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Analyst Liability and the Internet Bubble: The Morgan Stanley/Mary Meeker Cases

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COMMENT

ANALYST LIABILITY AND THE INTERNET BUBBLE: THE MORGAN STANLEY/MARY MEEKER CASES

Jaimee L. Campbell[*]

I. INTRODUCTION

Recently a group of cases brought in the Southern District of New York have raised questions as to securities analysts' liability for harms resulting from the recommendations they offer.[1] These cases have further suggested that the firms the analysts represent would also be implicated when the stocks touted are ultimately valued at a small fraction of their value at the time the recommendation to buy was issued.[2] *Thomson v. Morgan Stanley*

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1. *See, e.g.*, Pludo v. Morgan Stanley Dean Witter & Co., No. 01-CIV-7072, 2001 WL 958922 (S.D.N.Y. 2001); Thomson v. Morgan Stanley Dean Witter & Co., No. 01-CIV-7071, 2001 WL 958925 (S.D.N.Y. 2001); Senders v. Morgan Stanley Dean Witter & Co., No. 01-CIV-7621, 2001 WL 958927 (S.D.N.Y. 2001); Soto v. Morgan Stanley Dean Witter & Co., No. 01-CIV-7072, 2001 WL 958922 (S.D.N.Y. 2001); Stein v. Morgan Stanley Dean Witter & Co., No. 01-CIV-7262, 2001 WL 958936 (S.D.N.Y. 2001); Lloyd v. Morgan Stanley Dean Witter & Co., No. 01- CIV-7263, 2001 WL 959190 (S.D.N.Y. 2001); Williams v. Morgan Stanley Dean Witter & Co., No. 01-CIV-7500, 2001 WL 964010 (S.D.N.Y. 2001); Malvan v. Morgan Stanley Dean Witter & Co., No. 01-CIV-7248, 2001 WL 965294 (S.D.N.Y. 2001). For the sake of expediency and ease of reference, the *Thomson* complaint will be used throughout this Comment to reference Judge Pollack's dismissal of these cases. *See infra* note 4 and accompanying text.

2. *See* Complaint at 5, Thomson v. Morgan Stanley Dean Witter & Co., No. 01-CIV-7071, 2001 WL 958925 (S.D.N.Y. 2001) (stating the claim that Morgan Stanley Dean Witter is culpable due to the conflicts existing between its research and analysts departments and its investment banking business).

Dean Witter & Co. and Mary Meeker[3] and other nearly identical cases brought against these defendants[4] sent shockwaves through the brokerage houses of Wall Street by raising the possibility that analysts could be held accountable for the millions of dollars lost in the wake of recent market tumbles.[5]

Some commentators have gone so far as to suggest the huge losses suffered as a result of the recent technology and Internet stock phenomenon were not the result of mistake, negligence or incompetence (or even merely bad luck), but collusive market strategy designed to cull favor with clients of the investment houses paying the analysts' salaries.[6] Though each of the recent spate of cases was dismissed because of "gross and unrestrained"

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3. *Thomson*, 2001 WL 958925.

4. *Pludo*, 2001 WL 958922; *Thomson*, 2001 WL 958925; *Senders*, 2001 WL 958927; *Soto*, 2001 WL 958922; *Stein*, 2001 WL 958936; *Lloyd*, 2001 WL 959190 are the six "companion cases" referenced by Judge Pollack in his dismissal order, but *Williams*, 2001 WL 964010, and *Malvan*, 2001 WL 965294, are virtually identical as well – "The Complaint filed herein is a virtual word for word copy of the complaint filed a few days earlier in *Thomson v. Morgan Stanley Dean Witter & Co., et al.* ... [t]he Complaint herein is dismissed for the same reasons.". *Williams*, 2001 WL 964010 at *1; *Malvan*, 2001 WL 965294 at *1. All eight were dismissed on August 21, 2001. *Pludo*, 2001 WL 958922, at *1; *Thomson*, 2001 WL 958925, at *1; *Senders*, 2001 WL 958927, at *1; *Soto*, 2001 WL 958922, at *1; *Stein*, 2001 WL 958936, at *1; *Lloyd*, 2001 WL 959190, at *1; *Williams*, 2001 WL 964010, at *1; *Malvan*, 2001 WL 965294, at *1. For ease of reference, this Comment will focus on the Complaint and dismissal of *Thomson*, 2001 WL 958925.

5. *See* Andres Rueda, *The Hot IPO Phenomenon and the Great Internet Bust*, 7 FORDHAM J. CORP. & FIN. L. 21,57 n240 (2001); Amy Johnson, *Sue Your Broker*, BUS. 2.0 (Oct. 2001) *available at* http://www.business2.com/articles/mag/0,1640,16921,00.html (last visited Jan. 22, 2002).

