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No. 01-16725

**UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT**

NO. 84 EMPLOYER-TEAMSTER JOINT COUNCIL PENSION TRUST FUND,
on behalf of itself and all others similarly situated, *Plaintiff*,

v.

AMERICA WEST HOLDING CORPORATION, *et al.*, *Defendants-Appellees*.

Appeal from the United States District Court
for the District of Arizona

Honorable Owen M. Panner, United States Senior District Judge
Case No. CV-99-00399-OMP

**BRIEF OF *AMICUS CURIAE* SECURITIES INDUSTRY ASSOCIATION
IN SUPPORT OF PETITION FOR PANEL REHEARING
AND *EN BANC* REVIEW**

Laurie B. Smilan
J. Christian Word
LATHAM & WATKINS LLP
Two Freedom Square, Suite 500
11955 Freedom Drive
Reston, Virginia 20190
Phone: (703) 456-1000
Fax: (703) 456-1001

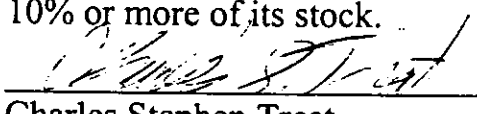
Charles Stephen Treat
Counsel of Record
LATHAM & WATKINS LLP
505 Montgomery Street
Suite 1900
San Francisco, California 94111
Phone: (415) 391-0600
Fax: (415) 395-8095

Attorneys for *Amicus Curiae*
Securities Industry Association

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CORPORATE DISCLOSURE STATEMENT

Pursuant to FRAP 26.1, *amicus curiae* Securities Industry Association states that it is a nonprofit corporation. As such, it has no parent corporation, and there are no publicly traded corporations that hold 10% or more of its stock.



Charles Stephen Treat
COUNSEL FOR AMICUS CURIAE

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INTEREST OF AMICUS CURIAE

The Securities Industry Association brings together the shared interests of more than 600 securities firms. SIA member-firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. Collectively they employ more than 495,000 individuals, representing 97% of total employment in securities brokers and dealers. The U.S. securities industry manages the accounts of nearly 93 million investors directly and indirectly through corporate, thrift, and pension plans. In 2001, the industry generated \$280 billion in U.S. revenue and \$383 billion in global revenue.

Accordingly, SIA has an interest, on behalf of its members, in ensuring rationality and soundness in the substantive and procedural law applied in securities litigation.

All parties have consented to the filing of this brief.

ARGUMENT

This Court has warned against pleading practices that would let any company be sued anytime it suffers a stock drop.¹ The panel majority in this case has gone one step further: It has erected a precedent under which companies will face securities lawsuits *even if there is no stock drop*.

This Court should rehear this case *en banc* to clarify the proper role of market price movements in a “fraud-on-the-market” case. The panel majority opinion establishes an irrational one-way rule: Stock price movement establishes that an alleged misstatement was material and relied upon—but *non*-movement is ineffective to show immateriality or non-reliance.

The panel majority’s reasoning contradicts the rationale for recognizing a fraud-on-the-market theory at all. See Basic v. Levinson, 485 U.S. 224 (1988). It’s also contrary to the holdings of other Circuits that the *absence* of any market reaction to a disclosure is fatal to a plaintiff invoking “fraud-on-the-market” to establish reliance and materiality. Oran v. Stafford, 226 F.3d 275 (CA3 2000); Nathenson v. Zonagen, 267 F.3d 400 (CA5 2001); ABC Arbitrage v. Tchuruk, 291 F.3d 336 (CA5 2002).

The Fraud-On-The-Market Theory

Plaintiffs here pleaded reliance, an essential element of their Section 10(b) claim, via the fraud-on-the-market presumption. That presumption is based on the efficient market hypothesis: When a company’s securities are traded on an efficient market, the market price of its securities reflects known material information about the company. The theory reasons that if there is a misrepresentation or omission of material information, the stock price will be

¹ E.g., Silicon Graphics Securities Litigation, 183 F.3d 970, 988 (CA9 1999); Lipton v. Pathogenesis, 284 F.3d 1027, 1038 (CA9 2002).

artificially inflated. A shareholder purchasing at the market price, confident that it fairly reflects the “true value” of the security, relies to his detriment. Without this presumption, individualized issues of reliance would predominate over common issues, precluding class certification. Basic, 485 U.S. 242.

