

## District of Colorado: Complex, Technical and Not Obvious Tax-Accounting Error Failed to Create a Strong Inference of Scienter

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On December 2, 2020, the District of Colorado dismissed with prejudice securities fraud claims against Molson Coors Beverage Company and certain of its officers and directors, which alleged that defendants knowingly or recklessly misstated Molson's financial statements in the wake of Molson's announcement that it had made a tax-accounting error causing it to significantly understate its tax liabilities. [In re Molson Coors Beverage Sec. Litig., No. 1:19-cv-00455 \(D. Colo. 2020\) \(Ebel, J.\)](#). The court explained that "[a]t bottom, [plaintiffs'] argument is that the existence of a \$400 million accounting error in a critical corporate acquisition is too meaty not to be the result of fraud." Under these circumstances, the court stated that it "would only find a strong inference of scienter if the error was so obvious that it would be absurd to conclude that [d]efendants did not know about it." Instead, the court found "that the tax-accounting error was technical and non-obvious."

### **Background**

In 2019, Molson filed a Form 8-K announcing that it had made a tax-accounting error in connection with a 2016 acquisition (the "Restatement"). Specifically, Molson announced that its "consolidated financial statements for 2016 and 2017 should be restated and should no longer be relied upon[.]" The error caused Molson to understate its deferred tax liabilities in its 2016 and 2017 financial statements by nearly \$400 million. After the announcement, Molson's share price fell by 9%. Subsequently, plaintiff stockholders commenced a securities fraud class action alleging that various Molson officers and directors knowingly or recklessly misstated Molson's financial statements in order to inflate share prices.

Plaintiffs claimed that they were injured due to Molson's false financial statements, because they purchased stock "at artificially inflated levels and were damaged when the truth was revealed" and Molson's stock price subsequently declined. Defendants moved to dismiss, arguing that plaintiffs failed adequately to plead scienter.

### **Strong Inference of Scienter Not Created by Complex, Technical and Non-Obvious Error**

The court began its analysis "by addressing each allegation of scienter or its absence, reviewing the merits of each." Plaintiffs alleged scienter based on Molson's erroneous financial statements alone. However, citing *In re Sun Healthcare Securities Litigation*, 181 F. Supp. 2d 1283

(D.N.M. 2002), the court stated that “the mere existence of an error warranting restatement does not necessarily reflect on the scienter behind that error.” Further citing *Sun Healthcare*, the court quoted “[t]o hold otherwise would subject every financial restatement to liability.” The court explained that “[w]hether the Restatement and the underlying tax-accounting error imply scienter depends on what exactly the error entailed.” The court continued that “[h]ere, as described in the 2018 Form 10-K, the error was Molson’s failure to reconcile[] its outside basis for its investment in the partnership to the book-tax differences in the underlying assets and liabilities within the partnership.”

In response to plaintiffs’ claim that it was an “Accounting 101 text book type of reconciliation” such that “the error was intentional or deliberately reckless[,]” the court evaluated the complexity of the error. The court stated that “[t]o determine the complexity of the error, the [c]ourt looks to Molson’s Form 10-K for its description of the error[.]” The court then announced that it “agrees with [d]efendants that this involves a technical tax-accounting error[.]” The court then stated “[t]hat the error was indeed complex, technical, and not obvious is confirmed by the fact that [Molson’s independent accounting firm] conducted annual audits of Molson’s financial reporting for both 2016 and 2017 and failed to identify the error.” Further, that Molson’s accounting firm “failed to identify the error until the Restatement strongly suggests that it was not a simple and obvious error indicative of scienter.” The court further found “that the [accounting firm] audits do not categorically insulate [d]efendants from liability, but they do weigh against an inference of scienter.” Additionally, the court found “that the Restatement error itself does not lend to a strong inference of scienter and that [the accounting firm’s] involvement weighs against an inference of scienter.”

Plaintiffs additionally argued that a number of other allegations supported scienter, including the magnitude of the error, weakness in Molson’s internal controls over financial reporting, and defendants’ motive, among others. The court analyzed each allegation under existing precedent, finding that they did little to support an inference of scienter.

***Holistic Analysis of Allegations Gives Rise to Only a Weak Inference of Scienter***

Beginning its holistic analysis, the court explained that it must “consider these allegations together and decide if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged.” The court noted that “[p]laintiffs’ inference of scienter relies primarily on the mere existence of a \$400 million tax liability understatement in Molson’s financial statements relating to a critical, costly acquisition.” The court “conclude[d] that, considering [p]laintiffs’ allegations together, they give rise to only a weak inference of scienter.” The court also “conclude[d] that [p]laintiffs have failed adequately to plead scienter, forestalling their claims under § 10(b) and Rule 10b–5.” The court dismissed the complaint in its entirety with prejudice.

<b>Authors and Contacts</b>	<b>Paul Gluckow</b> Partner and General Counsel <a href="mailto:pgluckow@stblaw.com">pgluckow@stblaw.com</a> <a href="tel:+12124552653">+1-212-455-2653</a>	<b>Linton Mann III</b> Partner <a href="mailto:lmann@stblaw.com">lmann@stblaw.com</a> <a href="tel:+12124552654">+1-212-455-2654</a>
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