CLIENT ALERT **JUNE 2010**

IN RE APOLLO GROUP, INC. SECURITIES LITIGATION: NINTH CIRCUIT TAKES A BROAD VIEW OF LOSS CAUSATION

On June 23, 2010, a three-person panel of the Ninth Circuit Court of Appeals consisting of Judges Kozinski, Fletcher, and Gettleman issued a cursory opinion which reversed the Arizona District Court's granting of Defendants' motion for judgment as a matter of law on the basis of failure to prove loss causation in the *In re Apollo Group, Inc. Securities Litigation*, Case No. 08-16971 (9th Cir.). In a decision not for publication, the Ninth Circuit found that, contrary to the district court's opinion,[1] a jury could have reasonably found that analyst reports issued subsequent to several newspaper articles were "corrective disclosures" providing additional or more authoritative fraud-related information which deflated the stock price of Apollo Group, Inc. ("Apollo"). Thus, the Ninth Circuit reversed and remanded, resulting in a reinstatement of the jury's verdict of $277.5 million in favor of Plaintiffs. The Ninth Circuit also held that Apollo is not entitled to a new trial and that there is no basis for remittitur.

A brief history of the litigation follows. The Apollo Group Securities Litigation was asserted on behalf of a class of persons who purchased Apollo stock between February 27, 2004 and September 14, 2004. Plaintiffs alleged that Defendants violated §10(b) of the '34 Act and Rule 10(b)-5 thereunder when they failed to publicly disclose a February 5, 2004 Department of Education Report which criticized the University of Phoenix's compensation system for its enrollment recruiters (the "DOE Report"). In his Orders denying Defendants' Motion to Dismiss and the parties' cross-motions for summary judgment, Arizona District Court Judge James Teilborg held that once Apollo addressed the DOE investigation with the analysts, Apollo had an obligation to disclose the negative DOE Report. Nevertheless, concluding that the trial testimony did not support the jury's finding of loss causation, Judge Teilborg vacated the judgment awarding damages of $5.55 per share for drops in Apollo's stock over a 6-day period, and entered judgment in favor of Defendants on August 4, 2008.

On appeal, Plaintiffs/Appellants argued that the jury had found the UBS Reports contained new information and revealed the fraud. According to Appellants, evidence supporting this finding included UBS's disclosures that the DOE Report created (a) more regulatory risks for Apollo; (b) new enrollment counselor risks; and (c) a threat to Apollo's premium price. Plaintiffs relied, in part, on *In re Gilead Sciences Securities Litigation*, 536 F.3d 1049, 1058 (9th Cir. 2008), where the Ninth Circuit upheld a loss causation allegation at the pleading stage based on a stock price decline which immediately followed the announcement of diminished sales, even though the FDA's Warning Letter had exposed Gilead's unlawful off-label marketing efforts three months earlier. While the district court in *Gilead* found that the complaint had too many logical and factual gaps, the Ninth Circuit found that the complaint sufficiently alleged a causal relationship between the increase in sales resulting from off-label marketing, the FDA Warning Letter's impact on physicians' prescriptions of the drug, and the resulting effect on stock price.

In *Gilead*, the Ninth Circuit applied the concept of materiality from *No. 84 Employer-Teamster Joint Council Pension Trust Fund v. America*

[1] *In re Apollo Group Sec. Litig.,* 2008 WL 3072731 (D. Ariz. Aug. 4, 2008).

West Holding Corp., 320 F.3d 920 (9th Cir. 2003), that information may be material even though the stock market does not react immediately and applied it to the analysis of loss causation. In so doing, the Ninth Circuit stated that "[a] limited temporal gap between the time a misrepresentation is publicly revealed and the subsequent decline in stock value does not render a plaintiff's theory of loss causation per se implausible" and that a later disclosure may have been corrective when the public initially "failed to appreciate [the] significance" of negative information. *Id.*, at 1058.

Defendants/Appellees relied on *Metzler Investment v. Corinthian Colleges*, 540 F.3d 1049 (9th Cir. 2008), in which the Ninth Circuit affirmed the dismissal of a complaint alleging securities fraud based on disclosure of a DOE investigation, noting that plaintiff had failed to adequately plead loss causation where statements identified as corrective disclosures resulted in declines in stock price, but did not provide new fraud-revealing facts to the market. Defendants also submitted as supplemental authority in support of their position *In re Omnicom Group, Inc. Securities Litigation*, 2010 WL 774311 (2d Cir. Mar. 9, 2010), which held that a securities-fraud claim fails as a matter of law where the alleged corrective disclosure does not provide new fraud-revealing facts to the market, and a "negative characterization of previously known information cannot constitute a corrective disclosure." *Id.*, at 512 (*citing* to *Teacher's Ret. Sys. of La. v. Hunter*, 477 F.3d 162, 187-88 (4th Cir. 2007); and *In re Merck & Co. Sec. Litig.*, 432 F.3d 261, 269-70 (3d Cir. 2005).

Not surprisingly, the Ninth Circuit in the Apollo Group Securities Litigation followed the Ninth Circuit *Gilead* opinion instead of the Second Circuit *Omnicom* opinion and, by necessity, gave great deference to the jury as fact-finder; however, it requires Talmudic wisdom to decipher why the Ninth Circuit found the loss causation theory in *Gilead* more plausible than the loss causation theory in *Corinthian*. Similarly, it would take a legal contortionist to reconcile the Ninth Circuit's loss causation analysis in *Apollo Group* with that in *Corinthian*. No doubt, the amorphous "implausibility" standard that the Ninth Circuit appears to have adopted will lead to seemingly inconsistent results.

Moreover, in applying a materiality approach to loss causation, the Ninth Circuit seemingly has provided '34 Act Plaintiffs in the Ninth Circuit with the best of both worlds, in that they receive the benefit of the efficient market hypothesis for purposes of the Fraud on the Market presumption, when an efficient market analysis arguably does not support their loss causation arguments.[2]

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[2] Under the fraud-on-the-market theory, reliance is presumed if the plaintiffs can show that (1) the defendant made public material misrepresentations, (2) the defendant's shares were traded in an efficient market, and (3) the plaintiffs traded shares between the time the misrepresentations were made and the time the truth was revealed. The efficient market hypothesis presumes that a stock's market price reflects all information currently available about the stock..