

# Fifth Circuit Revives Securities Class Action Against Six Flags

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Last week, the Fifth Circuit reversed a decision from the United States District Court for the Northern District of Texas that had dismissed a class action against Six Flags Entertainment Corporation. The complaint in *Oklahoma Firefighters Pension and Retirement System v. Six Flags Entertainment Corp., et al.*, alleged Six Flags and its former CEO and CFO violated federal securities laws in connection with statements regarding the construction of new theme parks in China. In overturning the lower court's decision, the Fifth Circuit provided important guidance regarding the weight of confidential witness allegations in securities class actions, as well as evaluating legal doctrines on forward-looking statements, puffery, and scienter.

## Background

The complaint stemmed from Six Flags announcing its plans to open multiple theme parks in China in 2019, 2020 and 2021, which were to be constructed through its partner, a Chinese real estate developer called Riverside Investment Group. Throughout 2018, the defendants publicly stated that the parks were “progressing nicely towards their anticipated opening dates,” even though the complaint alleged that little to no construction was happening on the parks during that year. In early 2019, Six Flags disclosed that the opening of the China parks would be delayed by six to twelve months, but that construction of the parks was still “progressing.” The plaintiffs alleged that these statements were also misleading, as the defendants knew that Riverside's development of the parks had stalled. It was not until February 2020 that Six Flags announced it had terminated its agreements with Riverside, which led to a drop in the company's stock price.

The majority of the allegations in the complaint came from information provided by a confidential witness, the former Director of International Construction and Project Management of Six Flags International. The plaintiffs alleged that this employee, who was responsible for overseeing the construction of the parks, knew from his arrival in China in May 2018 that the parks would not be able to open on schedule due to Riverside's failure to move the projects forward. Although there were some corroborating allegations in the complaint, such as an April 2018 photograph of one of the sites that showed essentially no construction, the complaint's claims hinged on the information provided by the former employee.

The district court granted the defendants' motion to dismiss, holding that the complaint did not make adequate allegations of material misrepresentations or omissions or allege a strong inference of scienter. Notably, the district court gave little weight to the information provided by the anonymous former employee. After the plaintiffs' motions to set aside the judgment and to amend the complaint were denied, they appealed to the Fifth Circuit.

## **The Fifth Circuit's Decision**

### *Weight of Confidential Witness Allegations*

The court began its analysis by evaluating the allegations based on the assertions of the anonymous former employee. Rather than "significantly discounting" these allegations like the district court, the Fifth Circuit held the employee's allegations should be only minimally discounted because of the witness's anonymity, but otherwise could be relied upon.

The court explained that there is reason to credit a confidential informant's reliability when their information is coupled with a particularized description of their job, and when that job puts them in a position to know the facts they assert firsthand. In the court's view, the plaintiffs satisfied that requirement. The complaint alleged that the former employee was responsible for overseeing the construction of the China parks and reported on their progress. They worked onsite at one of the park locations and performed site inspections and checked on the progress of the others. The complaint also contained information regarding specific meetings the former employee had attended at which Six Flags executives discussed Riverside's failure to pay its vendors or make progress on construction. Although the court admitted that the former employee was only one source (as compared to other cases giving substantial weight to allegations of multiple confidential witnesses), the court stated that the former employee's significance in the development of the China parks was a "substitute for numbers."

#### *Forward Looking Statements*

The court next evaluated whether Six Flags' statements regarding anticipated completion of the China parks were forward-looking statements that could be granted safe harbor under the PSLRA. In the court's view, the defendants' statements that addressed present construction progress – e.g., "right now, barring some other decision that's made, all our parks are progressing nicely towards their anticipated opening dates" – were mixed present/future statements ineligible for safe harbor protection.

The only statements that the court considered forward-looking were certain 2018 statements regarding plans to open the parks with no commentary about present construction progress. However, the court held that even those did not warrant safe harbor because they were not accompanied by meaningful cautionary language. The defendants' claimed cautionary language – e.g., "[international deals] sometimes take a long time to come to fruition" – did not qualify, as they came in response to different analysts' questions, were not offered unprompted, and did not address the actual risk of the China parks being delayed or failing to open.

The court then turned to whether the statements contained material misrepresentations or omissions. In holding that they did, the court rejected the defendants' argument that the plaintiffs were required to plead specific facts demonstrating that the disclosed opening dates were "impossible." The court held that requiring the plaintiffs to make a plausible allegation that Six Flags' stated timelines were totally impossible would require investigation into industry-specific factual questions that were inappropriate at the pleadings stage.

### *Puffery*

The court separately addressed whether the challenged statements constituted mere puffery, as the district court had held. Although the court agreed that certain statements such as "we will not be stopping at 10 parks" and "I think 20 parks is possible" were vague and optimistic generalizations, other statements regarding the timing of park openings were too specific to constitute puffery. For example, the court held that the statement "the parks are progressing nicely" was not puffery because it confirmed projections previously provided by the defendants. It also noted that the district court's conception of puffery was "too broad."

### *Scienter*

The court's analysis of whether the plaintiffs sufficiently pled a strong inference of scienter focused on the collective weight of numerous allegations included in the complaint. For the defendants' 2018 statements, the court considered the potential for the defendants to receive significant bonus awards if the company hit a target EBITDA, which was unlikely to occur if the China parks did not open on schedule. The court also noted internal corporate reports that the anonymous former employee alleged senior executives received, which contained information regarding the lack of construction progress. Although the court noted that neither motive nor internal corporate reports would necessarily support an inference of scienter on their own, when viewed together, they showed that Defendants had actual knowledge that the 2018 statements were misleading.

The court also held that the plaintiffs had alleged a strong inference of scienter as to the defendants' statements in 2019, which recognized that there would be delays in the parks' openings but construction was progressing. The court acknowledged that by 2019, there was no longer a financial motive, as the defendants had already lost the opportunity to receive the bonuses that they would have earned had the parks opened on time. However, the court held that they still could have a motive to "save face" regarding the parks. Coupled with "circumstantial allegations" from the former employee regarding Defendants' receipt of regular reports on construction progress and the fact that the China parks "were so important to Six Flags' success" that they supported application of the core operations theory, the court found scienter to be satisfied for these statements as well.

### ***Implications***

The *Six Flags* decision does not overwhelmingly alter the standards by which federal securities lawsuits are evaluated. However, the Fifth Circuit's at times sharp rebuke of the lower court's decision may affect how district courts review allegations at the pleadings stage – especially with respect to information provided by confidential witnesses. The Fifth Circuit was significantly more willing than the district court to give substantial weight to the former employee's allegations, but only because their role and responsibilities were described in detail. Because the former employee's allegations were the crux of the plaintiffs' case, once the Fifth Circuit determined that they should be "minimally discounted," the entire complaint stood on much stronger ground. Notably, the court's view does not seem very different from the framework for evaluating confidential witness allegations that is already in place in other circuits, including – as the *Six Flags* opinion pointed out – the Third and the Fourth Circuits. Thus, by bringing the Fifth Circuit in line with other jurisdictions, securities plaintiffs who have obtained information from former employees have another forum in which to file their complaints.

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