or misleading public statements.

Plaintiff alleged that General Cable and its CEO and CFO had violated Sections 10(b) and 20(a) of the Exchange Act, as well as Rule 10b-5, by acting at least recklessly in issuing or approving materially false public financial statements. Defendants countered that the misstatements were a product of accounting errors and theft in General Cable's Brazilian operations, and that they had promptly remediated these problems upon learning of them. The district court granted defendants' motion to dismiss, on the grounds that plaintiff had failed to plead scierter, and denied plaintiff's request to file an amended complaint as futile.

In evaluating the district court's rulings, the Sixth Circuit emphasized the standards set forth in *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007), which requires that allegations of scierter be assessed

"holistically," and that courts weigh the strength of scienter allegations against "plausible opposing inferences" of innocent conduct. *Doshi*, 2016 WL 991006 at *4 (quoting *Tellabs*, 551 U.S. at 323, 326). In performing the *Tellabs* holistic review, the Sixth Circuit examined the nine factors listed in its decision in *Helwig v. Vencor, Inc.*, 251 F.3d 540, 552 (6th Cir. 2001) (*en banc*). These factors, which are not exhaustive, include the following:

(1) insider trading at a suspicious time or in an unusual amount; (2) divergence between internal reports and external statements on the same subject; (3) closeness in time of an allegedly fraudulent statement or omission and the later disclosure of inconsistent information; (4) evidence of bribery by a top company official; (5) existence of an ancillary lawsuit charging fraud by a company and the company's quick settlement of that suit; (6) disregard of the most current factual information before making statements; (7) disclosure of accounting information in such a way that its negative implications could only be understood by someone with a high degree of sophistication; (8) the personal interest of certain directors in not informing disinterested directors of an impending sale of stock; and (9) the self-interested motivation of defendants in the form of saving their salaries or jobs.

Doshi, 2016 WL 2991006 at *4 (citing *Helwig*, 251 F.3d at 552).

Plaintiff's scienter arguments as to General Cable turned in large part on the conduct of a non-defendant executive named Mathias Sandoval, who headed the "Rest of World" ("ROW") division that included the company's operations in Brazil. While the Sixth Circuit accepted plaintiff's theory that Sandoval's knowledge of the theft and accounting errors in Brazil could be imputed to General Cable, it cited its decision in *Omnicare* in refusing to impute Sandoval's scienter to General Cable, because plaintiff had not alleged that Sandoval had drafted, reviewed, or approved General Cable's erroneous public statements—in other words, that Sandoval had "made" a statement. *Doshi*, 2016 WL 2991006 at *5 (citing *In re Omnicare, Inc. Sec. Litig.*, 769 F.3d 455, 476, 481 (6th Cir. 2014)). The court then concluded that seven out of the nine *Helwig* factors weighed against an inference of scienter on the part of the company. Although "one could infer that General Cable acted recklessly by issuing its public financial statements," the court concluded, the facts alleged in plaintiff's complaint established a stronger countervailing inference that the materially false statements

were a product of theft and errors by local managers in Brazil and the legitimate freedom accorded to ROW to report financial data. *Id.* at *7.

Having concluded that plaintiff's complaint failed to create a strong inference that General Cable acted with scienter, the Sixth Circuit turned to the two individual executive defendants. Although the court allowed that a holistic review of the facts lent "some support to an inference that [the executive defendants] consciously disregarded the obvious risks that each issued or authorized false public financial statements," it once again concluded based on the *Helwig* factors that there was no strong inference of scienter, and that at most the alleged facts supported an inference that the two executives had been negligent in issuing or authorizing false statements. *Id.*

In considering plaintiff's request to file an amended complaint, the Sixth Circuit evaluated plaintiff's new proffered allegations, which included, *inter alia*, assertions that General Cable had disclosed FCPA violations in foreign countries that were not Brazil, and that the executive defendants could have lost previously-issued incentive compensation by disclosing the misstatements. The Sixth Circuit held that the district court had correctly decided that these proposed amendments would have been futile, given that the FCPA violations were unrelated to the theft and errors in Brazil, and the new incentive compensation allegations were too general to support a strong inference of scienter.