

# 10-1372-cv

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IN THE UNITED STATES COURT OF APPEALS  
FOR THE SECOND CIRCUIT

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BARCLAYS CAPITAL INC., MERRILL LYNCH, PIERCE, FENNER  
& SMITH INCORPORATED, AND MORGAN STANLEY & CO.  
INCORPORATED

*Plaintiffs-Appellees,*

*vs.*

THEFLYONTHEWALL.COM, INC.

*Defendant-Appellant.*

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On Appeal From the United States District Court  
for the Southern District of New York (*Foley Square*)

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**BRIEF FOR *AMICUS CURIAE* THE SECURITIES INDUSTRY AND  
FINANCIAL MARKETS ASSOCIATION (SIFMA) IN SUPPORT OF  
AFFIRMANCE**

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## **CORPORATE DISCLOSURE STATEMENT**

Pursuant to Rules 26.1 and 29(c) of the Federal Rules of Appellate Procedure, *Amicus Curiae*, the Securities Industry and Financial Markets Association, hereby certifies that it is a non-profit corporation. It has no parent corporation and no publicly held corporation owns 10% or more of its stock.

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## **STATEMENT TO CONSENT OF FILING**

The Securities Industry and Financial Markets Association is authorized to file this brief pursuant to Rule 29(a) of the Federal Rules of Appellate Procedure, as all parties have consented to its filing.



## I.

### **STATEMENT OF INTEREST**

The Securities Industry and Financial Markets Association (“SIFMA”) brings together the shared interests of more than 600 securities firms, banks, and asset managers locally and globally (“SIFMA Members”).<sup>1</sup> SIFMA has offices in New York, Washington, D.C., and London, and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong. SIFMA’s mission is to champion policies and practices that benefit investors and issuers, to expand and perfect global capital markets, and to foster the development of new products and services. Fundamental to achieving this mission is earning, inspiring, and upholding the public’s trust in the securities industry and markets.

SIFMA commonly appears as *amicus curiae* in cases raising issues of importance to the securities markets and the commercial banking industry. Those interests are implicated here, as the illegal business practices of Defendant-Appellant Theflyonthewall.com, Inc. (“Fly”) create significant economic disincentives for dozens of SIFMA Members – including Plaintiffs-Appellees Barclays Capital Inc. (“Barclays”), Merrill Lynch, Pierce, Fenner & Smith Incorporated (“Merrill Lynch”), and Morgan Stanley & Co. Incorporated (“Morgan Stanley”) (collectively, the

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<sup>1</sup> Pursuant to Local Rule 29.1(b), SIFMA discloses that no party’s counsel authored this brief in whole or in part; no party or party’s counsel contributed money intended to fund preparing or submitting the brief; and no person contributed money intended to fund preparing or submitting the brief.

“Plaintiff Firms”) – who expend significant effort and resources preparing highly sought after equity research reports and recommendations for their brokerage clients. The continued creation of equity research reports and expert analysis benefits investors and issuers at-large, and promotes an efficient market.

Fly misappropriates the exclusive and time-sensitive value of labor-intensive research and recommendations prepared by many SIFMA Members for their clients. Without investing any of its own creative or other resources, Fly profits by repackaging and reselling those recommendations to its own subscribers nearly simultaneously with the release of the underlying research reports, often before SIFMA Members’ own clients can act on this valuable advice. Fly’s very name reflects their misappropriation of confidences, and it, and others like it, boldly advertises the same. Yet, the ability of SIFMA Members to provide their clients with exclusive advice and analysis during the pre-trading and early trading windows is a critical component of brokerage services and is a centerpiece of the business model of many investment banks. It is disingenuous to suggest that Fly is merely reporting market “news.” In contrast to entities that merely report exchange pricing, trade data, or market developments, Fly seeks to profit by misappropriating – and thereby devaluing – a highly sought-after product derived from expert commentary, opinion, and analysis. It is precisely this type of unfair competitive practice that the “hot news” misappropriation doctrine was designed to remedy.

Fly’s conduct is an example of an industry-wide problem affecting many

SIFMA Members. Unless protected, SIFMA Members, including the Plaintiff Firms, will have substantially less economic incentive to produce equity research and recommendations, which would also deprive investors of critical company, industry, and market analysis that facilitates open and efficient markets. SIFMA Members therefore have a substantial interest in the Opinion that the Court will render. SIFMA urges the Court to affirm the District Court's order in favor of the Plaintiff-Appellees. *See Barclays Capital Inc. v. Theflyonthewall.com*, No. 06 Civ. 4908 (DLC), --- F. Supp. 2d ---, 2010 WL 1005160, at \*32 (S.D.N.Y. Mar. 18, 2010); (Opinion & Order, Special Appendix SPA1-89).

