

Corporate & Financial Weekly Digest

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Shareholder Suit Dismissed for Insufficient Scierter Allegations

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The U.S. Court of Appeals for the Eleventh Circuit affirmed the dismissal of a consolidated securities fraud action, holding that the complaint's scierter allegations did not meet the required heightened pleading standards.

Plaintiffs were shareholders in Technical Olympic USA, Inc. (TOUSA), and defendants were TOUSA executive officers. TOUSA entered into a significant joint venture acquisition funded in large part by a \$675 million loan. TOUSA provided certain guarantees to the lenders. After the acquisition, TOUSA described the loan as "non-recourse" to TOUSA in Securities and Exchange Commission filings, press releases and analyst conference calls, and did not disclose the guarantees until March of 2006, after it had finalized the loan in August 2005. In November of 2006, TOUSA disclosed demand letters by the lenders under the guarantees. TOUSA's share price plummeted and it subsequently went bankrupt. Litigation followed.

Plaintiffs' securities fraud allegations focused on the characterization of the loan as non-recourse and the delayed disclosure of the guarantees. Affirming the trial court's dismissal of plaintiffs' claims, the Eleventh Circuit held that the "amended complaint fails to allege any direct evidence showing defendants acted with the requisite scierter." The complaint included no allegations that the defendants did not reasonably believe the loan to be non-recourse to TOUSA, no allegations that anyone ever questioned the non-recourse nature of the loan, no evidence that the defendants ever read the guarantees or believed more disclosures were required, thought any person at TOUSA was engaged in fraud, or had any other reason to believe the guarantees represented a material risk for TOUSA and its shareholders. Because the complaint rested only on speculative or conclusory allegations of scierter, the Eleventh Circuit found that the lower court properly dismissed the claims. (*Durgin, Briclayers & Trowel Trades Int'l Pension Fund et al. v. Mon et al.*, No. 09 Civ. 15595, 2011 WL 573483 (11th Cir. Feb. 18, 2011))

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