

## [Securities Regulation Daily Wrap Up, TOP STORY—9th Cir.: Failure to meet \*Omnicare\* falsity standards, plead scienter correctly led to dismissal, \(May 8, 2017\)](#)

Securities Regulation Daily Wrap Up

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By [Amy Leisinger, J.D.](#)

A Ninth Circuit panel affirmed dismissal of securities fraud and related controlling person claims for failure to adequately plead falsity or scienter in connection with alleged misstatements regarding the goodwill valuation of a subsidiary. The panel found that the standards for pleading falsity of opinion statements articulated in *Omnicare, Inc. v. Laborers Dist. Council Constr. Ind. Pension Fund* apply to Section 10(b) and Rule 10b-5 claims and that the plaintiffs failed to adequately allege facts demonstrating any stated belief or any fact contained within an opinion was untrue or any omitted fact rendered a statement misleading. The plaintiffs also failed to plead facts raising a strong inference of scienter, the court concluded ([City of Dearborn Heights Act 345 Police & Fire Retirement System v. Align Technology, Inc.](#), May 5, 2017, Smith, M.).

**Alleged fraud and dismissal.** In April 2011, Align Technologies, Inc., a dental appliance manufacturer, acquired Cadent Holdings, Inc., for \$187 million in cash, \$135 million of which was considered "goodwill" exceeding the fair value of the company's net assets. Cadent began to experience financial issues in 2011, but Align did not take any interim goodwill impairments until October 2012. Over time, the company's stock price began to fall.

In a fraud class action, investors alleged that Align made a number of allegedly false statements in press releases and SEC filings relating to the goodwill valuation. The district court dismissed the action, [finding](#) that investors did not allege enough facts showing that the defendants knew their statements were false. The court agreed that the plaintiffs had to plead particularized facts establishing that the defendants did not believe their statements concerning goodwill at the time they made them, and noted that the complaint lacked allegations identifying the assumptions actually relied on in conducting goodwill impairment analyses. The court also found that the investors did not establish scienter and did not allege sufficient facts showing knowledge or belief that the results reported were false or unreasonable. Considered holistically, the facts painted "a picture of corporate mismanagement and unrealized optimism," not fraudulent intent or deliberate recklessness, the court concluded.

**Falsity.** In *Omnicare*, the Supreme Court noted that Section 11 imposes liability for both material misstatements and omissions, the panel noted. When a plaintiff relies on a theory of material misrepresentation, the complaint must allege that the speaker did not hold the belief and that the belief was objectively untrue. When a plaintiff argues that a statement of fact contained within an opinion statement is materially misleading, the complaint must allege that the supporting fact is untrue. When a plaintiff cites a material omission, the complaint must identify facts forming the basis for the opinion whose omission makes the opinion statement misleading.

The panel held that *Omnicare's* Section 11 reasoning is equally applicable to Section 10(b) and Rule 10b-5 claims and that the complaint failed to sufficiently plead falsity under any of the standards. The investors failed to allege facts showing that the defendants did not believe the subsidiary's goodwill was impaired in late 2011 and early 2012 or that Align failed to perform impairment testing when required, the panel stated. In addition, the panel noted that Align could have found positive occurrences to balance the negative circumstances the investors suggested required impairment testing. Without allegations concerning the actual assumptions relied on in conducting the goodwill analyses, it is not possible to plausibly infer that the defendants intentionally disregarded information during the class period, according to the panel.

The panel also held that, to the extent that the Ninth Circuit's prior standard permitted plaintiffs to plead falsity by alleging "no reasonable basis for the belief" under a material misrepresentation theory of liability, the prior standard was "clearly irreconcilable" with *Omnicare* and was therefore overruled.

**Scienter.** The panel also found that the investors failed to establish a strong inference that the defendants knew of or were deliberately reckless in ignoring issues surrounding the goodwill inflation. At most, the defendants' knowledge establishes a possible GAAP violation in connection with Align's failure to perform goodwill impairment testing, but a GAAP failure alone is insufficient to establish a strong inference of scienter, the panel stated. The investors did not allege the specific assumptions relied on in the earlier goodwill valuations, and an inference that the defendants showed poor business judgment is just as compelling as one of scienter, the panel found.

Additionally, in finding that an employee resignation and stock transactions failed to support an inference of scienter, the court affirmed dismissal of the fraud action.

The case is [No. 14-16814](#).

Attorneys: Darren Jay Robbins (Robbins Geller Rudman & Dowd LLP) for City of Dearborn Heights Act 345 Police & Fire Retirement System. Douglas John Clark (Wilson Sonsini Goodrich & Rosati) for Align Technology, Inc.

Companies: Align Technology, Inc.

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