## II.

### **SUMMARY OF ARGUMENT**

Protection of equity research recommendations from misappropriation by free-riding news aggregators like Fly is vital to the health and competitiveness of financial services firms. Equity research is a key source of competitive advantage for SIFMA Members that enables them to generate trading revenue. Much like the Plaintiff Firms here, many SIFMA Members invest significant resources in gathering, analyzing, and producing sophisticated equity research and investment recommendations. SIFMA Members are incentivized to do so because in exchange for providing clients with time-sensitive research and recommendations, those clients often act on the recommendations and place trades with the SIFMA Members who provide the advice. In turn, this produces trading commissions that fund equity

research. But when other economic actors, such as Fly, can systematically misappropriate the same time-sensitive product and sell it in competition with SIFMA Members at a lower cost (because Fly is free riding on SIFMA Members' work), the incentives to produce equity research and recommendations are greatly diminished.

The narrow injunction that the District Court entered not only protects investment firms from irreparable injury, but it also serves the public interest.

Although equity research is a private good produced principally for firm clients, it is broadly disseminated among those clients, including pension funds and other institutional investors upon which ordinary Americans depend. Courts universally recognize that the sophisticated analyst work produced by SIFMA Members is a substantial factor in facilitating open and efficient markets. Without the incentives for firms to invest in and create equity research and analyses, the capital markets will be deprived of important information that enables them to price securities appropriately. When securities are correctly priced, investors are more likely to allocate their resources efficiently by making sound investment decisions.

The "hot news" misappropriation doctrine, narrowly cabined to protect time-sensitive intellectual capital that reflects intensive investment that will not continue if firms cannot earn returns from it, affords an appropriate remedy to the Plaintiff Firms. In this case, the Plaintiff Firms proved at trial that all elements of the doctrine were met. The limited equitable relief fashioned by the District Court properly serves to maintain the economic incentives that drive the Plaintiff Firms'

allocation of resources to create valuable equity research and recommendations.

SIFMA therefore respectfully requests the Court to affirm the District Court's order below.

### III.

#### ARGUMENT

In *National Basketball Association v. Motorola, Inc.*, 105 F.3d 841 (2d Cir. 1997), this Court recognized the existence of a “hot news” misappropriation tort under New York law that survives preemption under the Copyright Act. That tort has five elements. The plaintiff must show that:

(i) [it] generates or gathers information at a cost; (ii) the information is time-sensitive; (iii) a defendant's use of the information constitutes free riding on the plaintiff's efforts; (iv) the defendant is in direct competition with a product or service offered by the plaintiffs; and (v) the ability of other parties to free-ride on the efforts of the plaintiff or others would so reduce the incentive to produce the product or service that its existence or quality would be substantially threatened.

*Id.* at 845.

While SIFMA will leave to the Plaintiff Firms the full rebuttal of Fly's arguments, Fly's central contentions are based on a false portrait of the equity research business models employed throughout the industry. Disregarding the District Court's findings of fact, *see* SPA6-38, Fly contends that banks widely disseminate their research reports publicly, and that Fly acts no differently from ordinary news outlets in reporting the news. (Appellant's Br. at 18.) According to

Fly, it is merely “reporting news in the public domain without any demonstrable harm to these goliath enterprises,” with which Fly claims not to compete because it does not provide brokerage or other investment services and does not provide independent substantive analysis of the stocks or market sectors. (*Id.* at 9, 20.)

To the contrary, Fly is wrong about both the facts and the policy implications of its conduct. SIFMA Members’ research reports and recommendations are not, in fact, publicly disseminated. As shown at trial, Plaintiff Firms, including SIFMA Members, send their reports and recommendations to their clients, which maintain valuable trading and other relationships with SIFMA Members, either directly or through licensed sources. As the District Court found, these companies expend great effort to limit the distribution of their reports and recommendations. (SPA12, SPA17-20.)

The practices of Fly and other purported news aggregators threaten to undermine the production of equity research throughout the industry (since the model employed by Plaintiff Firms is reasonably typical of other SIFMA Members). SIFMA Members invest substantial capital in equity research to generate trading revenue, and the principal source of research-generated trading revenue is actionable recommendations, the value of which is necessarily time-sensitive. Fly competes with Plaintiff Firms (and other SIFMA Members) in providing access to the recommendations, and the fact that Plaintiff Firms’ revenue model (indirect revenue through enhanced trading revenues) differs from Fly’s (indirect revenue through

enhanced subscription fees) does not alter the fact of competition. The “hot news” doctrine is properly drawn to protect the creation of costly intellectual capital that would not otherwise be produced against systematic free riding, and would not extend (for example) to the mere compilation and reporting of market data. The District Court properly applied that doctrine here.

The problem that the likes of Fly pose is not limited to Plaintiff Firms, but extends to all similarly situated research firms. Fly alone admits to “reporting” – no doubt usually by misappropriation – the equity recommendations of as many as 65 firms, many of which are SIFMA Members. (*See* SPA64.) Not surprisingly, if SIFMA Members cannot sustain adequate returns on their research investment, such investment will diminish, and the ordinary investor will pay the price. This Court should uphold the measured and thorough order of the District Court enjoining Fly from its unlawful conduct.

**A. Equity Research Is Not Economically Viable Unless Firms Can Provide Exclusive Access To Time-Sensitive Recommendations To Their Clients**

**1. Firms Invest Significant Resources To Create Original Equity Research**

Equity research is a critical source of competitive advantage for financial services firms, both against other firms and also against electronic discount brokerages. As the District Court found, “The Firms use their equity research – and their reputations for creating reliable and valuable advisory reports based on that

research – to attract and retain clients, to entice clients, to execute trades through them, and to differentiate themselves from other financial services firms.” (SPA7.)

