

Corporate & Financial Weekly Digest

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Mere Failure to Disclose Unfavorable Regulation Is Insufficient to Establish Scierter

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The U.S. Court of Appeals for the First Circuit affirmed dismissal of securities fraud claims against a technology company, holding that the plaintiffs failed to establish that the failure to disclose unfavorable regulatory changes in Japan was a result of defendants' wrongful intent.

Waters Corp. manufactures and sells water treatment equipment worldwide, deriving 10% of its revenue from sales in Japan. The Japanese government eased water regulations in March 2007, reducing the demand for Waters' equipment, but company officials did not mention this development during a conference call with investors in October, stating instead that the "softness in Japan" was related to general economic conditions. When Waters missed its 2007 fourth quarter earnings forecast, company officials disclosed the Japanese government's actions and Waters' stock price dropped 20%. Investors sued the company and its directors for securities fraud under the Private Securities Litigation Reform Act (PSLRA), but their claims were dismissed by the district court.

The First Circuit affirmed the dismissal, holding that that the failure to disclose the Japanese government's actions did not give rise to a strong inference of scienter as required by the PSLRA. The court ruled that even though company officers knew about the new regulations in March 2007, the plaintiffs failed to establish that the defendants knew the change would have a material impact on the company. Because company officials could have reasonably believed the regulatory changes would not significantly impact worldwide sales during 2007, the failure to disclose the changes did not establish that they acted with the requisite scienter for securities fraud. (*City Of Dearborn Heights v. Waters Corp.*, 2011 WL 167837 (1st Cir. Jan. 20, 2011)).

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