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Fifth Circuit Puts Pier 1 Shareholder Suit to Bed

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The U.S. Court of Appeals for the Fifth Circuit ended a significant shareholder action against Pier 1 Imports Monday, not with a bang, but a quote from Coco Chanel.

"Fashion changes, but style endures."

A three-judge, unanimous panel ruled that a Dallas federal judge rightfully dismissed a class action lawsuit brought by a group of Pier 1 investors because they failed to prove that the Fort Worth-based retailer committed securities fraud.

Although the investors argued that Pier 1 "is a 'trend-based fashion retailer' whose inventory carried a significant markdown risk that the company's executives failed to disclose," Circuit Judge Jennifer Walker Elrod wrote in the 19-page opinion, "we conclude that Pier 1 operates largely in the sturdier business of style and that the investors failed to adequately plead scienter."

Pier 1's lead lawyer, **Stephen Crain**, called the decision a "superb win."

"I hope the market sees this as good news and is reflective of Pier 1 having a good business strategy — one that at last is not subject to very, very damaging allegations that the company was participating in fraud on the market," Crain, a partner at Bracewell, told The Texas Lawbook. "I thought that was grotesquely unfair from the get-go."

Adam Wierzbowski, who represents the shareholders, declined to comment on the ruling or whether his clients would try to take further action.

Crain suggested further action by the plaintiffs was unlikely due to the narrow probability that the Fifth Circuit would grant an en banc review or the U.S. Supreme Court would grant a petition for certiorari.

"Statistically that's just a tremendous uphill battle," Crain said. "It's difficult to say which of the two is more of an uphill battle statistically [speaking]."

Monday's ruling ties the bow on the third oral argument made in the case, which was brought by the Municipal Employees' Retirement System of Michigan and also names former Pier 1 CEO Alexander Smith and former CFO Cary Turner as defendants. MERS alleged Smith and Turner committed scienter — or the knowledge of wrongdoing — because they failed to disclose Pier 1's severe markdown risk of its merchandise.

In essence, MERS alleged, this misrepresentation of Pier 1's inventory misrepresented the company's financial health to investors.

The case's first two oral arguments were tied to two separate motion to dismiss hearings that MERS and Pier 1's lawyers made before two different federal district judges. Pier 1 prevailed both times.

U.S. District Judge Sidney Fitzwater of the Northern District of Texas first dismissed MERS' suit in April 2017, but allowed the plaintiffs to re-plead their arguments. After MERS did so, the case got reassigned to U.S. District Judge Karen Gren Scholer two days after she was sworn to the Northern District's bench last spring. After an extensive hearing in her court, Judge Scholer dismissed the case again, determining that MERS had still failed to prove scienter in its case.

During oral argument two months ago before the Fifth Circuit, Crain said the plaintiffs' argument fixated on a September 2015 decision by Pier 1 to put a bulk of its items on clearance to help get rid of its extra inventory. MERS alleged this announcement caused the company stock to plummet since Pier 1 had said only months before that the company's inventory complexion was "clean, healthy and did not pose a significant immediate markdown risk," the opinion says.

On appeal, MERS had argued that it was evident scienter was present because Smith and Turner had two major motives for concealing Pier 1's markdown risk.

For one, the opinion says, they "staked their careers" on an initiative they launched that allowed customers to buy Pier 1 products online for in-store pickup or home delivery — and clearly overstated the success of it since it didn't go as planned. For another, MERS had argued, Smith and Turner's employment contracts promised them cash bonuses based on Pier 1's earnings before interest, tax, depreciation and amortization.

The Fifth Circuit determined MERS' arguments were unconvincing for many reasons, including the fact that neither Pier 1 nor its executives ever tried to conceal its inventory problems — in fact, the company revealed this material information many times in public disclosures.

Crain said Judge Elrod's opinion was very concise, and in some instances, she dissected the plaintiffs' case in ways he wished he would have thought of for oral argument.

For example: An indication of whether scienter is present, as established in the Fifth Circuit's 2005 decision in Barrie v. Intervoice-Brite, Inc., is whether a substantial compensation package was present to sway an executive. In that case, the defendant received a performance-based bonus that was 175% of his base salary.

"But Barrie is not this case," Judge Elrod wrote. "Here, even the lowest possible performance-based bonuses that Smith and Turner could receive — which were only 11.5% and 8% of their respective base salaries — proved to be well out of reach: Pier 1's Fiscal Year 2015 earnings before interest, tax, depreciation, and amortization were $60 million lower than the lowest target number in their employment contracts."

And although the contracts provided the possibility of Smith and Turner earning bonuses as high as 288% and 200% of their base salaries, Judge Elrod continued, Pier 1's earnings were $125 million shy of the target number for those bonuses.

Since the likelihood of Smith and Turner receiving high-level bonuses was so low, "we reject the investors' motive allegations as creating any inference of scienter, much less a strong one."

In addition to helping clear the company's name, Crain said the Fifth Circuit's ruling was especially helpful for one group in particular: Pier 1's "lean and mean" in-house legal team.

While the Fifth Circuit's decision will likely save Pier 1 the several million dollars in legal fees that the company might have spent to defend these allegations at trial, Crain said, "the better savings" is the fact that Pier 1's lawyers "no longer have to be distracted" by the time-consuming demands the defense of a class action securities fraud lawsuit requires.

"They can get on with being part of just running the business as opposed to being distracted by allegations of securities fraud," Crain said.

Throughout the litigation, Crain said he worked very closely with former Pier 1 General Counsel Mike Carter, who retired from the company last September, as well as current Pier 1 GC Robert Bostrom. Crain also worked with a Pier 1 lawyer Ray McKown from beginning to end, who Crain said especially "was excellent support" and "offered great comments throughout the whole process."

Other Bracewell lawyers on the Pier 1 team who played significant roles included **Brad Benoit, Amy Parker Beeson** and **Joe Cox**.