6. *Id.* Rueda quotes several sources that considered analysts during the "dot-com boom" "nothing more than glorified sales people for their firms' offerings," and cites an alarming statistic: "investors who followed the advice of analysts employed by investment banks that underwrote the recommended stocks lost an average of 52% of their investments." *Id.* 57. This statistic seems to suggest that the enthusiastic buy recommendations were based more on the relationship the company had with the firm employing the analyst than any objective analysis of the potential performance of its stock.

improprieties contained within the complaints,[7] whether this was a result of the improper pleadings or the underlying theories is unclear. The two may be so inextricably linked as to preclude any further actions based on theories of analyst/firm liability. If a court were to find the elements of securities fraud could be established based on an analyst's faulty opinion, the awards from such suits could reach billions of dollars.[8]

The co-defendants in the cases were Morgan Stanley Dean Witter and Morgan Stanley analyst Mary Meeker. Meeker and her colleague, Merrill Lynch analyst Henry Blodget, were considered more than mere industry experts – they were the media stars of the Internet Age.[9] While the Meeker suits were not refiled within the requisite thirty day period, one of Blodget's recommendations resulted in a suit that was ultimately settled.[10] The Meeker cases warrant further analysis as to the future of securities fraud claims based on theories of analyst liability.

The allegations of securities fraud contained within the several complaints stemmed from Meeker's dual role, as both investment banker who courted companies to do business with Morgan Stanley, and as analyst, who recommended buying or selling stocks,

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7. *See, e.g.*, *Thomson.*, 2001 WL 958925, at *2. The cases were dismissed with leave to refile on August 21, 2001, but none were refiled.

8. Rueda, *supra* note 5, at 21 (estimating the amounts lost during the "speculative bubble" that was the Internet and technology stock market phenomenon); *see also* Andy Kessler, *We're All Analysts Now*, WALL ST. J., July 30, 2001 (estimating that "[p]aying back the $500 billion loss of market cap in Cisco alone would wipe out Wall Street's capital, as virtually every firm recommended that stock.").

9. *See* Simon Goodley, *End of An Era As Blodget Walks*, DAILY TELEGRAPH (London), Nov. 20, 2001 at 30; *see also* Tina Marie O'Neill, *Dotcom Anger Turns on Analysts*, SUNDAY BUS. POST, Oct. 21, 2001; Rueda, *supra* note 5, at 57 n240 (quoting a FORTUNE MAGAZINE article that proclaims Meeker "'the unquestioned diva of the Internet Age'" (citation omitted)).

10. Blodget had touted an Internet company that was about to be purchased by one of Merrill Lynch's investment banking clients. O'Neill, *supra* note 9. Plaintiff alleged that Blodget's recommendation clearly benefited the firm and its investment banking business, and the subsequent worthlessness of the stock was a result of its being overvalued by Blodget for the purpose of bolstering the company's value prior to its sale. *Id.* Merrill Lynch settled the investor's $500,000 claim for $400,000. *Id.*

sometimes of those very same companies.[11] Specifically mentioned in the *Thomson* complaint, which will be used as an example throughout this Comment, is Amazon.com, a company whose stock was recommended early in the company's history by Meeker. Amazon.com eventually became a lucrative Morgan Stanley investment banking client.[12]

Presiding Judge Milton Pollack of the Southern District chastised the plaintiffs for the excessive length of the complaint,[13] and the "improprieties" contained therein; specifically, that the complaint contained several colloquial phrases and references to the role the media played in the alleged improprieties leading to plaintiffs' losses.[14] Judge Pollack seemed particularly chagrined by the references to the analysts' lifestyles and remuneration and the Wall Street culture itself.[15] Notably, the dismissal was initiated by the Court and had not been requested by defendants Morgan Stanley and Mary Meeker, who stated they would not pursue punitive measures against plaintiffs or their attorneys.[16] That Judge Pollack dismissed the cases on the lack of particularity of the claims in and the length of the pleadings meant the decision never reached the question of whether the allegations raised in the

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11. The complaint filed in *Thomson* alleges "materially false and misleading statements which were designed to and did artificially inflate the price of Amazon common stock." Complaint at 5, Thomson, 2001 WL 958925. Further, the complaint alleged that Meeker made recommendations with a motive to influence Morgan Stanley's investment banking business, thereby increasing her own profit-based salary, particularly in the case of Amazon. *Id.* at 9. The *Thomson* complaint is used as an example throughout this Comment.

12. *Id.*

13. Judge Pollack cites Rule 8(a) of the Federal Rules of Civil Procedure in chastising plaintiffs for the length and convoluted nature of the complaint, which he admonished, should not be used as "a vehicle in which to air and put in issue the views of newspapers, magazines, and social engineers, and their conclusions." Thomson v. Morgan Stanley Dean Witter & Co., No. 01-CIV-7071, 2001 WL 958925 (S.D.N.Y. 2001); *see also* FED. R. CIV. P. 8(a).

14. Judge Pollack called the complaints "a rhetorical exercise in length and forensic embroidery," as well as "hopelessly redundant, argumentative and [containing] much irrelevancy and inflammatory material." *Id* at *1.