In order to create original equity research and analysis, many SIFMA Members, including each of the Plaintiff Firms, employ large research departments consisting of hundreds of highly-skilled analysts who possess expertise in the many industries and sectors they cover. SIFMA Members often expend hundreds or thousands of hours tracking a single company’s performance, researching its competitors and market segment, meeting with its principals, analyzing its financials, and drafting and editing research reports and recommendations. Through years of experience and careful study, analysts develop a trusted expertise regarding the discrete business practices, participants, and the key factors affecting that industry. Given the ever-changing investment landscape, these analysts must constantly filter and assess relevant market data, such as corporate filings with the Securities and Exchange Commission, competitive benchmarking and analysis, financial models, and industry-specific trends and patterns. In addition, analysts frequently interview corporate managers, directors, and other industry contacts, participate in earnings calls, perform site visits, and meet with important customers and suppliers. When additional information is needed, analysts may purchase third-party content or data. Finally, after all of the data is processed and analyzed, significant additional efforts are required to prepare the research reports and recommendations, which are then extensively reviewed by SIFMA Members’ internal review committees.



Collectively, SIFMA Members' equity research covers many thousands of companies and scores of industries. SIFMA Members' market research is the leading source of high-quality equity research for securities of issuers traded on "exchanges in the United States and around the world." (*See, e.g.*, SPA10-11.) SIFMA Members' equities coverage is global, blanketing markets in Asia, Europe, Europe Middle-East and Asia, Japan, Latin America, and North America. SIFMA Members collect and review data in a wide variety of sectors of the economy.

The cost of covering this broad range of companies is enormous. Undertaking such a task requires hundreds of millions of dollars to pay salaries for analysts and support staff, as well as additional incidental costs such as overhead, travel, and subscriptions to industry publications. (SPA9-10.) By way of example, Merrill Lynch alone invests hundreds of millions of dollars each year to produce original equity research. (K. Lynch Test. E486 ¶ 11; C. Browning Test. E504 ¶ 6.) Many other SIFMA Members expend comparable levels of resources. *See, e.g.*, Jill E. Fisch, *Does Analyst Independence Sell Investors Short?*, 55 UCLA L. REV. 39, 48 (2007) (for example, firms spent \$9.1 billion producing research in 2003).

## **2. A Firm's Research And Recommendations Generate Trading Commissions and Strengthen Client Relationships**

SIFMA Members produce research to provide their clients with sound investment advice and a full range of investment services. Research helps generate trading revenue for SIFMA Members, both in specific transactions and over the long-

term in attracting and retaining clients. As the District Court found, the “substantial investment in producing high-quality equity research is ultimately justified by the role that research plays in driving commission revenue.” (SPA16.)

SIFMA Members, like the Plaintiff Firms, grant “entitled clients” – both institutional and individual investors – regular and simultaneous access to research through tightly controlled channels. (SPA11-12.) The institutional investors include money managers, who account for the majority of SIFMA Members’ trading commissions. These money managers not only represent big business, but they also manage pensions for blue and white collar workers and retirees, from Main Street to Wall Street and beyond.

From an economic perspective, SIFMA Members are incentivized to produce equity research by bundling the product with their other services. *See* Fisch, 55 UCLA L. REV. at 49 (“research can be bundled with trading commissions”). Bundling is understood as “the practice of offering, for a single price, two or more goods or services that *could be sold separately*.” *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883, 894 (9th Cir. 2008) (emphasis added). In this scenario, SIFMA Members’ clients effectively pay for both the cost of executing trades and the cost of underlying research and recommendations as a single package. *See* Fisch, 55 UCLA L. REV. at 49-50; *see also* *Jefferson Parish Hospital Dist. No. 2 v. Hyde*, 466 U.S. 2, 12 (1984) (explaining the benefit to buyers and sellers purchasing and selling products and services in “package sales”), *abrogated on other grounds by* *Ill. Tool Works Inc. v. Indep. Ink*,

*Inc.*, 547 U.S. 28 (2006).

Scholars consider these bundling practices a basic means for SIFMA Members to recover costs for their heavy investment into equity research. *See, e.g., id.*; Gerald T. Lins, *Soft Dollars and Other Brokerage Arrangements*, J. Fin. Plan., Feb. 1998, Vol. 11, Iss. 1, at 89; D. Bruce Johnsen, *The SEC's 2006 Soft Dollar Guidance: Law and Economics*, 30 CARDOZO L. REV. 1545, 1553-54 (2009). For example, many investment advisers pay “soft dollar” commissions set at a premium. *See* Office of Compliance Inspections and Examination, U.S. Sec. & Exch. Comm’n, *Inspection Report on the Soft Dollar Practices of Broker-Dealers, Investment Advisers and Mutual Funds* 3 (1998). “Soft dollars are the use of brokerage commissions to pay for research products and services.” Fisch, 55 UCLA L. REV. at 50 n.41. Soft dollar commissions greatly increase the revenue received by the SIFMA Members to fund equity research. *See* Charles Gasparino, *Mutual-Fund Investors Risk Bite from ‘Soft-Dollar’ Deals*, Wall St. J., Sept. 16, 1998, at C1 (soft dollars can have the effect of doubling the commissions paid by mutual funds).

