



Three Specific Elements for Goodwill Impairment Claims

City of Sterling Heights Police & Fire Retirement System v. Vodafone Group Public Limited Co., 2010 WL 309009 (S.D.N.Y.)(Jan. 22, 2010)

In perhaps the first of many such cases, the U.S. District Court for the Southern District of New York considered a securities fraud class action alleging a company's failures to recognize and report material impairment to goodwill values. Specifically, the plaintiffs claimed that Vodafone PLC (currently the world's largest mobile phone operator by revenue) misrepresented its financials following its takeover of a German telecommunications company (Mannesmann) in 2000, which at the time was the largest corporate merger in history, worth \$183 billion.

The defendants moved to dismiss the fraud claims for lack of particularity. The court initially granted the motion, finding the complaint failed to state: 1) when the company should have recognized material impairment to its goodwill value; 2) what specific factors should have triggered the company to take an impairment charge; and 3) the precise amount of the impairment charges the company was allegedly obligated to incur.

The plaintiffs submitted a second amended complaint, but on review, the court found continued flaws with the pleading. In particular:

1. In attempting to provide a meaningful time when the company should have recognized material goodwill impairment, the plaintiff simply lifted statements from the company's annual reports concerning goodwill and growth forecasts and then asserted that the company had turned a "blind eye" to the implicit impaired value. The plaintiffs also said the company's competitors had "thoroughly tested" for goodwill impairment while the company had not. At most, these allegations pointed to some unspecified point in time, prior to the class action period, when the company "should have followed its competitors' lead in revising its standards for evaluating ... goodwill," the court held. This "vague assertion" lacked particularity and did not adequately state the time for incurring an impairment charge.
2. The plaintiffs' allegations regarding facts that should have triggered an impairment charge were similarly vague. For example, the plaintiff said the market knew the company's growth expectations for its 3G phones were "unrealistically overstated." However, shifting market expectations for 3G phone sales did not adequately prove the company was obligated to incur a goodwill impairment charge, the court said, any more than making inaccurate forecasts of business conditions states a claim for fraud.
3. Lastly, the proposed amended complaint failed to approximate the amount of the impairment charge the company should have incurred at some earlier point in time. On the one hand, the plaintiffs noted the company had written down its goodwill value by \$49 billion. On the other, they asserted the company's goodwill value was impaired by "tens of billions of dollars ... over a period of several years." It remained unclear whether the plaintiffs claimed that that \$49 billion was the appropriate write-down amount, "or whether it ... was some other unspecified amount totaling in the 'tens of billions of dollars'—a figure that could implicate any sum between \$20 billion and \$90 billion," the court held.

Could the plaintiffs have used a valuation specialist? Because the amended complaint failed to cure the identified defects and still fell short of pleading securities fraud with the requisite particularity, the court dismissed the claims. Perhaps future securities fraud plaintiffs would be well-advised to retain valuation specialists to determine and document with the specific timing, triggering events, and amount of any alleged failures to report goodwill impairment.