No. 03-15883

IN THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

IN RE ORACLE CORPORATION SECURITIES LITIGATION

NURSING HOME PENSION FUND, LOCAL 144, ET AL.,

Plaintiffs-Appellants,

v.

ORACLE CORPORATION, ET AL.,

Defendants-Appellees.

On Petition For Rehearing En Banc

BRIEF OF THE CHAMBER OF COMMERCE OF THE UNITED STATES AS *AMICUS CURIAE* IN SUPPORT OF DEFENDANTS-APPELLEES' PETITION FOR REHEARING EN BANC

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INTEREST OF THE AMICUS CURIAE

Representing an underlying membership of more than three million businesses and organizations, the Chamber of Commerce of the United States is the world's largest business federation. As the principal voice of American businesses, the Chamber regularly advocates the interests of its members in courts throughout the country on issues of national concern.

This case involves issues of substantial importance to the Chamber's members. Proper private securities litigation serves as an effective mechanism for deterring and correcting corporate malfeasance; when abused, however, this powerful device presents a real danger of wasting corporate and investor resources. As became the practice, with every drop in a company's stock price, plaintiffs would rush to the courthouse – often alleging fraud in the most conclusory terms – in the hope of developing a case during discovery. This rash of lawsuits exacted a toll on corporations in both time and money, often forcing them to settle meritless claims to avoid the costs of defense.

In response to this growing problem, Congress enacted the Private Securities Litigation Reform Act of 1995, 15 U.S.C. § 78u-4 *et seq.* ("Reform Act" or "PSLRA"). Congress was prompted "by significant evidence of abuse in private securities lawsuits to enact reforms to protect investors and maintain confidence in our capital markets." H.R. Conf. Rep. 104-369, at 31 (1995). As a key component of the

Act, Congress required plaintiffs to meet heightened pleading standards, which were designed to ensure that complaints against corporations survive dismissal only if the plaintiff is able to cite concrete evidence of actual fraud. These requirements force plaintiffs to determine whether a legitimate cases exists *before* bringing suit, rather than filing first and developing a case (if one exists) later, during the costly discovery process.

The Chamber's members, who are frequent targets of baseless securities suits, have a substantial interest in seeing these heightened standards enforced according to their explicit, statutory terms, so that district courts can properly eliminate cases filed on the assumption – rather than evidence – of wrongdoing. The panel's opinion in this case undermined those standards, in the process creating a conflict with previous decisions of this Court (and of other federal appellate courts) that warrants en banc reconsideration.

SUMMARY OF ARGUMENT

In *Ronconi* v. *Larkin*, this Court recognized a basic truth about securities fraud class actions:

> [L]awsuits can extort a great deal of undeserved settlement money if the courts do not filter out the unfounded ones early enough to avoid huge litigation expenses. Juries can make mistakes, especially in matters of great complexity where the trials are lengthy. If a defendant is entirely innocent of wrongdoing, yet faces a 10% chance of a []100 million dollar jury error, the rational course, if the case cannot be kept from a jury, may be to pay []10 million undeserved dollars. That just

> wastes capital and unfairly transfers money from those who have earned it to those who have not. Securities fraud cases typically claim that optimistic statements were lies. But business decisions have to be based on predictions about the future that "can only be taken as a result of animal spirits," and "if the animal spirits are dimmed and the spontaneous optimism falters, leaving us to depend on nothing but a mathematical expectation, enterprise will fade and die."

253 F.3d 423, 428 (9th Cir. 2001) (quoting JOHN MAYNARD KEYNES, THE GENERAL THEORY OF EMPLOYMENT INTEREST AND MONEY 161-162 (1956)). The panel in this case entirely ignored these important lessons, which lie at the heart of the PSLRA's strict pleading requirements.