SIFMA Members invest in equity research because it creates significant value for their clients. Through equity research, analysts “turn information into insight” and valuable advice. (*See* Exhibit Volume I, E511.) The value of equity research results from (1) the unique expertise and recognized judgment regarding the performance of equity investments and (2) the opportunity for the firm’s clients to act promptly on that expertise and judgment before others are able to do so. (SPA16.)

Clients rely and place great value on the expertise and judgment of SIFMA Members due to their proven track record in producing high-quality market analysis and recommendations.

Research generates trading revenue. If a client determines to act on a recommendation, it often executes its trade through the recommending firm. (SPA16-17); *see also* Jill E. Fisch & Hillary A. Sale, *The Securities Analyst as Agent: Rethinking the Regulation of Analysts*, 88 IOWA L. REV. 1035, 1040-41 (2003) (describing analysts as “information conduits”). It is a classic *quid pro quo* arrangement. *See* Johnsen, 30 CARDOZO L. REV. at 1553. SIFMA Members provide valuable information to clients, and, in exchange, if a client acts on that information, SIFMA Members will benefit through brokerage commissions and client loyalty. (SPA4, SPA16); *see also* Robert G. Eccles & Dwight B. Crane, *Doing Deals: Investment Banks at Work* 174 (Harvard Bus. Press 1988). The ultimate purpose of creating equity research is thus to attract and retain clients, drive trading, and earn commissions. (SPA16, SPA23); *see also* *Investment Banks at Work* at 173 (commenting that analyst research is a cost that contributes “to the ability of sales and trading to generate revenues from investing customers”).

### **3. The Value Of Recommendations Depends On Time-Sensitive Rights Of Exclusivity**

For a critical segment of the investor market, the primary economic value inheres in “actionable” research (*i.e.*, that which is “likely to spur any investor into

making an immediate trading decision”). (SPA8.) The District Court defined such actionable research as “Recommendations,” which encompasses “reports” and “summaries” that “upgrade or downgrade a security . . . or predict a change in the security’s target price.” (*Id.*) As the District Court noted, “Recommendations may move the market price of a stock significantly, particularly when a well-respected analyst makes a strong Recommendation.” (*Id.*)

Recommendations are critical because many of SIFMA Members’ most sophisticated individual and institutional clients (including hedge funds) rely upon the exclusivity, timeliness, and content of the recommendations in making trading decisions before other investors do. Thus, whether a client has a short horizon, is a long-term investor, or follows a hybrid approach, it wants prompt notice of changes in recommendations in order to anticipate potential consequent market movements and to otherwise facilitate trading decisions. Indeed, the District Court found:

These sophisticated clients seek an advantage over other investors by relying on the high-quality analysis underpinning the Firms’ Recommendations, anticipating market movement, and making rapid trading decisions. *Such “short-horizon” investors are also the principal drivers of trading revenues for the Firms.*

(SPA16 (emphasis added).)

In all events, SIFMA Members are likely to derive greater benefit from those who learn of recommendation changes directly from the SIFMA Members, rather than from another source. As the District Court found:

For other investors, with longer investment horizons, research reports retain value over hours, days, or even longer. Whatever a client's trading model, however, it is the Firms' experience that their clients are more likely to execute a trade through the Firm if they learn of the Recommendation directly from the Firm rather than from another source.

*(Id.)*

The value of such information is time-sensitive and depends on its limited distribution to clients (*i.e.*, preserving the exclusive access of its entitled clients to the information). *(Id.)* Thus, SIFMA Members provide recommendations in a time-sensitive manner only to clients and only after the clients have agreed to maintain the confidentiality of the information received. While SIFMA Members disseminate research ratings changes simultaneously to all clients entitled to receive them, they seek to ensure that their recommendations are made available only to their targeted audience. For example, clients of SIFMA Members gain access to reports and recommendations via password protected internet platforms, email, and password-protected conference calls, as well as through licensed distributors such as Bloomberg (again, password-protected). (SPA12-23.)

Also, to ensure restricted access to their recommendations, SIFMA Members periodically “scrub” their lists of recipients to ensure that only clients and other intended recipients are included on the distribution lists. There has been a relatively recent proliferation of on-line trading platforms that offer to execute trades at lower costs (because they do not provide equity research or other services provided

by SIFMA Members). (*See, e.g.*, SPA38.) This heightens the importance of maintaining limits on access to research and recommendations that differentiate the valued-added products offered by the SIFMA Members' brokerage services.

Providing exclusive access to research and recommendations thus represents an important means by which SIFMA Members maintain relationships with their most valuable clients. Without the ability to provide exclusive client access to valuable research and recommendations, SIFMA Members face the serious threat of losing clients to lower cost trading platforms.

