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Oklahoma Firefighters Pension & Retirement Systems v. Six Flags:
Fifth Circuit Opinion Reviving Securities Class Action Creates Tension with Other Circuits on Key Issues

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Introduction

On January 18, 2023, the Fifth Circuit unanimously reversed the Northern District of Texas's dismissal of a securities class action contending that Six Flags and two of its executives misled investors by projecting impossible timelines for opening new theme parks in China, which were anticipated to be highly profitable. In the Fifth Circuit's view, allegations regarding construction setbacks and other challenges—derived in large part from an anonymous former employee responsible for overseeing construction of the parks—were sufficient to state a claim against Six Flags, its former Chairman and CEO, and its former CFO under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934. In its opinion, the Fifth Circuit rejected several grounds for dismissal commonly offered by securities class action defendants and departed from—or at minimum, created tension with—the law in other circuits. While the full impact remains to be seen, this plaintiff-friendly opinion may make defending against investor claims in the Fifth Circuit more challenging and, accordingly, warrants close attention from public companies and their securities counsel.

Case Update. In a surprising twist, on remand, the US District Court for the Northern District of Texas issued a June 2, 2023, decision again dismissing the case. This time, however, the district court did so not due to substantive deficiencies with the securities law claims, but based on the plaintiff's standing. Read more about the district court's opinion on remand in this post.

Background

Six Flags is the largest theme park operator in the world.[1] Around 2014, Six Flags embarked on an international licensing strategy: Six Flags would license foreign entities to build theme parks abroad in return for substantial ongoing fees.[2] In connection with this strategy, Six Flags partnered with Chinese real estate developer Riverside Investment Group ("Riverside") and—between 2015 and 2018—announced that Riverside would develop 11 theme parks in China.[3]

Between 2018 and 2020, Six Flags made a series of statements concerning progress at the Chinese theme parks. At first, the statements were principally optimistic. In 2018, Six Flags represented that, despite a 1–2 month delay at one park, the parks were "progressing nicely towards their anticipated opening dates."[4] In early 2019, Six Flags conceded the park openings would be delayed 6–12 months, but maintained that construction was "progressing" and that Riverside was "fully committed to developing and opening" the parks.[5] During the ensuing months, Six Flags stated that there was "ongoing building" and "no delays" to the projected openings.[6]

Starting in late 2019, Six Flags's representations became gloomier. In October 2019, Six Flags acknowledged that the Chinese parks could suffer further delays and that there was a "very high likelihood . . . that we will see changes in the timing of the park openings."[7] In January 2020, Six Flags disclosed that Riverside had defaulted on its payment obligations to vendors and that this could cause "the termination of all Six-Flags-branded projects in China."[8] Finally, in February 2020, Six Flags announced it had terminated its agreement with Riverside.[9] On February 20, 2020, Six Flags's stock dipped to its lowest trading price in seven years—a 56% drop from its high in June 2018.[10]

In early 2020, Oklahoma Firefighters Pension and Retirement System and other investors sued, accusing Six Flags and its top executives of securities fraud in violation of Sections 10(b) and 20(a) of the Exchange Act. As the district court later explained, the complaint relied heavily on information from an "anonymous, midlevel" former employee (the "FE") who was responsible for overseeing construction of the Chinese theme parks.[11] According to the FE, it was "obvious" the parks could not open on time because Riverside was unable or unwilling to fund the rides, had not procured needed blueprints, and had hardly begun construction.[12] The Northern District of Texas dismissed the case, holding that the complaint failed to plead any actionable misrepresentations, omissions, or inference of intent to defraud (scienter).[13]

The Decision

The Fifth Circuit reversed, holding that plaintiffs adequately alleged both falsity and scienter. In the process, the Fifth Circuit created tension with numerous other circuits on key issues:

Former Employee Allegations. Whereas the district court determined that the FE's allegations should be discounted "generally" and discounted "significantly" with respect to Riverside's financial health—in large part because the FE was responsible for overseeing construction, not internal finances—the Fifth Circuit held that the circumstances merited only a "minimal discount" and that "iscount does not mean unfettered discretion to discard."[14] The Fifth Circuit credited the FE's account on grounds that the complaint adequately alleged his title (Director of International Construction and Project Management), responsibilities (overseeing construction of the China parks and reporting internally on progress), and firsthand observations (working onsite at the parks and attending meetings with Riverside).[15] As to scienter, the Fifth Circuit determined that the FE's account of having prepared "weekly presentations" regarding infrastructure and construction to his superiors—one of whom allegedly shared the presentations' content with the CEO and Board—was sufficient, even though "Plaintiff did not allege that FE1 had any contact with the Defendants."[16]

Other circuits, however, have been far less willing to credit such FE allegations. For example, whereas the Fifth Circuit credited a Six Flags non-finance employee's account of the finances of a *third party* (Riverside),[17]the Ninth Circuit has refused to credit the accounts of employees outside a company's finance department—for example, members of HR or IT departments—when considering statements related to a company's *own* financial condition.[18] Moreover, several circuits have declined to infer an individual defendant's scienter from allegations of a confidential witness who never allegedly communicated with that defendant. The Fourth Circuit, for example, recently held that former employees' allegations were insufficient because the employees did "not allege that they passed their concerns" to the individual defendants, who may have "been unaware of the problems, the causes of the problems, or the extent of the problems."[19] The First Circuit has reached the same conclusion, where "plaintiffs d not allege that any of the confidential witnesses . . . spoke with before he made his statements," and most of the witnesses were "several levels removed from the company's executive team.[20] And the Ninth Circuit has likewise found allegations of confidential witnesses insufficient where the witnesses "lack firsthand knowledge regarding what the individual defendants knew or did not know."[21] The Fifth Circuit's view here—that an employee with operational responsibilities who never had contact with any defendant may nonetheless speak reliably about the defendants' state of mind, and thus support a strong inference of scienter—appears out of step with the weight of this authority.

"Impossibility" of Projections. The district court also dismissed the allegations that Six Flags's projected timeline was "'impossible' to meet based on . . . the China parks' lack of progress," reasoning that the complaint did not explain how Six Flags was precluded from executing on its projected park-opening dates.[22] The Fifth Circuit disagreed. The court rejected the premise that plaintiffs challenging the impossibility of "future deadlines" must in fact plead categorical impossibility, explaining that "equiring plaintiffs to make a plausible allegation that a company's timeline was 'impossible' would be an excessively difficult burden . . . at the pleading stage."[23] The court held that it was enough that plaintiff claimed that "inadequate construction" at the parks made Six Flags's projections "misleading, even if theoretically possible (though highly unlikely) under the facts alleged."[24]

Courts outside the Fifth Circuit have been less inclined to find that allegations of "impossibility" can be adequately pleaded by identifying statements that are merely "highly unlikely." For example, the Northern District of California has dismissed claims that a defendant's "long term projections" for "revenue growth" were "unattainable" on the grounds that the plaintiffs had not shown how the defendant was "necessarily precluded . . . from reaching its projected growth targets."[25] Likewise, the Eleventh Circuit has held that allegations of a defendant's "serious problems" meeting certain compliance standards were not enough to support the inference that compliance was "impossible."[26] The Eighth Circuit, for its part, has rejected claims that a forecast was false where the allegations failed to shed light on "whether the forecasts were necessarily unattainable."[27] Outside the Fifth Circuit, alleging "impossibility" requires plaintiffs to—in a more literal sense—allege "impossibility."

Forward-Looking Statements and Puffery. Unlike the district court, the Fifth Circuit also rejected the arguments that several statements regarding the progress of construction were forward-looking statements within the PSLRA's safe harbor or inactionable statements of corporate optimism ("puffery").[28] These included, for example, statements that "right now, barring some other decision that's made, all our parks are progressing nicely towards their anticipated opening dates," and "he timing of the parks remains exactly the same as previously discussed, there's no change on any of those."[29] In the Fifth Circuit's view, these statements were not forward-looking because they concerned "the Company's present construction progress," which was "a mixed present/future statement ineligible for safe harbor protection."[30] The Fifth Circuit further reasoned that these statements were not puffery because they "confirmed the projections previously provided by Defendants."[31]