This case is a classic example of "fraud by hindsight." Defendants – a major software company and several of its top officers – made optimistic, but qualified, projections about anticipated quarterly earnings. When the company ultimately announced that it had (narrowly) missed those projections, its stock price fell and plaintiffs sued. The PSLRA was designed to interpose significant barriers for a suit of this kind. Under the Act, a company's projection about future performance is actionable only if the plaintiffs allege not merely that the projection proved inaccurate, but also that it was *known* by the defendant to be false or misleading *at the time that it was made*. See *Ronconi*, 253 F.3d at 432 ("Honest optimism followed by disappointment is not the same as lying or misleading with deliberate recklessness."). To satisfy that pleading requirement, it is not enough to *assert* that the defendants knew their projections were false. Instead, the plaintiff must supply specific reasons

why the statement was false and provide *particular facts* giving rise to a *strong* inference that the defendant acted intentionally or recklessly in making the misleading forecast.

In concluding that the plaintiffs here satisfied those requirements, the panel made a number of mistakes, only three of which the Chamber will address. *First*, to conclude that Oracle's overall earnings projections were made with knowledge that they were false, the panel focused on scattered reports from various lower-level employees that – from their parochial perspective – business was down. But, in a firm of Oracle's size and diversity, the gloomy – and quite vague – reports of a few individuals about narrow slices of the company do virtually nothing to suggest that the top managers must have known that Oracle, *as a whole*, would not meet performance expectations.

Second, the panel placed great emphasis on the statements of Oracle's top executives that theirs was a hands-on and detail-oriented management style. From that abstract statement of corporate philosophy, the panel reasoned that any predictions of future growth that ultimately were not achieved must have been fraudulent. That reasoning is as dangerous as it is unsound, and both this Court and others have rejected it. Unless corrected, the holding that such general boasts satisfy the PSLRA's scienter requirement will have the perverse result of making the best corporate

managers the ones most likely to be sued for fraud. This is hardly what Congress intended when it enacted the PSLRA to stem the tide of frivolous class actions brought by investors disappointed by the ordinary vicissitudes of the market.

Third, the panel relied on statements that the complaint attributes to anonymous witnesses. The use of unnamed witnesses, problematic in itself, was especially so here, where the panel made no attempt to ascertain that those witnesses were actually in a position to speak accurately about the subjects on which they opined. The panel's uncritical acceptance of secret sources jettisons the important safeguards that must be applied before these kinds of allegations can be used to plead falsity and scienter. That approach allows plaintiffs to evade the PSLRA's pleading requirements simply by putting allegations into the mouths of persons whose identities need not be disclosed and whose reliability will not be questioned.

ARGUMENT

"The story in this complaint is familiar in securities litigation. At one time the firm bathes itself in a favorable light. Later the firm discloses that things are less rosy. The plaintiff contends that the difference must be attributable to fraud." *DiLeo* v. *Ernst & Young*, 901 F.2d 624, 627 (7th Cir. 1990). The PSLRA was intended to put a stop to just this sort of securities fraud complaint, to end the practice of pleading "fraud by hindsight." *In re Vantive Corp. Sec. Litig.*, 283 F.3d 1079, 1084-85 (9th

Cir. 2002). By failing to take seriously the Reform Act's deliberately onerous standards, however, the panel's decision will do much to revive that discredited practice. Cf. *Ronconi*, 253 F.3d at 437 ("The heightened pleading requirements of the [PSLRA] are an unusual deviation from the usually lenient requirements of federal rules pleading. In few other areas are motions to dismiss for failure to state a claim upon which relief can be granted so powerful.").

I. GLOOMY STATEMENTS FROM ISOLATED OFFICES WITHIN A VAST CORPORATION DO NOT CREATE A STRONG INFERENCE THAT MORE OPTIMISTIC COMPANY-WIDE EARNINGS FORECASTS WERE KNOWINGLY FALSE

For those who see any drop in stock prices as an opportunity to claim securities fraud, the recent boom/bust cycle of the tech sector was a dream come true. As long as the protections of the PSLRA are ignored, it is easy to concoct a story about how any tech company that rode the waves of the general market was lying – and not merely mistaken – about the future.