Clients benefit from receiving research-based recommendations before they penetrate the market and are reflected in market prices. (SPA8-9.) To maximize the value of the recommendations, Plaintiff Firms and SIFMA Members typically provide their research reports and recommendations to their clients before the markets open or shortly thereafter. (SPA35.) Recognizing the time-sensitive nature of this information, SIFMA Members work to ensure that their clients receive the analysis and recommendations at the same time, with equal access and opportunity to consider the information before the market reacts. Moreover, many SIFMA Members have developed model portfolios and extensive investment strategies around their research and recommendations, notice of which coincides with the simultaneous dissemination of the recommendation changes to clients and salespeople. Allowing non-clients access to such information at the same time would permit them to take advantage of such products and services designed and intended

for clients and would deprive SIFMA Members of trading and other revenues.

(SPA15.)

**B. Fly's Conduct Constitutes Misappropriation Under *Motorola*.**

The District Court properly concluded that the Plaintiff Firms had satisfied the third, fourth, and fifth elements of the *Motorola* test, which were the only ones that the parties contested. (*See* SPA57-58.) The evidence clearly showed that (1) Fly free-rides on Plaintiff Firms' costly research investment; (2) that Fly directly competes with Plaintiff Firms in the provision of time-sensitive recommendations; and (3) that Fly undermines the entire equity research business model by destroying incentives of Plaintiff Firms, including SIFMA Members, to invest in such research.

**1. Fly Is Free Riding On SIFMA Members' Creative Efforts**

In *Motorola*, this Court held that a defendant's copying from sources created by the plaintiff constitutes "free-riding and might well cause [plaintiff] to be unprofitable because it had to bear costs to collect facts that [defendant] did not." 105 F.3d at 854. The same is true here: Fly's subscription business relies heavily on its ability to access and redistribute the investment firms' recommendations. (SPA59.)

Fly's ability to sell research and recommendations at sharply reduced rates reflects the fact that it "free rides" on the work of SIFMA Members. (*Id.*) The District Court correctly determined that Fly's "reporting" consists merely of obtaining, copying, and then republishing the substance of Plaintiff Firms and SIFMA Members' research recommendations. (*Id.* ("Fly's Recommendation headlines consist



entirely of regurgitations of the Firms' Recommendations and those of other investment institutions").) Fly does not invest in producing its own commentary or otherwise scrutinize the substance of the research in any way. (SPA34, SPA58-59.) Thus, the District Court concluded, the costs incurred by Fly are solely in the resources it expends to misappropriate the Plaintiff Firms' Recommendations. (SPA59.) For this reason, Fly was able to offer the Recommendations "at a cut-rate price to its subscribers and still make a profit." (*Id.*)

Fly free-rides not just on the actual direct and indirect costs SIFMA Members expend in producing a given recommendation, but on the reputation that SIFMA Members have acquired through years of such investment. Moreover, SIFMA Members assume the expense of complying with all the regulatory and supervisory obligations related to analysts (which protect the public), *see, e.g.*, 17 C.F.R. §§ 242.500-242.504 (SEC regulations covering securities analysts and research reports), but Fly escapes those costs by simply republishing SIFMA Members' recommendations. Thus, Fly's posting of the core of the recommendation in its on-line feed so that its subscribers can readily act on the efforts and expertise of SIFMA Members' analysts without paying for the true costs of access is clearly actionable under *Motorola*. *See Chicago Prof'l Sports Ltd. P'ship v. NBA*, 961 F.2d 667, 675 (7th Cir. 1992) ("Free-riding is the diversion of value from a business rival's efforts without payment."); *c.f. Wainwright Securities, Inc. v. Wall Street Transcript Corp.*, 558 F.2d 91, 96 (2d Cir. 1977) (declining to apply fair use exception to copyright claim where the

defendant's purported news coverage "appropriated almost verbatim the most creative and original aspects of the reports, the financial analyses and predictions, which represent a substantial investment of time, money and labor").

## **2. Fly And SIFMA Members Are Competitors**

The fourth *Motorola* factor is also satisfied here. Fly directly competes with SIFMA Members in providing the SIFMA Members' investment advice to trading clients. As its very name implies, "the Fly" receives subscription revenue for misappropriating and providing subscribers access to a valuable commodity – SIFMA Members' recommendations – in direct competition with the investment advice provided by the SIFMA Member who created the recommendations. Fly's "reporting" or republication of the recommendations is thus "a substitute for" the recommendations under *Motorola*. See 105 F.3d at 854. Fly's near simultaneous resale and distribution of the critical components of the recommending SIFMA Members' analysis and investment advice usurps its most valuable qualities: time-sensitivity and exclusivity.