Here too, the Fifth Circuit's reasoning is in tension with that of other circuits. As to forward-looking statements, for

example, the Ninth Circuit recently held that an auto manufacturer's "various statements that it was 'on track' to achieve goal and that 'there are no issues' that 'would prevent' from achieving the goal" were forward-looking.[32] The Ninth Circuit explained that "ecause any announced 'objective' for 'future operations' *necessarily* reflects an implicit assertion that the goal is achievable based on current circumstances, an unadorned statement that a company is 'on track' to achieve an announced objective, or a simple statement that a company knows of no issues that would make a goal impossible to achieve, are merely alternative ways of declaring or reaffirming the objective itself." The Ninth Circuit went on to point out that "he statutory safe harbor would cease to exist if it could be defeated simply by showing that a statement has the sort of features that are inherent in *any* forward-looking statement."[33] And as to puffery, the Seventh Circuit (Easterbrook, J.) recently held that a statement that a company's post-merger integration was "progressing as planned" was inactionable.[34] As Judge Easterbrook explained, this statement "did not make any concrete assertion" and instead "expressed only vague optimism."[35] In deeming the statement that the project was "progressing nicely" neither forward-looking nor puffery, the Fifth Circuit meaningfully departed from these precedents.

Internal Reports. The Fifth Circuit also held that the FE's description of "weekly presentations and periodic reports on the progress of construction" supported a strong inference of scienter, where the reports allegedly described a "lack of construction."[36] Notably, the Fifth Circuit found these allegations sufficient even though (as the district court had noted) the complaint was missing key details about these internal presentations and reports—for example, "no specific dates" were alleged "for when the reports and presentations were created when they were presented."[37]

Once again, other circuits have demanded significantly more detail than the Fifth Circuit found sufficient. The Ninth Circuit, for instance, has long held that "egative characterizations of reports relied on by insiders, without specific reference to the contents of those reports, are insufficient to meet the heightened pleading requirements of the PSLRA."[38] Thus, for example, the Ninth Circuit has held that allegations of a "stream of complaints and incident reports and a general concern that these reports supposedly caused" within a medical device company seeking FDA approval were insufficient, where the complaint lacked "details about these reports"—such as the "number of patients" and "details on the circumstances" of patients experiencing complications."[39] The Tenth Circuit has similarly held that allegations regarding quarterly cost reports provided to the individual defendants were not sufficient, where "plaintiffs have not detailed the content of the quarterly cost reports."[40] The Fifth Circuit's view that an FE's account of internal presentations or reports is sufficient to support an inference of scienter, without further detail as to their content, is difficult to square with the approach taken by these other circuits.

Motive. The Fifth Circuit held that Six Flags executives had a motive to mislead investors with respect to two differently situated sets of representations in 2018 and 2019. First, the court held that Six Flags executives had reason to mislead investors in 2018 as to the timing of park-openings because the executives would have been eligible for bonuses equating to "300% of their base salaries" if Six Flags achieved a "target EBITDA" threshold by the end of 2018.[41] Notably, the court reached this conclusion despite the fact that the Six Flags executives themselves disclosed a "downward revenue revision" for the fourth quarter of 2018 that directly prevented them from achieving the target EBITDA. To the court, this could easily have been a gamble to conceal bad news that simply did not pan out.[42] Second, the court held that Six Flags executives had reason to mislead investors in 2019 as to the timing of park-openings, even though they had already lost the opportunity to receive "extraordinary bonuses."[43] The court held that even absent a "pecuniary motive," the executives "could still be plausibly motivated by a desire to save face regarding the parks."[44]

Once again, the Fifth Circuit's opinion skews plaintiff-friendly in ways that diverge from other circuits and its own precedent. To start, while there are exceptions, the law is generally "clear that a defendant's . . . desire for enhanced incentive compensation" is "insufficient to support an inference of scienter."[45] As the Second Circuit and other courts have observed, "an allegation that defendants were motivated by a desire to maintain or increase executive compensation is insufficient because such a desire can be imputed to all corporate officers."[46] In fact, the Fifth Circuit itself previously stated that "ccepting" a theory of motive based on the fact that "the defendant officers and directors were motivated by incentive compensation . . . would effectively eliminate the state of mind requirement as to all corporate officers" and amount to a "nihilistic approach" to fraud pleadings.[47] Next, the Fifth Circuit's conclusion that the desire to "save face" is enough to supply motive is arguably even more disruptive: that reasoning could apply to virtually any statement by an executive expressing confidence in earlier predictions.