The fraud-on-the-market theory was originally articulated in the context of reliance. Courts have recognized, further, that it also has implications for materiality—another essential element of a Section 10(b) claim. Typically, materiality is judged by whether the allegedly misrepresented or omitted facts “would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.” Basic, 485 U.S. 231-32. The fraud-on-the-market theory substitutes the actual, observable workings of an efficient securities market, for a dubious guess as to what a “reasonable investor” might or might not find material, and might or might not rely upon. By definition, a “material” fact is one that causes the stock price to move significantly.

In a fraud-on-the-market case the hypothetical “reasonable investor,” by reference to whom materiality is gauged, must be “the market” itself, because it is the market, not any single investor, that determines the price of a publicly traded security.

Shaw v. Digital Equipment, 82 F.3d 1194, 1218 (CA1 1996).

The fraud-on-the-market theory is often invoked by plaintiffs (especially in class actions) as a substitute for having to prove reliance investor-by-investor. Thus, for example, a significant stock drop immediately after a corrective disclosure—revealing the incorrectness of a prior misleading statement or omission—is a strong indication that “the market” (and thus most individual investors in it) considered the information at issue to be material, and relied on the prior misstatement.

Two Circuits have correctly recognized that this principle works in both directions. Just as the market's price *movement* is indicative of materiality and reliance, so does price *non-movement* indicate *immateriality* and *non-reliance*.

In...an efficient market "information important to reasonable investors...is immediately incorporated into the stock price." As a result, when a stock is traded in an efficient market, the materiality of disclosed information may be measured post hoc by looking to the movement, in the period immediately following disclosure, of the price of the firm's stock. Because in an efficient market "the concept of materiality translates into information that alters the price of the firm's stock," if a company's disclosure of information has no effect on stock prices, "it follows that the information disclosed...was immaterial as a matter of law."

Oran, 226 F.3d 282, quoting Burlington Securities Litigation, 114 F.3d 1410, 1425 (CA3 1997); accord, Nathenson, 267 F.3d 415; ABC, 291 F.3d 361.

The Panel Majority's Misapplication

The panel majority erred in allowing plaintiffs the benefits of the fraud-on-the-market theory, but exempting them from its consequences. A securities plaintiff isn't obligated to use the fraud-on-the-market theory at all; he may elect instead to prove reliance and materiality "the old-fashioned way", by individualized direct evidence.² But if a plaintiff chooses to invoke the theory and its presumption of reliance, he may not ignore the theory when it disproves his case.

That's what the panel majority allowed here. Plaintiffs made no effort to try to plead any individual reliance, instead alleging that America West stock was traded in an efficient market and invoking the fraud-on-the-market presumption. The majority nevertheless disregarded what Judge Tallman rightly called the "market's collective yawn" (Slip Op. 2118) in response to the alleged corrective

² Of course, if that's the available evidence, the plaintiff will litigate only his own claim.

disclosures—the June 23 Wall Street Journal article, and the July 14 announcement of the FAA settlement and fine. By definition, “efficient markets are those in which information important to reasonable investors...is immediately incorporated into stock prices.” Slip Op. 2120 (dissent), quoting Burlington, 114 F.3d 1425. Thus, if (as everyone agrees) America West is traded on an efficient market, and if (as plaintiffs allege) the June-July revelations uncovered a material prior untruth, then they would necessarily have resulted promptly in a stock drop. *But they did not*. That necessarily means either (1) the market is inefficient; or (2) the market—the embodiment of the “reasonable investor”—didn’t consider this information material, and didn’t rely on the prior alleged misinformation; or (3) the market already knew or guessed the alleged truth, again disproving reliance. Nobody contends (1) is true here—and (2) and (3) are each fatal to plaintiffs’ case.