Taking advantage of Oracle's size and diversity, the plaintiffs in this case identified approximately 40 ex-employees who alleged that at around the time of the class period (they are often vague about exactly what time period their allegations cover) the divisions of Oracle in which they worked were not doing well. Although the panel described these as "hard numbers" and "specific allegations," Op. 12576, they are neither hard nor specific. As illustrated by the panel's own examples – the

phones "went dead" in General Business West; there was a "severe slowdown in consulting in the Southeast," Op. 12576 – plaintiffs' "confidential" witnesses typically offer no concrete data about the company as a whole, but instead imprecise intimations of gloom. More to the point, those downbeats reports were limited to activity in narrow slivers of Oracle's business in particular geographic regions; the reports have virtually nothing to say about the performance of the entire company.

The panel's reliance on allegations such as these betrays a fundamental misunderstanding of the purpose of the PSLRA's scienter requirements. To apply correctly the Reform Act's requirement that falsity and scienter be pleaded "with particularity," a court must identify a strong correlation between the scope of the allegedly false statement and the scope of the evidence used to show that the statement was untrue. In this case, however, there was none.

Plaintiffs' allegations here simply do not map onto the allegedly false earnings predictions. Those earnings projections concerned Oracle *as a whole*; and allegations that business was sluggish *in specific regions* and *in particular divisions* say little about whether the company would be unable to make those expectations. To show that defendants' companywide projections were deliberately false, plaintiffs must point not merely to individual aspects of the business, but instead to the company's overall performance (and to what the defendants *actually knew* about that performance

when they made their projections). Without specific allegations of facts that establish that the entire company's revenues would fall short of the projections (and that each defendant was *aware* of those facts when the projections were made), the frustrations of employees in the lower echelons of the corporate structure are "not necessarily inconsistent" with the greater optimism expressed by the company's top management. *Ronconi*, 253 F.3d at 432.

The veracity of a prediction that a company's sales will increase by *x* percent is simply not called into doubt by the fact that discrete segments of the business may have been in decline when the prediction was made. That shortfall may well be balanced by other parts of the company that were meeting or exceeding expectations. It is the *plaintiffs'* responsibility to provide the necessary context for their claims. If such *Rashomon*-like impressions are to be given any weight at all, the complaint must contain sufficient factual allegations to make clear that sluggish performance in one part of the corporation did in fact carry over to the entire business, and was not counteracted by robust performance elsewhere. See *Ronconi*, 253 F.3d at 434 (faulting plaintiffs for failing to "allege specific facts that show how * * * 'problems' and 'difficulties' translated into decreasing revenues").

The complaint here conspicuously did not do so. The scattered pixels on which plaintiffs rely (and on which the panel focused) simply do not reveal the whole

picture. By accepting the sufficiency of plaintiffs' incomplete image, the panel failed to insist on the required "strong inference" that defendants acted deceitfully in making optimistic predictions about Oracle's overall financial health.

These problems are particularly pronounced in this case because, as the panel itself acknowledged, Oracle operates in sixty countries around the world and earns half of its revenue abroad. Op. 12576-77. Yet plaintiffs' allegations of facts that portended disappointing sales in the third quarter of 2001 concerned *only* the company's *U.S.* operations. Thus, in addition to excusing plaintiffs from making particularized allegations even about Oracle's domestic sales, the panel inexplicably accepted plaintiffs' allegations that the company lied about its earnings predictions without requiring any showing that earnings were down abroad, or that foreign growth did not make up for domestic stagnation. This will not do. Even if all United States operations were off (a point that the complaint falls well short of establishing), without some allegation about foreign sales, it simply cannot be inferred – much less strongly inferred – that Oracle's optimistic *overall* earnings forecasts were knowingly false.

The panel tried to sidestep this obvious defect in the complaint by faulting *defendants* for not affirmatively stating that "whatever effect the declining U.S. economy had on their projections would be offset by growth elsewhere in the world."