Core Operations. Finally, the Fifth Circuit held that plaintiffs adequately alleged a "core operations" theory of scienter, finding that "the China parks were so important to Six Flags' success that misrepresented or omitted information at issue would have been readily apparent to the speaker."[48] The district court, by contrast, noted that there was no allegation that "the China parks were critical to the company's continued vitality"—indeed, "the China parks were just a portion of Six Flags's international licensing program, which accounts for just 3% of Six Flags's revenue."[49] While acknowledging that the parks "were not critical to Six Flags' survival," the Fifth Circuit held that that the parks were nonetheless "an important aspect of future growth prospects and EBITDA," and that the Company had "touted the international licensing

deals as a 'key growth driver.'"[50] The Fifth Circuit concluded that the core operations allegations were "not adequate on their own, but contribute to the inference of scienter."[51]

Other circuits have applied the core operations doctrine far more narrowly. The Fourth Circuit, for instance, recently rejected the argument that the core operations theory applied to a technology company's statements about its "move into the digital space and investments in its human capital," simply because "those issues were key concerns for the company."[52] The Fourth Circuit expressed skepticism that "such broad corporate strategies can constitute core operations" and held that allegations of "Defendants' knowledge of shortcomings regarding the digital space and investments in its employees" were required.[53] Similarly, the Ninth Circuit has held that the core operations theory did not apply simply because "the nature of the problem concerned flagship product," absent allegations that "at least someone at had knowledge of the extent of liability."[54] The Fifth Circuit's ostensible view that being important to a company's "future growth prospects" is enough to bring a matter within the ambit of the core operations doctrine again appears out of step with the law established in other circuits.

Takeaways

- Confidential sources may be credited if: (1) the source's "credentials" are clearly stated, and (2) the "relevance of the person's job" is not too "attenuated" from the allegations, even if the source lacks direct responsibility for the subject of a challenged statement and even if the source is not alleged to have communicated with the speaker or any other individual defendant.
- Statements regarding a company's projections or plans are susceptible to challenge even if they are not "impossible"; it may be sufficient to allege that the company faces significant challenges in meeting its objectives.
- Statements regarding whether a project is "progressing" as planned or "on track" to meet stated objectives may not qualify as "forward-looking" and may be deemed specific enough to be actionable.
- Motive may be pled more easily through allegations of incentive-based compensation, particularly if defendants may have been motivated to "save face" after missing prior targets.
- Allegations about the existence of negative internal reports may more easily support an inference of scienter, even absent specific allegations regarding their timing or contents.
- The core operations theory may apply in the context of business segments a company has touted as key sources of "future growth," even if they represent a small portion of current revenue or profits.

Oklahoma Firefighters Pension & Retirement Sys. v. Six Flags Entertainment Corp., __ F.4th ___, 2023 WL 228268, at *1 (5th Cir. Jan. 18, 2023).

Id.

Id.

Id. at *2.

Id.

Id.

Id.

Id.

Id.

Id.

Elec. Workers Pension Fund, Loc. 103, I.B.E.W. v. Six Flags Ent. Corp., 524 F. Supp. 3d 501, 508 (N.D. Tex. 2021).

Six Flags, __ F.4th ___, 2023 WL 228268, at *2.

Id. Post-judgment, the district court also rejected plaintiffs' motions to set aside the judgment and amend their complaint. *Id.* at *3. Because these denials were rendered irrelevant on appeal by the substantive reversal of the Exchange Act claims, this post does not discuss them further.

Id. at *4–5.

Id. at *4–5.

Id. at *11 & n.18.

Id. at *5 (“here is enough here to conclude that FE[] had personal and relevant, even if not comprehensive, knowledge about Riverside’s financial health.”).

Zucco Partners, LLC v. Digimarc Corp., 552 F.3d 981, 996–98 (9th Cir. 2009).

KBC Asset Mgmt. NV v. DXC Tech. Co., 19 F.4th 601 (4th Cir. 2021) (internal citations omitted).