The panel majority argued that applying the fraud-on-the-market theory to a market non-reaction is inconsistent with the fact-specific reasonable-investor test of materiality. Slip Op. 2095-96. That proves too much: It would apply just as strongly to plaintiffs as defendants. By the majority’s logic, plaintiffs shouldn’t have been allowed to invoke the fraud-on-the-market theory at all, and the complaint should have been dismissed (and the class decertified) for insufficient fact-specific allegations of materiality and reliance.

The point of the fraud-on-the-market theory is that, in an efficient market, the market’s reaction is as good as—nay, better than—any attempt to reconstruct what a “reasonable investor” would think, because the market *is* the “reasonable investor”. Shaw, 82 F.3d 1218. The panel majority erroneously substituted their own judgments of what was or wasn’t “material”, in lieu of the truer and more objective judgment of the marketplace. The majority also allowed plaintiffs to plead “reliance” on the integrity of a market price, when the actual market facts prove that defendants’ alleged misdeeds *have not harmed* that integrity.

The “Distortion” Argument

The panel majority shrugged off the market’s actual non-response, asserting cursorily that “[t]he market is subject to distortions that prevent the ideal of ‘a free and open public market’ from occurring.” Slip Op. 2095. But as Judge Tallman correctly observed, neither the majority opinion, nor (more importantly) plaintiffs’ complaint, gives any cogent hint what those distortions might possibly be, or how they would work, or how long they would continue to operate. See Slip Op. 2123 n.1.

The majority’s blithe reference to “distortions” cannot be squared with the fundamental logic of the fraud-on-the-market theory, nor with plaintiffs’ express invocation of it. The fraud-on-the-market theory acknowledges that some markets may suffer from the kind of “distortions” referred to here: They are what are called *inefficient* markets. Invoking the theory, by contrast, necessarily and critically assumes that the market in question is *efficient*—meaning precisely that material information is “immediately incorporated into stock prices” (Burlington, 114 F.3d 1425). If there were sufficient “distortions” in this market to warrant the majority’s disregard for actual market events, then by definition the market would be too inefficient to permit plaintiffs’ own presumption of reliance. See Binder v. Gillespie, 184 F.3d 1059, 1064-65 (CA9 1999).

The majority overread a footnote in Basic declining to specify how quickly an efficient market reacts to news. Slip Op. 2095-96 & n.12, citing 485 U.S. 248 n.28. The Supreme Court didn’t hold that efficient markets delay their reactions; it pointedly declined to comment one way or the other. In any event, that uncertainty cannot arguably justify the imputed “delay” in this case—a matter not of hours or even days, but of *over two months* (June 23-September 3). No market can be assumed to react that slowly, and still be deemed “efficient”. If the stock markets

were really that slow in digesting news, it would be vastly easier than it is for any astute newspaper reader to make a killing on Wall Street.

The fraud-on-the-market presumption is only a presumption, rebuttable by an adequately alleged contrary explanation. See Basic, 485 U.S. 245-48. Conceivably there might be some particular “distortion” at work in an otherwise efficient market, based on unusual facts. But under the particularity requirements of the PSLRA, a plaintiff who wants to allege an efficient market—but nevertheless wants to invoke some idiosyncratic “distortion” to explain away the absence of market reaction—must at least allege *what the distortion was* as a factual matter. If he can allege a logical *reason* for the market’s non-reaction, with the specificity required by the PSLRA—and without fatally undermining his own “fraud-on-the-market” reliance allegations—he may survive a motion to dismiss.

But those are precisely the allegations that these plaintiffs haven’t made. If conclusory speculation about market “distortions” were sufficient to excuse particularized pleading of facts explaining a lack of market reaction, then every alleged misstatement would be automatically material for pleading purposes just on plaintiffs’ say-so.

The September Stock Drop

The panel majority did suggest a possible “distortion”, namely America West’s July 14 assurances that the FAA settlement would have no noticeable adverse effects. Slip Op. 2097. In the first place, that cannot explain the market’s non-reaction to the June 23 Journal article. Moreover, this analysis ignores the PSLRA’s heightened pleading requirements.