Op. 12577 n.1. That is entirely backwards. It is the *plaintiff's* burden to "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." 15 U.S.C. § 78u-4(b)(2). If the alleged fraud involves a forecast of a multi-national corporation's expected earnings, the plaintiffs must plead facts showing that the defendant knew that forecast was wrong *with respect to the company as a whole*. There is no basis for relieving the plaintiff of that obligation merely because the defendant's allegedly fraudulent statement did not mention foreign sales. The panel invented this disclaimer requirement out of whole cloth.

Unless corrected, the panel's errors will have serious practical consequences for corporations operating in this Circuit. In any large, multi-faceted corporation – particularly one that, like Oracle, does business around the world and thus simultaneously confronts a wide variety of economic conditions – different divisions will be in upswings and downswings at the same time. For that reason, it is all too easy for plaintiffs to identify some division of a major corporation that experienced sluggish sales during a particular quarter, or to find some low-level manager whose unit was slow. The tendency to universalize one's own perspective often leads people to believe that if they had a poor quarter the whole company therefore must have been in decline.

It is, however, the role of the courts applying the PSRLA to resist that false logic. Unless courts do what the panel here did not – insist that plaintiffs allege specific facts that contradict the company's predictions about its *overall* performance – the falsity and scienter requirements will become virtual dead letters. Any time a large corporation falls short of its predictions about the future – predictions that "will almost always prove wrong in hindsight," *Raab* v. *Gen. Physics Corp.*, 4 F.3d 286, 290 (4th Cir. 1993) – plaintiffs will be able to allege that those projections were intentionally misleading by pointing to slivers of the company that were not doing well. This is not what Congress intended when it enacted the Reform Act. It is not what this Court intended when it required plaintiffs to show an actual inconsistency (not the mere *possibility* of one) between the allegedly false statement and the actual facts at the time the statement was made. *Ronconi*, 253 F.3d at 433-34.

II. THAT A COMPANY BOASTS OF A "HANDS-ON" MANAGEMENT STYLE DOES NOT GIVE RISE TO A STRONG INFERENCE THAT ANY MISSED EARNINGS PROJECTIONS WERE THEREFORE FRAUDULENT

Plaintiffs try to fill the obvious gaps in their scienter allegations by suggesting that, because Oracle had an internal database that provided information about sales, and because individual defendants claimed to use a "detail-oriented" management style, they "must have been aware" that Oracle would not meet its earnings projections for the third quarter of 2001. Op. 12575-76, 12581. In accepting this argument, the

panel effectively concluded that, whenever active corporate managers make optimistic forecasts that do not prove entirely accurate, a strong inference arises that those projections were fraudulent. Such dubious reasoning ignores the teachings of this Court's cases and further undermines the PSLRA's pleading requirements.

This Court has resisted similar efforts to establish scienter in reliance on the general existence of internal reports and the possibility that they were monitored by company management. In *Vantive*, this Court specifically rejected as insufficient plaintiffs' allegations about defendants' "hands on management style" – even when combined with the existence of internal reports about the company's revenues. Such allegations were insufficiently specific to give rise to a strong inference that defendants actually knew their optimistic performance assurances were false at the time they were made. 283 F.3d 1087-88. Similarly, in *Lipton* v. *Pathogenesis Corp.*, 284 F.3d 1027, 1036 (9th Cir. 2002), this Court was thoroughly unimpressed by the allegation that defendants "tracked patient demand using data" that "supposedly indicated that patient demand was flat." More specific reference to what the internal reports showed and, correspondingly, to what defendants actually knew about the state of the company was required. *Ibid*.

