

APR 10 2008

Municipal Employees v. Skechers USA, Inc., 05-55980
PAEZ, Circuit Judge, dissenting:

CATHY A. CATTERSON, CLERK
U.S. COURT OF APPEALS

I respectfully dissent. I would reverse the district court's dismissal of Plaintiffs' consolidated complaint and remand for further proceedings. Considering the totality of Plaintiffs' allegations as required by *Tellabs, Inc. v. Makor Issues & Rights Ltd.*, 551 U.S. ___, 127 S. Ct. 2499 (2007), I would hold that they have met their burden under the heightened pleading requirements of the Private Securities Litigation Reform Act (PSLRA) to allege a strong inference of scienter. Although this is a high standard, it is not an impossible one.

When reviewing a complaint alleging fraud under section 10(b), "courts must consider the complaint in its entirety" to determine "whether *all* of the facts alleged, taken collectively, give rise to a strong inference of scienter, not whether any individual allegation, scrutinized in isolation, meets that standard." *Tellabs*, 127 S. Ct. at 2509. *Tellabs* requires that overall, "[t]he inference of scienter must be more than merely 'reasonable' or 'permissible'—it must be cogent and compelling . . . at least as compelling as any opposing inference one could draw from the facts alleged." *Id.* at 2510. Thus, while we must also consider "plausible opposing inferences" that are unfavorable to Plaintiffs, to satisfy their burden

under the PSLRA, Plaintiffs “must plead facts rendering an inference of scienter *at least as likely as* any plausible opposing inference.” *Id.* at 2509, 2513.

Plaintiffs allege a complex pattern of fraud whereby Defendants knowingly made false statements regarding future sales when they already knew that sales were declining, misrepresented the true cause of a temporary rise in sales that was the product of an alleged cover-up by Defendants prior to the class period, and cushioned their losses by taking advantage of artificially inflated stock prices with carefully timed insider trading during the class period. In support of these allegations, Plaintiffs allege particularized facts, which, taken in their totality, give rise to a strong inference of scienter.

Plaintiffs allege that Defendant M. Greenberg represented that retailers were placing their 2002 orders with Skechers three to four months in advance. This statement was independently corroborated by Confidential Witness 5, a regional sales manager. Taken together with additional allegations from other confidential witnesses that Defendants knew in January and February 2002 that sales had declined significantly and were continuing to do so for the upcoming second, third, and fourth quarters, these allegations support a plausible inference that Defendants knew in April and July 2002 that their statements predicting increased profits were

false. *See Nursing Home Pension Fund, Local 144 v. Oracle Corp.*, 380 F.3d 1226, 1231 (9th Cir. 2004) (concluding that factual allegations describing specific information about declines in sales and its availability to defendants during the relevant time period was sufficient to support an inference of scienter when considered with remaining allegations in complaint). Taking into account plausible competing inferences, they are no more compelling than the inference of scienter supported by Plaintiffs' entire complaint.

Plaintiffs also allege that Defendants knew that statements they made about \$20 million in sales shifted from the third quarter into the second quarter were false because they implied that retailers, rather than Skechers, had requested the early sales. Although, as the majority observes, that Skechers requested early sales is not, by itself, necessarily improper, Plaintiffs allege that these statements falsely portrayed increased demand for Skechers products when demand was in fact decreasing. Whether the shifted sales were necessary to meet second-quarter expectations does not affect the misleading nature of the statements, nor does M. Greenberg's explanation that the increase attributable to the shifted sales would come out of third-quarter expectations. Plaintiffs alleged facts demonstrating that Defendants falsely stated that the \$20 million in early shipments were requested by

retailers and concealed the fact that the early sales were initiated by Skechers. I disagree with the majority's characterization of these allegations; at a minimum, the statements were misleading to investors because they overstated demand for Skechers' products.

In support of these allegations, the complaint includes detailed information from six confidential witnesses who corroborate one another, describing how managers acting at the direction of M. and R. Greenberg were instructed to offer their customers extended payment terms to encourage acceptance of early delivery and identifying specific customers that were offered these terms. Two of these confidential witnesses, both Distribution Supervisors, confirmed that neither of them had been contacted by customers requesting early delivery, which directly contradicts the allegedly false statements made by M. Greenberg, R. Greenberg, and D. Weinberg that retail requests were responsible for the boost in second quarter sales. The complaint includes additional allegations from another confidential witness, a Territory Sales Manager, confirming that only Defendants had the authority to extend payment terms. Taken together, these allegations support a strong inference of scienter.

Finally, Plaintiffs allege that Defendants engaged in insider trading during

the class period, when the Greenbergs sold between 7% and 17% of their total holdings and Weinberg sold 42% of his smaller stake in the company. While this court has not generally inferred scienter from sales in this range, as Plaintiffs allege, the timing of the sales is suspicious because the sales took place during the period when Skechers' stock price hit its peak. See *In re Daou Systems Sec. Litig.*, 411 F.3d 1006, 1024 (9th Cir. 2005); *In re Silicon Graphics Inc. Sec. Litig.*, 183 F.3d 970, 987 (9th Cir. 1999); *Ronconi v. Larkin*, 253 F.3d 423, 435 (9th Cir. 2001). As the Supreme Court noted in *Tellabs*, 127 S. Ct. at 2511, allegations that defendants engaged in insider trading are not necessary to establish scienter, but may contribute to our evaluation of whether a strong inference of scienter is supported by the entirety of the complaint. Here, these allegations of insider trading contribute to the overall picture that Defendants had actual knowledge of the true state of Skechers' financial health at the time they made allegedly false statements. They thereby strengthen the inference of scienter drawn from the complaint taken as a whole.

Plaintiffs are not required to allege facts amounting to a "smoking gun," but may rely upon circumstantial evidence to allege fraud. In light of the detailed allegations, it is hard to imagine what more Plaintiffs could have alleged to raise a

strong inference that Defendants knew their statements were false when made. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 391 n. 30 (1983). *See also Tellabs*, 127 S. Ct. at 2510, 2513. Considering all allegations in the complaint collectively, the alleged facts demonstrate that Skechers is a relatively small, family-run corporation, where the principal officers are aware of the state of the corporation's financial health and are involved in all aspects of the business. Particularly when viewed in this context, Plaintiffs' allegations support a strong inference that Defendants knew their statements were false when made. *See Oracle*, 380 F.3d at 1234. With regard to the allegations attributed to confidential witnesses, although Plaintiffs may not have alleged facts giving a complete description of their identities, they have provided sufficient facts to demonstrate that the witnesses were in a position to have knowledge supporting their allegations. Considering the complaint holistically, and taking all allegations as true, these allegations are sufficient to provide a strong inference of falsity and scienter. *See Tellabs*, 127 S. Ct. at 2510.

Because I would conclude that Plaintiffs have met their pleading burden under the PSLRA to allege a strong inference of scienter, I would reverse the district court's dismissal of their complaint and remand for further proceedings.