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COURT INVOKES "ENRON" AS BASIS FOR REINSTATING SECURITIES FRAUD SUIT

by
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When Congress enacted the Sarbanes-Oxley Act in 2002, it did nothing to alter the Private Securities Litigation Reform Act of 1995 ("PSLRA") or the heightened pleading requirements that it places on securities fraud class action complaints. Nonetheless, a recent decision from the U. S. Court of Appeals for the Ninth Circuit — a court that had up to this point strictly enforced the PSLRA — indicates that courts may relax the PSLRA's pleading standards as a judicial response to Enron and the other notable corporate scandals.

The Ninth Circuit issued this decision in *No. 84 Employee-Teamster Joint Council Pension Trust Fund v. America West Holding Corp.*, No. 01-16725, 2003 WL 328998 (9th Cir. Feb. 13, 2003), a case that involved a "fraud on the market" class action complaint. The trial court granted defendants' motion to dismiss the complaint because, *inter alia*, plaintiff did not sufficiently allege materiality or reliance given that the security's price did not drop immediately upon disclosure of the allegedly concealed information. In an opinion written by Judge Ferguson, the Ninth Circuit reversed the dismissal. The majority's conclusion regarding the materiality/reliance issue is in conflict with a number of other Courts of Appeal and evinces a distrust of the very "efficient market theory" on which "fraud on the market" claims are based.

However, the most noteworthy aspect of the majority opinion is its admonition that, given "this era of corporate scandal, when insiders manipulate the market with the complicity of lawyers and accountants," the trial court may have overemphasized the PSLRA's pleading standards while underemphasizing the benefit of the doubt generally given plaintiffs on motions to dismiss. This admonition contrasts starkly with the Ninth Circuit's earlier opinion in *In re Silicon Graphics Inc. Securities Litigation*, 183 F.2d 970 (9th Cir. 1999), which emphasized the "great detail" that the PSLRA requires in plaintiffs' allegations and implemented a state of mind pleading standard more stringent than even the "motive and opportunity" standard of the Second Circuit. It is therefore worth noting that an Eighth Circuit judge sitting by designation was one of the two judges forming the majority in *America West*, leaving open the future vitality of the decision.

Against this background, it is not surprising that the *America West* decision generated a strong dissent. That dissent, written by Judge Tallman, focused on the majority's failure to acknowledge the determinative importance of the market's failure to react negatively and quickly to the ultimate disclosure of the concealed information and, thereby, the majority's failure to require the plaintiff to plead materiality

and reliance with particularity. In a clear rebuke of the majority's focus on current events, Judge Tallman wrote that, despite "this post-Enron era . . . the law is the law. Under the [PSLRA], the burden to plead facts with particularity establishing the required element of materiality remains squarely on the plaintiff." Plaintiffs also maintain the burden to plead detrimental reliance.

The *America West* decision, issued by a court that had stringently enforced the PSLRA, may herald, at least for now, a shift in the application of the PSLRA's pleading standards. In particular, even though Congress itself has done nothing to change those stringent standards, courts may follow the Ninth Circuit's lead and, under the rubric of protecting investors in this "era of corporate scandal," de-emphasize those heightened standards when considering a motion to dismiss a securities fraud class action. This could result in decisions based on "post-Enron suspicions . . . regarding corporate malfeasance and insider trading," rather than the PSLRA's legislatively enacted pleading standards.

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