The panel here thought that these cases did not control because Oracle's CEO, Larry Ellison, boasted that he loves "getting involved in every detail of the business"

and because the other individual defendants "said that they monitored portions of Oracle's global database." Op. 12581. That conclusion is both wrong and dangerous. First, the allegation that the defendants monitored generally *portions* of the database does not come close to satisfying the PSLRA because it lacks the crucial details that the Act (as applied in *Vantive* and *Lipton*) requires. It says nothing about *what* portions the defendants actually looked at; nothing about *when* they looked; and nothing about *what* the database showed. These crucial details are missing from the complaint; the panel contradicted Circuit precedent in overlooking that absence. See *No. 84 Employer-Teamster Joint Council Pension Trust Fund* v. *Am. West Holding Corp.*, 320 F.3d 920, 942, n.20 (9th Cir. 2003) ("Although Plaintiffs have provided some corroborating details regarding the internal reports in this case, they have not provided the content. We note that, although requiring a plaintiff to provide specifics from the reports prior to discovery seems a bit unfair, we are bound by our prior caselaw and give the internal reports little or no weight in our analysis.").

If anything, the panel's reliance on the Ellison quotation is even more dubious. Like "I spend every waking hour working" or "I root for the 49ers with every fiber in my being," the remark makes a point without being meant literally. No CEO can actually get involved in *every* detail of a business the size of Oracle. To be the chief executive of a multi-billion-dollar multinational corporation is, by definition, to make

choices about which aspects of the company to monitor actively and what to delegate to others. That reality is not altered by the executive's slight hyperbole in describing his management style.

To treat that statement as an admission that Ellison (or Oracle's other top managers) were, at any given moment, actually aware of every detail regarding the company's performance unacceptably relieves plaintiffs of their burden under the PSLRA to put forward *particular* facts that give rise to the strong inference that defendants knew their earnings projections to be false. The Act requires plaintiffs to identify *specific* information in the defendants' possession that contradicted the defendants' public statements. Plaintiffs here did not do so.

That onerous pleading requirement exists for a reason. Even the best and most active managers miss things. That does not mean that they committed fraud. To separate true fraud claims from fishing expeditions, the Reform Act insists that the complaint contain concrete facts that show in detail what defendants actually knew and when they knew it. Without supporting details, the broad proposition that defendants were actively involved in managing their company is not enough. It may be a start of the inquiry, but it cannot be the end.

The result endorsed by the panel also has the perverse effect of punishing the best corporate executives, those who take an active role in the management of their

companies. Any manager who admits to keeping an active eye on his business – as good managers certainly *should* – risks exposure to a securities fraud suit if his predictions about performance turn out to be wrong and he has not used lawyer-like precision every time he spoke publicly about his style. This gives executives a strong incentive to keep quiet, to say nothing about how they run their companies, which in turn will needlessly deprive the market of important information and business leadership. Once again, then, the panel's holding would have effects starkly at odds with the goals of the Reform Act.

III. THE PANEL'S UNCRITICAL ACCEPTANCE OF ALLEGATIONS MADE BY ANONYMOUS WITNESSES ALLOWS PLAINTIFFS TO MAKE AN END RUN AROUND THE PSLRA'S PLEADING REQUIREMENTS

To try to support their allegation that Oracle fraudulently overstated its revenues for the second quarter of 2001 by improperly booking a series of debit memos as revenue, plaintiffs relied on the statements of two unnamed witnesses. With little analysis and virtually no scrutiny, the panel held that the claims made by these witnesses constituted sufficient pleading of falsity and scienter. Op. 12580. In so doing, the panel ignored the serious tension between the liberal use of anonymous evidence and the strict pleading requirements of the PSLRA, a tension that has led other Circuits to regulate such evidence far more carefully.

