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CORPORATE & FINANCIAL
WEEKLY DIGEST

Corporate & Financial Weekly Digest

Posted at 11:49 AM on April 8, 2011 by William M. Regan

Revision of Earnings Due to Overbilling Supports Fraud Claims

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Allegations that a medical device manufacturer knowingly overbilled insurance companies and reported these unrecoverable accounts as income were sufficient to support security fraud claims.

According to plaintiffs, Zynex Inc. deliberately overbilled insurance companies and reported this inflated income on its financial statements even though top officers knew that the company would not be able to collect this amount. Zynex announced on April 1, 2009, that it was revising its financial reports for the first three quarters of 2008, telling investors that the reduction in earnings was based on "provider discounts" that should have been recognized during that period. Zynex's stock price dropped 56% following the announcement, and plaintiffs sued the company and two officers for securities fraud under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10(b)(5) promulgated thereunder.

The defendants moved to dismiss, arguing that plaintiffs' allegations at most showed that accounting mistakes occurred, and that the alleged over-billing did not give rise to a strong inference that the company intended to mislead investors. The U.S. District Court for the District of Colorado disagreed, holding that the alleged insistence of Zynex officers to continue the practice of overbilling—despite being aware that collection was impossible— demonstrated an intent to deceive. The Court also noted that the amount of the earnings reduction was "substantial," which also supported the federal fraud claims. (*Mishkin v. Zynex Inc.*, Civil Action No. 09–cv–00780–REB–KLM, 2011 WL 1158715 (D. Colo.))