Fly's contention that it does not compete with the Plaintiff Firms (Appellant's Brief at 9, 18) is unfounded.<sup>2</sup> Securities investors comprise an identifiable market. As relevant here, those investors, broadly speaking, demand two

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<sup>2</sup> Fly admitted that it competed with Plaintiff Firms by bringing an unfair competition counterclaim against them. The District Court properly recognized the inconsistency between that claim and Fly's argument that it does not compete with Plaintiff Firms. (SPA68.)

kinds of products: information to evaluate potential trades, and sales and trading services. Fly competes directly with the Plaintiff Firms and SIFMA Members to provide one type of information product – recommendations. (SPA66.) The fact that the SIFMA Members typically bundle the recommendations with trading services – by providing time-sensitive and exclusive access to the recommendations in return for a certain volume of trading, or by providing the recommendations for free in sales efforts to induce a trade – does not eliminate the competition between Fly and SIFMA Members. *See LePage's Inc. v. 3M*, 324 F.3d 141, 156 (3d Cir. 2003) (bundling rebates for products in which parties did not compete affected competition in other products); *Cascade Health Solutions*, 515 F.3d at 894 (discussing competition between sellers of bundled and standalone products).

Thus, just like SIFMA Members, Fly endeavors to provide recommendations to its subscribers before the market opens (or upon its release after market opening) to enable its subscribers to make investment decisions before the market reacts to them. (SPA66-67.) Both Fly and SIFMA Members are, in other words, in the business of providing their clients with trading recommendations about a given company, sector, or industry before that information is available to the general investing public. (*Id.*) Fly systematically republishes the research and recommendations within minutes of release by the issuing SIFMA Members to their respective clients, illustrating that Fly is simultaneously offering the same types of information products to subscribers as SIFMA Members offer to their clients. Fly

may have a different revenue model – it offers a wide array of SIFMA Member recommendations to increase subscriptions and support a higher subscription price, *see* SPA30-31 – but it competes with the SIFMA Members just the same.

Indeed, as evidence of the direct competition, Fly now aligns with discount brokerages so that in tandem they can offer on an unbundled basis market information (including recommendations) from Fly and trading services from brokers so as to compete with the bundled research/trading products offered by SIFMA Members. The District Court correctly found that Fly’s alignment with discount brokerages, such as Cyber Trader, eSignal, and Newswire, “reflect[s] the final stage in its direct competition with the Firms.” (SPA68.) Fly distributes its newsfeed through these on-line discount brokerages, which effectively allows them to bundle the same services provided by SIFMA Members. (*Id.*) Through its relationship with discount brokerages, Fly “leverag[es] its access to [the Plaintiff Members’] Recommendations and driv[es] away their commission revenue.” (*Id.*); *see also* Fisch, 55 UCLA L. REV. at 52 (free access to research allows investors to trade through discount brokerages). Therefore, Fly and other unauthorized redistributors directly compete with SIFMA Members’ business model by partnering with discount brokerages to provide clients virtually identical services.

Thus, fundamentally, both SIFMA Members and Fly sell equity research recommendations to clients that wish to receive and potentially act on the SIFMA Members’ advice. As the District Court correctly held, “[t]o the extent that Fly

succeeds in fulfilling that demand at a lower cost, it is directly to [the Plaintiff Firms'] detriment, not a mere collateral windfall.” (SPA67.) This constitutes direct competition in a primary business line of SIFMA Members, *i.e.*, providing advice and recommendations to clients who will seek to place brokerage trades. *See Int’l News Serv. v. Associated Press*, 248 U.S. 215, 245-46 (1918) (granting relief to plaintiff when misappropriation affected a narrow aspect of the parties’ business).

### **3. Fly’s Misappropriation Undermines The Equity Research Model**

On the final *Motorola* factor, Fly’s activities disrupt the incentive structure that supports equity research and has a “profound effect” on SIFMA Members’ business models. (SPA76.) Fly’s systematic publication of Plaintiff Firms’ and SIFMA Members’ actionable recommendations before or shortly after the market opens deprives the firm’s clients of the value of that recommendation. (SPA16, SPA58, SPA64.) Once widespread disclosure of the recommendation occurs, SIFMA Members’ clients become just members of the crowd. (SPA71.)

Misappropriation by Fly and others has far-reaching effects on the equity research model. When the recommendations do not create money-making opportunities, clients are less inclined to act on the recommendations and therefore less likely to place trades with the SIFMA Members that provided the advice. Thus, where a client seeks to trade based on a recommendation that has been widely disclosed, the *quid pro quo* arrangement breaks down: if the recommendation is

available from a third-party source such as Fly, SIFMA Members no longer provide the client with “exclusive” information, and clients feel less obligated, and are less likely, to execute trades through SIFMA Members. (SPA57-58.) Fewer trades mean fewer brokerage fees for SIFMA Members, which fees are necessary to fund equity research. (SPA16, SPA72, SPA76.) It also means that SIFMA Members have less to offer when recruiting new clients.

At trial, the Plaintiff Firms proved that Fly and similar companies are among the factors that reduce the incentive of firms to produce equity research to the point where the viability of the equity research model is substantially threatened. (SPA71-72.) As the District Court noted, the ability of the Plaintiff Firms to “monetize” their research by generating trading activity from it is “critical to its continued production.” (SPA72.) But Fly’s activities disrupt this cycle. For example, SIFMA Members have already substantially cut back budgets for equity research and are now covering far fewer companies.

