

Eleventh Circuit Affirms Dismissal of Securities Fraud Class Action for Failure to Plead Corporate Scienter in Alleged Fraudulent Sales Scheme

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The Eleventh Circuit Court of Appeals [recently affirmed the dismissal](#) of a purported securities fraud class action, because lower-level corporate officials with knowledge of an alleged fraudulent sales scheme were not “responsible for” any of the CEO’s or CFO’s challenged statements. For claims under section 10(b) of the Securities Exchange Act of 1934, plaintiffs must “state with particularity” facts giving rise to an inference of scienter on the part of the individual making a misrepresentation so as to impute intent to the company. When a plaintiff fails to do so, a court will dismiss. Several shareholders sued Tupperware and certain corporate officers for securities fraud based on alleged misrepresentations of Tupperware’s financial performance, arising out of direct-sales activities in Mexico. The plaintiffs alleged that the company schemed to ship extra products to sales representatives, despite the sales representatives not having ordered those products. According to the complaint, the company recognized the revenue associated with these shipments when the products were sent out, knowing that the products would be returned. Importantly, the shareholders did not allege that the CEO and CFO acted with scienter. When the truth about these practices became known to the market, the shareholders alleged, the stock dropped 35% and then, with more disclosures, 45%. The district court dismissed the third amended complaint with prejudice, and the Eleventh Circuit affirmed, dismissing the misrepresentation claims for failing to plead corporate scienter with specificity. The Eleventh Circuit found, for purposes of the appeal, that three corporate officials knew of the alleged fraud. The court held, however, that none of the three was directly connected to the company’s public reporting such that their knowledge could be attributed to the corporation in making those disclosures. The court explained that in cases alleging securities fraud based on a misrepresentation, courts look to the state of mind of the corporate official (a) who makes or issues the statement or (b) “who order[s] or approve[s] a statement or its making or

issuance, or who furnish[es] information or language for inclusion therein, or the like.” The plaintiffs urged the court to adopt a more broad and novel standard. In their view, if a corporate official’s fraudulent act is a “proximate cause” of a materially false or misleading statement, then the corporate official’s scienter should be imputed to the corporation consistent with the “responsible for” standard in *Mizzaro v. Home Depot Inc.* The court declined to adopt the plaintiffs’ standard, noting that the plaintiffs’ reading of *Mizzaro* was incorrect. *Mizarro* focused on scienter in connection with the *issuing* of a misleading statement, not the underlying fraudulent conduct. Defense counsel should be cognizant of grounds for dismissal based on a failure to plead corporate scienter with specificity, even where plaintiffs plead scienter as to lower-level corporate officials and underlying fraudulent conduct that results in inaccurate content later being incorporated into public financial statements.

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