Metzler Asset Mgmt. GmbH v. Kingsley, 928 F.3d 151, 162 (1st Cir. 2019).

Police Ret. Sys. of St. Louis v. Intuitive Surgical, Inc., 759 F.3d 1051, 1063 (9th Cir. 2014); *see also Zucco Partners, LLC v. Digimarc Corp.*, 552 F.3d 981, 998 (9th Cir. 2009). (holding that a witness must have “reliable personal knowledge of the defendants’ mental state”).

Six Flags, __ F.4th ___, 2023 WL 228268, at *9.

Id.

Id.

City of Royal Oka Retirement Sys. v. Juniper Networks, Inc., 880 F. Supp.2d 1045, 1064 (N.D. Cal. 2012).

Carvelli v. Ocwen Fin. Corp., 934 F.3d 1307, 1329 n.13 (11th Cir. 2019).

In re Cerner Corp. Sec. Litig., 425 F.3d 1079, 1085 (8th Cir. 2005).

See 15 U.S.C. § 78u-5(i)(1) (defining “forward-looking” statement as “(A) a statement containing a projection of revenues, income … or other financial items; (B) a statement of the plans and objectives of management for future operations …; (C) a statement of future economic performance …; (D) any statement of the assumptions underlying or relating to ”).

Six Flags, __ F.4th ___, 2023 WL 228268, at *6.

Id. at *6.

Id. at *14.

Wochos v. Tesla, Inc., 985 F.3d 1180, 1192 (9th Cir. 2021).

Id. (emphases in original).

City of Taylor Police & Fire Ret. Sys. v. Zebra Techs. Corp., 8 F.4th 592, 595 (7th Cir. 2021).

Id.

Six Flags, __ F.4th ___, 2023 WL 228268, at *11.

Six Flags, 524 F. Supp. 3d at 511.

Lipton v. Pathogenesis Corp., 284 F.3d 1027, 1036 (9th Cir. 2002).

Nguyen v. Endologix, Inc., 962 F.3d 405, 416–17 (9th Cir. 2020).

Anderson v. Spirit Aerosystems Holdings, Inc., 827 F.3d 1229, 1240–41 (10th Cir. 2016).

Six Flags, __ F.4th ___,2023 WL 228268, at *10.

Id. at *11.

Id. at *13.

Id.

Financial Acquisition Partners, LP v. Blackwell, No. Civ. A. 3:02-CV-1586-K, 2004 WL 2203253, at *16 (N.D. Tex. Sept. 29, 2004) (citing *In re Capstead Mortgage Corp. Sec. Litig.*, 258 F. Supp.2d 533, 562 (N.D. Tex. 2003)).

Kalnit v. Eichler, 264 F.3d 131, 140 (2d Cir. 2001); *see also*, *e.g.*, *Phillips v. LCI Intern., Inc.*, 190 F.3d 609, 622 (4th Cir. 1999) (“nsufficient are allegations that corporate officers were motivated to defraud the public because an inflated stock price would increase their compensation.” (citation omitted)); *In re Rigel Pharm., Inc. Sec. Litig.*, 697 F.3d 869, 884 (9th Cir. 2012) (cautioning against concluding that “there is fraudulent intent merely because a defendant’s compensation was based in part on” the “successes” of “achieving key corporate goals”); *Pittman v. Unum Group*, 861 F. App’x 51, 57 (6th Cir. June 28, 2021) (“e have explained that merely alleging that an executive’s ‘compensation is directly tied to the company’s performance’ is not enough to bolster an inference of scienter.’” (quoting *Helwig v. Vencor, Inc.*, 251 F.3d 540 (6th Cir. 2001)).

Melder v. Morris, 27 F.3d 1097, 1102 (5th Cir. 1994).

Six Flags, __ F.4th ___, 2023 WL 228268, at *13.

Six Flags., 524 F. Supp. 3d. at 536.

Six Flags, __ F.4th ___, 2023 WL 228268, at *14.

Six Flags, __ F.4th ___, 2023 WL 228268, at *14.

KBC Asset Mgmt., 19 F.4th at 612.

Id.

In re NVIDIA Corp. Sec. Litig., 768 F.3d 1046, 1064 (9th Cir. 2014).

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