This is an industry-wide problem affecting many SIFMA Members. Unless this Court limits the ability of companies, such as Fly, to misappropriate Plaintiff Firms’ time-sensitive recommendations, the market faces the possibility of losing the insightful equity research upon which the markets have historically relied. *See Motorola*, 105 F.3d at 854 (warning that the incentive to create the original content “would be substantially deterred because any potential [producer] would know that the first entrant would quickly encounter a lower cost competitor free-riding on the

originator's [efforts]”).

**C. Equity Research Serves The Public Interest In An Open And Efficient Market**

As the District Court properly found (SPA77), equity research is a private good that has very important collateral benefits to the public interest: while not disseminated directly into the public domain, nevertheless equity research and analysis are vital to promoting an open and efficient market. (*Id.*) Accordingly, the District Court’s decision to grant narrowly tailored equitable relief promotes an important public interest while protecting the incentives for Plaintiff Firms to continue to invest and produce high-quality equity research. *See eBay, Inc. v. MercExchange, L.L.C.*, 547 U.S. 388, 391 (2006) (permanent injunction appropriate when consistent with public interest).

**1. Analyst Reports Are Vital To Promoting An Efficient Market**

Market analysts are “*necessary* to the preservation of a healthy market.” *Dirks v. SEC*, 463 U.S. 646, 658 (1983) (emphasis added). They play a “central role” in “revealing information that corporations may have reason to withhold from the public . . . .” *Id.* at 658 n.17 (market analysts perform an invaluable role in capital markets by collecting information, analyzing and processing it, and reporting it in a form that is easily digestible to investors).<sup>3</sup> That information is then incorporated into the market price of securities over the course of the first day or several days after the

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<sup>3</sup> *See also* Fisch & Sale, 88 IOWA L. REV. at 1040 (describing analysts as “information conduits”).

release of the research recommendation.<sup>4</sup> Often information obtained by analysts serves as “the basis for judgments as to the market worth of a corporation’s securities.” *Id.* at 658-59; *see also The Regulation of Securities Offerings*, 63 Fed. Reg. 67,216-217 (Dec. 4, 1998) (“analysts fulfill an important function by keeping investors informed”). The analysts’ work “significantly” enhances the “market efficiency in pricing.” *Dirks*, 463 U.S. at 658 n.17 (quotations omitted).<sup>5</sup> “An efficient market requires an analyst to make it efficient in many cases . . . . An analyst must take the information that is available in the public domain and assemble it in a way that makes sense. It is only at that point that the price of the security can truly reflect the available information.” *In re Res. Am. Sec. Litig.*, 202 F.R.D. 177, 190 (E.D. Pa. 2001).

Numerous courts, including the Supreme Court and this Court, consistently acknowledge that broad analyst coverage facilitates open and efficient markets. *See Dirks*, 463 U.S. at 658 n.17; *Teamsters Local 445 Freight Div. Pension Fund v. Bombardier Inc.*, 546 F.3d 196, 205 (2d Cir. 2008) (a market is “efficient” if enough “securities analysts following and reporting on” the securities are “mak[ing] buy/sell recommendations to client investors”). Likewise, every other Circuit to consider the

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<sup>4</sup> Analyst recommendations are not – as Fly attempted to demonstrate at trial – immediately reflected in the price of the security. The District Court correctly rejected Fly’s contention that it merely reports what has “already happened” in the marketplace as well as Fly’s related “untested hypothesis” that the market has already adjusted to the Plaintiff Firms’ Recommendations by the time Fly posts the information for its subscribers. (SPA70-71.)

<sup>5</sup> *See also* Brad M. Barber *et al.*, *The Fraud-on-the-Market Theory and the Indicators of Common Stocks’ Efficiency*, 19 J. CORP. L. 285, 305 (1993-994) (explaining that “securities with low volume and fewer analysts are more likely to be traded inefficiently”).



issue recognizes the importance that analyst coverage plays in facilitating an efficient market. See *In re Xcelera.com Sec. Litig.*, 430 F.3d 503, 514 (1st Cir. 2005); *Hayes v. Gross*, 982 F.2d 104, 107 n.1 (3d Cir. 1992); *Gariety v. Grant Thornton, LLP*, 368 F.3d 356, 368 (4th Cir. 2004); *Bell v. Ascendant Solutions, Inc.*, 422 F.3d 307, 313 n.10 (5th Cir. 2005); *Freeman v. Laventhol & Horwath*, 915 F.2d 193, 199 (6th Cir. 1990); *Asher v. Baxter Int'l Inc.*, 377 F.3d 727, 731 (7th Cir. 2004); *Binder v. Gillespie*, 184 F.3d 1059, 1065 (9th Cir. 1999).

## **2. Promoting An Efficient Market Ensures That Prices Accurately Reflect All Available Information**

An efficient market assumes “that in a free and actively traded market, absent compelling reasons to believe otherwise, the market price is held to take account of asset value as well as the other economic, political, and financial factors that determine ‘value.’” *Seaboard World Airlines, Inc. v. Tiger Int'l, Inc.*, 600 F.2d 355, 361-62 (2d Cir. 1979). In other words, securities in an efficient market are traded and priced on the basis of all known relevant facts. See *Basic Inc. v. Levinson*, 485 U.S. 224, 243-45 (1988). In this respect, the important contribution of analysts “to the liquidity and transparency of the U.S. markets is well recognized.” See Manuel Garciadiaz, *Offering Or Listing Shares In The United States: A Handbook For Foreign Companies*, 1798 PLI/Corp. 301, 310 (Mar. 8, 2010); Securities Exchange Bill of 1934, H.R. Rep. No. 73-1383, at 11 (1934) (*available at* 1934 WL 1290) (market regulation is meant to assure that price reflects as nearly as possible the correct price for the security).

