

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

ISRAEL H. BUCK, et al. : CIVIL ACTION
v. :
PIERCING PAGODA, INC., et al. : NO. 98-5535

MEMORANDUM AND ORDER

FULLAM, Sr.J. OCTOBER , 1999

The Private Securities Litigation Reform Act of 1995 (“Reform Act”), 15 U.S.C.A. §78u-4 *et seq.*, was designed to cure the perceived widespread abuse of the securities class action litigation process. It established a heightened pleading standard for alleging a violation of Rule 10b-5. A complaint must

specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed.

15 U.S.C.A §78u-4(b)(1). With regard to *scienter*, a plaintiff must

with respect to each act or omission alleged to violate this chapter, state with particularity the facts giving rise to a strong inference that the defendant acted with the required state of mind.

15 U.S.C.A. §78u-4(b)(2).

In In re Advanta Corp. Securities Litigation, 180 F.3d 525 (3d Cir. 1999), our

Court of Appeals was required to determine whether the Reform Act codified the pleading requirements developed by the Second Circuit in Beck v. Manufacturers Hanover Trust Co., 820 F.2d 46, 50 (2d Cir. 1987), or whether it imposes an even more stringent standard, *see, e.g.*, In re Silicon Graphics, Inc. Securities Litigation, 970 F. Supp. 746 (N.D. Cal. 1997)(eliminating recklessness as a basis for liability), an issue on which the district courts have split. The Court concluded that the Reform Act “established a pleading standard approximately equal in stringency to that of the Second Circuit,” Advanta, 180 F.3d at 534, and held:

[I]t remains sufficient for plaintiffs [to] plead scienter by alleging facts ‘establishing a motive and an opportunity to commit fraud, or by setting forth facts that constitute circumstantial evidence of either reckless or conscious behavior.’ Motive and opportunity, like all other allegations of scienter (intentional, conscious, or reckless behavior), must now be supported by facts stated ‘with particularity’ and must give rise to a ‘strong inference’ of scienter.

Id. at 534-35 (citations omitted). The Advanta case involved allegations the corporate officials failed to disclose the implementation of aggressive techniques to attract new credit card customers -- specifically, the use of lower “teaser,” or introductory, rates that were left in place for longer periods of time -- which resulted in more defaults and, accordingly, a decrease in revenues. The court held that plaintiffs had failed to meet the pleading requirements of the Reform Act and affirmed the district court’s dismissal of the complaint.

This action arises from the July 1998 acquisition by defendant Piercing Pagoda, Inc., of 104 stores previously owned by Sedgwick Sales, Inc. Piercing Pagoda operates a chain of jewelry kiosk stores, located primarily in shopping malls. Almost three months later, in late September 1998, defendant announced that it expected lower than anticipated second quarter results, due to difficulties in integrating the Sedgwick stores into the chain, and lower than

expected sales at those stores. The company's stock dropped more than seven points in the next two days of trading. Defendant has moved to dismiss the complaint.

Plaintiffs claim that defendants made four misleading statements in press releases and in the company's 1998 10-K regarding the Sedgwick acquisition. First, defendants claimed that the new stores would "complement [the company's] current geographic mix" and that the acquisition "underscores [defendants'] commitment to finding desirable real estate opportunities." Second, defendants stated that "[t]he Company believes it can successfully apply its prior experience opening new stores and integrating the previous acquisitions to this purchase." Third, defendants announced on July 2, 1998 that "[t]he process of transitioning these stores to the Company's format was begun earlier this week and all should be operating under [the Company's] banner by this weekend." Fourth, defendants asserted that "[i]n addition to evaluating malls in which it does not operate stores, the Company continually evaluates malls where its stores are located to determine whether net sales volumes warrant another kiosk in such malls."

The first three statements identified by plaintiffs will not, as a matter of law, support a securities fraud claim. The first is nothing more than a vague statement of corporate goals and strategies. It is difficult to see how plaintiffs can allege that it is false, and even if it were, it is not material-- that is, it is too general to be the type of statement that a reasonable investor would rely upon. The second statement is merely an example of a forward-looking, generalized statement whereby a corporation paints itself in a favorable light. Even if defendants knew that the statement were false at the time it was made, it too is immaterial. The third statement is not alleged to be false at all.

Plaintiffs' most serious allegations concern the unspecified daily and weekly sales reports from each store, which defendants claimed to receive as a result of their highly-touted "sophisticated" management information systems. These reports, plaintiffs assert, should have alerted defendants to the fact that the purchase of the Sedgwick kiosks was a bad idea, and that their integration into the chain would be more difficult than defendants' allegedly misleading statements led investors to believe. (If defendants knew they were painting a misleadingly rosy picture, their "forward-looking" statements about the prospects for integrating the new stores would not be entitled to the "safe harbor" provided by 15 U.S.C. §78u-5.) Specifically, plaintiffs allege that 53 of the 104 Sedgwick kiosks were in malls where there was already at least one Piercing Pagoda store, and that defendants knew from the sales reports they were receiving that these malls would not support additional stores.

Assuming that there were reports that contained such information -- and plaintiffs do not identify the documents at issue -- the most that has been alleged is an instance of bad business judgment. There are no facts pled which would permit a court to infer that any of the defendants had actual knowledge of the falsity of their statements. *See Advanta*, 180 F.3d at 536-37. In the case of the individual defendants, their positions with the company are not enough to support an inference that they must have known that their positive statements concerning the Sedgwick acquisition were false or misleading. *See id.* at 539. Plaintiffs attempt to distinguish *Advanta* based on the fact that the purchase of the Sedgwick stores was the largest acquisition in company history, and therefore was related to the company's "core business," providing "strong circumstantial evidence" that defendants were familiar with the "operational detail" alleged to be contained in the sales reports. *See In re Aetna Securities Litigation*, 34 F.

Supp.2d 935, 952-53 (E.D. Pa. 1999). The Aetna plaintiffs, however, alleged that the individual defendants falsely represented in two quarters' financial statements that the integration of Aetna with U.S. Healthcare after the merger of the two companies was proceeding successfully, whereas in fact serious problems existed. Here, only one quarter elapsed between the acquisition of the Sedgwick stores and defendants' announcement of lower than expected second quarter results. Plaintiffs are not claiming that defendants were required to have proclaimed their new venture a failure any sooner than this; the conclusion plaintiffs have apparently reached is that these defendants, one of whom owns a large percentage of the company's stock, deliberately entered into a transaction that they knew would fail and result in a decrease in their individual net worths. There are no facts pled which would support this inference.

An Order follows.