Plaintiffs and the majority merely posit—they don’t allege, explain, or elaborate on—a supposed causal link between the September expenditures versus the July assurances. The July 14 statement didn’t say no additional maintenance

expense would be required at all; it simply predicted that compliance with the FAA settlement wouldn't have noticeable adverse effects. The majority assumed that that statement was proven false by the actual maintenance expenditures announced in September. But there was no sufficient allegation that the September expenditures were *actually connected* in any causal (or other) way to the July FAA settlement—and hence no sufficient allegation that it was the settlement that caused the adverse third-quarter results. On the contrary, as Judge Tallman pointed out, the settlement required no additional expenditures. Slip Op. 2124. The PSLRA required plaintiffs to allege *with specificity* the details of how the July 14 assurances were false, and known to be false at the time; and how the supposed falsity actually resulted in the September stock drop. Cf. Oran, 226 F.3d 283. *None* of that is alleged in this complaint.

CONCLUSION

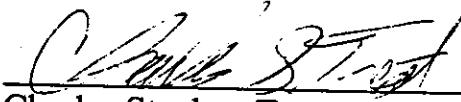
As the dissent correctly concluded:

While we are required to draw all inferences in favor of plaintiffs for purposes of a motion to dismiss, under the [PSLRA] the burden remains on the plaintiffs to plead with specificity the facts showing a materially misleading statement....The plaintiffs here have not alleged with specificity facts that would support the inferences the plaintiffs ask us to draw.

Slip Op. 2124. The Court should rehear this case to clarify both the application of the fraud-on-the-market theory, and the specificity requirements of the PSLRA.

March 13, 2003

LATHAM & WATKINS LLP

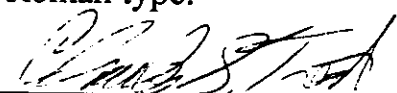

Charles Stephen Treat

COUNSEL FOR *AMICUS CURIAE*

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2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because it has been prepared in a proportionally spaced typeface using Microsoft Word 2000 (version 9.0.4402) with 14-point Times New Roman type.



Charles Stephen Treat
COUNSEL FOR AMICUS CURIAE

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I am employed in the County of San Francisco, State of California. I am over the age of 18 years and not a party to this action. My business address is Latham & Watkins LLP, 505 Montgomery Street, Suite 1900, San Francisco, CA 94111-2562.

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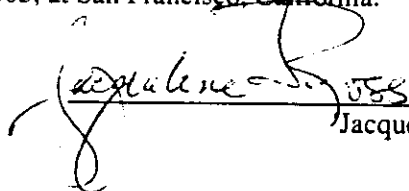
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Executed on March 13, 2003, at San Francisco, California.


Jacqueline F. Ross

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vs. America West Holding Corp., *et al.*
Ninth Circuit Court of Appeals, Case No. 01-16725
United States District Court District of Arizona, Case No. CIV-99-0399-PHX-EHC (OMP)

Counsel Contact Information

Edward P. Dietrich
MILBERG WEISS BERSHAD
HYNES & LERACH LLP
401 B Street, Suite 1700
San Diego, CA 92101-5050
(619) 231-1058
(619) 231-7423 (fax)

Patrick J. Coughlin
MILBERG WEISS BERSHAD
HYNES & LERACH LLP
100 Pine Street, Suite 2600
San Francisco, California 94111-5238
(415) 288-4545
(415) 288-4534 (fax)

COUNSEL FOR PLAINTIFFS-APPELLANTS

Charles T. Newton, Jr.
VINSON & ELKINS, L.L.P.
2300 First City Tower
1001 Fannin Street
Houston, TX 77002-6760
(713) 758-2222
(713) 758-2346 (fax)

cnewton@velaw.com

Andrew Weissman
Jon Nuechterlein
WILMER, CUTLER &
2445 M. Street, N.W.
Washington, D.C. 20037-1420
(202) 663-6000
(202) 663-6363 (fax)

Andrew.Weissman@wilmer.com
Jon.Nuechterlein@wilmer.com

Bruce G. Vanyo
Lloyd Winawer
John P. Stigi III
WILSON SONSINI GOODRICH &
ROSATI
650 Page Mill Road
Palo Alto, CA 94304
(650) 493-9300

COUNSEL FOR DEFENDANTS-APPELLEES