Ultimately, accurate stock pricing ensures “an efficient allocation of capital and to efficient investments.” Marcel Kahan, *Securities Laws and the Social Costs of “Inaccurate” Stock Prices*, 41 DUKE L.J. 977, 1006 (1992); Dennis W. Carlton & Daniel R. Fischel, *The Regulation of Insider Trading*, 35 STAN. L. REV. 857, 866 (1983) (the more accurate stock prices are, the better they guide capital investments); N. Gordon & Lewis A. Kornhauser, *Efficient Markets, Costly Information, and Securities Research*, 60 N.Y.U. L. REV. 761, 769 (1985) (allocative efficiency results in correct investment decisions). As such, efficient markets serve the critical public interest of promoting the effective use of society’s limited resources. Allowing Fly to continue its conduct would restrict research and hinder market efficiency because the analysts’ views would no longer be reflected in price of securities.

**D. The “Hot News” Doctrine Offers Narrowly Tailored Protection To Time-Sensitive Research And Recommendations**

Fly’s illegal business practices create strong economic disincentives for the SIFMA Members to invest in market research. The “hot news” doctrine provides a narrow but appropriate remedy that preserves the economic incentives by protecting the time-sensitive value of SIFMA Members’ research and recommendations. *See INS*, 248 U.S. at 235. Without any protection from the misappropriation of the valuable analysis, SIFMA Members will simply “cease to collect” and analyze market data that forms the basis for actionable recommendations. *Motorola*, 105 F.3d at 853. State law thus properly remains flexible “to afford a remedy (under traditional

principles of equity) against a consistent pattern of unauthorized appropriation by a competitor of the facts (*i.e.*, not the literary expression) constituting ‘hot’ news . . . in the newer form of data updates from scientific, business, or financial data bases.” *Id.* at 850 (quoting H.R. Rep. No. 94-1476 at 132 (1976)).

Upholding the District Court’s narrow application of the “hot news” misappropriation doctrine to Fly’s conduct will not lead to an undue proliferation of property rights in information. The essence of the decision below is that protection may be afforded to the production of new intellectual capital: time-sensitive content that would not otherwise exist absent substantial investment, and absent the application of knowledge and analysis to facts. The District Court’s reasoning would not apply, for example, to the compilation of pure facts, such as stock quotes and last sale price and securities order data. But without the protection of the misappropriation doctrine, the valuable investor resource of equity research will not long endure in its present form.

Moreover, the permanent injunction is narrowly tailored to “provide an incentive for the production of socially useful information without either under- or over- protecting the efforts to gather such information.” (SPA80.) In doing so, the District Court placed a *limited* restriction on Fly’s ability to disseminate Plaintiff Firms’ Recommendations: Fly is restricted only for a very short time period, and only as to “a narrow range of competitive conduct” involving the publication of the Plaintiff Firms’ Recommendations (without independent analytical reporting). (SPA86-87.)

Instead of protecting the full value of the Recommendations to the Plaintiff Firms, the District Court carefully crafted the relief to protect the Plaintiff Firms' economic incentive to continue providing the valuable service. (*Id.* (declining "to provide relief beyond the minimum level of protection necessary to ensure a socially valuable product is not driven out of the market through unfair competition").) Therefore, the District Court appropriately exercised its discretion to frame equitable relief that comports with the public interest.

#### IV.

#### CONCLUSION

For the foregoing reasons, SIFMA requests that this Court affirm the decision of the District Court in favor of the Plaintiff Firms.

Dated: July 22, 2010

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## **CERTIFICATE OF COMPLIANCE**

Pursuant to Rule 29(d) and Rule 32(a) of the Federal Rules of Appellate Procedure and Rule 32.1 of the Local Rules of the Second Circuit, SIFMA certifies that the foregoing brief complies with the applicable type-volume and spacing requirements. According to the word count feature on the word processing system used to prepare the brief, the brief, including text, footnotes, headings, and quotations (but excluding the parts exempted by Fed. R. App. P. 32(a)(7)(B)(iii)), contains 6,603 words.

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**CERTIFICATE OF SERVICE**

I, Stephen B. Kinnaird, hereby declare under penalty of perjury as follows:

I am employed by the law firm of Paul, Hastings, Janofsky & Walker LLP, 875 15th Street, N.W., Washington, DC 20005. I am over the age of eighteen years, and am not a party to this action.

On July 22, 2010, I served Brief for *Amicus Curiae* the Securities Industry and Financial Markets Association (SIFMA) in Support of Affirmance, together with this Certificate of Service, on the parties listed below, by causing true and correct copies of same to be electronically served on all other parties to this appeal.

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