Because the Reform Act demands "particularity" for allegations made on information and belief, 15 U.S.C. § 78u-4(b)(1), "some allegations based on anonymous sources will not, on their face, be adequate." *In re Cabletron Systems, Inc.*, 311 F.3d 11, 29 n.8 (1st Cir. 2002); cf. *In re Silicon Graphics Inc. Sec. Litig.*, 183 F.3d 970, 985 (9th Cir. 1999) ("It is not sufficient for a plaintiff's pleadings to set forth a belief that certain unspecified sources will reveal, after appropriate discovery, facts that will validate her claim."). Courts nationwide have thus developed a screening process "for evaluating whether confidential source material meets the PSLRA particularity requirement." *Cabletron*, 311 F.3d at 29; see also *ABC Arbitrage Plaintiffs Group* v. *Tchuruk*, 291 F.3d 336, 353-54 (5th Cir. 2002); *Novak* v. *Kasaks*, 216 F.3d 300, 313-14 (2d Cir. 2000).

That process requires the court to ensure that the secret witnesses "are described in the complaint with sufficient particularity to support the probability that a person in the position occupied by the source would possess the information alleged." *Novak*, 216 F.3d at 314. "This involves an evaluation, inter alia, of the level of detail provided by the confidential sources, the corroborative nature of the other facts alleged (including from other sources), the coherence and plausibility of the allegations, the number of sources, the reliability of the sources, and similar indicia." *Cabletron*, 311 F.3d at 29-30; see also *Adams* v. *Kinder-Morgan, Inc.*, 340 F.3d 1083,

1103 (10th Cir. 2003) ("[W]here a plaintiff does not identify the sources of the facts stated in the complaint, the facts alleged in an information and belief complaint will usually have to be particularly detailed, numerous, plausible, or objectively verifiable by the defendant before they will support a reasonable belief that the defendant's statements were false or misleading.").

Although the panel alluded to the Second Circuit's decision in *Novak*, it utterly failed to apply the rigorous analysis called for by that decision and its progeny. The complaint in this case gave no reason to believe that either of plaintiffs' unidentified witnesses would have had any reason to know what they claimed to know: that Oracle had in fact fraudulently booked various debt memos as revenue. One was an Oracle *collections* manager; plaintiffs never pleaded that revenue recognition was among his duties or within his experience. The other was not even an Oracle employee. Instead, he was an outside analyst, and nothing in the complaint suggests that he had personal knowledge of how Oracle treated the debit memos in question or where any such knowledge might have come from. Thus, there is simply no basis to infer from the sketchy information in the complaint that these unnamed sources were in a position to know what they were talking about. Under the Reform Act, falsity and scienter must be built on a more solid foundation.

Moreover, by permitting plaintiffs to use anonymous sources without the aforementioned safeguards, the panel has given plaintiffs an easy way of avoiding the PSLRA's pleading requirements. If such sources are not carefully scrutinized, plaintiffs will be able to accomplish through information-and-belief pleading exactly what Congress wanted to prevent: the substitution of guesses for knowledge and hopes for facts. Plaintiffs' lawyers will be able to use secrete witnesses as mouthpieces to assert allegations that would plainly be inadequate if articulated by the lawyer himself. Anonymous can very often mean unaccountable; because secret witnesses are harder to rebut, they may be more likely to embellish their stories. See *Adams*, 340 F.3d at 1102 (observing that "the support provided by [disclosing] source information will often be helpful in distinguishing whether a particular allegation is mere rumor and speculation or whether it is based on concrete information from relevant documents or people who were in a position to know the truth of the allegations"). The panel inexplicably ignored these dangers.

CONCLUSION

The petition for rehearing en banc should be granted.

Respectfully submitted.

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CERTIFICATE OF COMPLIANCE

Pursuant to Ninth Circuit Rule 40-1(a) and Federal Rules of Appellate Procedure 29(b)(5) and 32(a)(7)(C), I hereby certify that this brief contains 4,199 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii). 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 WordPerfect Version 10 in 14-point Times New Roman font.

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CERTIFICATE OF SERVICE

I certify that on October 8, 2004, I caused copies of the Brief of the Chamber of Commerce of the United States as *Amicus Curiae* In Support of Defendants-Appellees' Petition for Rehearing En Banc to be served by United States Mail on each of the counsel listed below:

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