15. *Id.*

16. *Notebook*, CONSUMER ELECTRONICS, Oct. 22, 2001 (available on file with the Fordham Journal of Corporate & Financial Law).

complaint warranted further inquiry – whether the prevailing industry practice of analysts as investment bankers creates a strong inference of motive and opportunity to commit securities fraud.[17]

II. THE HEIGHTENED REQUIREMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT

Though Judge Pollack found the pleadings in these cases inadequate under the Private Securities Litigation Reform Act ("PSLRA"),[18] the form of pleading may not be all that stood between plaintiffs and their quest for relief. Under Section 10(b) of the Securities Exchange Act of 1934[19] and Rule 10(b)(5),[20] a plaintiff must demonstrate that the defendant made a misstatement or omission of a material fact, reliance on which was the proximate cause of plaintiff's harm, and that the statement or omission was made with scienter, or the requisite intent.

In *Press v. Chemical Investment Services Corp.*,[21] the Second Circuit held that in order to establish the element of scienter[22] necessary to sustain a cause of action for securities fraud, "a plaintiff must either (a) allege facts to show that defendants had both motive and opportunity to commit fraud or (b) allege facts that constitute strong circumstantial evidence of conscious misbehavior or recklessness."[23] The PSLRA moved the threshold for scienter to the pleading stage, where the plaintiff must "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind" in order to

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17. For a discussion of the requirements to sustain a cause of action based on securities fraud, see *infra* notes 20-24 and accompanying text.

18. 15. U.S.C. § 78u-(4) (2000) (demanding that instances of securities fraud, along with the requisite guilty state of mind, or scienter, be pled with particularity); *see also infra* notes 20-24 (discussing scienter and particularity requirements).

19. 15 U.S.C. § 78j(b) (2000).

20. 17 C.F.R. § 240.10b-5 (2001).

21. Press v. Chem. Inv. Servs. Corp., 163 F.3d 529, 538 (2d Cir. 1999).

22. "[I]ntent to deceive, manipulate, or defraud, or knowing misconduct." *Id.* at 538 (quoting SEC v. First Jersey Sec., Inc., 101 F.3d at 1467 (2d Cir. 1996)).

23. *Press*, 163 F.3d at 538.

sustain a cause of action for securities fraud.[24]

Separate and apart from the issue of particularity, it is difficult, though not impossible, for a plaintiff to establish the requisite strong showing of motive and opportunity in the case of an analyst's misstatements and/or omissions.[25] A major obstacle lies in proving that an analyst's statement of opinion was motivated by fraudulent intent.[26] The potential conflicts of interest that existed between Mary Meeker and Morgan Stanley and the need, real or perceived, for the analyst to avoid disrupting the business of the investment bank,[27] could have served as a source for the requisite

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24. *Id.* (quoting 15 U.S.C. § 78u-4(b)(2) (2000)); *see also* Beck v. Mfgs. Hanover Trust Co., 820 F.2d 46 (2d Cir. 1987)) (first outlining the Second Circuit standard for scienter based on 10-b and 10b-5 actions). The Second Circuit standard was articulated prior to the Private Securities Litigation Act, but the Court has continued to apply the motive and opportunity test at the pleading stage — a test established before the PSLRA was promulgated — finding nothing in the PSLRA or its legislative history to preclude such an interpretation. *See* Janine C. Guido, *Seeking Enlightenment From Above: Circuit Courts Split on the Interpretation of the Reform Act's Heightened Pleading Requirement*, 66 BROOK. L REV. 501, 514 (2000) (noting that the Second Circuit has held that its "motive and opportunity or recklessness standard still satisfies the Reform Act's heightened pleading requirement, and the SEC agrees."). Judge Pollack himself reiterated this heightened standard in *Liberty Ridge LLC v. RealTech Systems Corp.* and outlined the reasoning behind it: "Heightened pleading requirement for allegations of fraud in securities litigation serves a threefold purpose: first, to provide defendant with fair notice of plaintiff's claim, to enable him to prepare a defense; second, to protect defendant from harm to his reputation or goodwill; and, third, to reduce the number of strike suits." Liberty Ridge LLC v. RealTech Sys. Corp., 173 F. Supp. 2d 129, 136 (S.D.N.Y. 2001).

25. In fact, Merrill Lynch was sufficiently threatened by an allegation of collusion and fraud made by a disgruntled investor to settle while the arbitration was still pending. O'Neill, *supra* note 9; *see also supra* note 10 and accompanying text.

26. Per Jebsen, *Analysts Can Breathe Easier After Meeker Ruling*, INDUS. STANDARD, Aug. 23, 2001, *available at* http://www.thestandard.com/wire/0,2231,27888,00.html (last visited Jan. 22, 2002). The author quotes Professor John Coffee of Columbia University School of Law, who illustrates the uphill battle in proving fraudulent intent in matters of opinion. *Id.*

27. Despite the ubiquitous Chinese Wall between analysts and investment bankers at brokerage houses and the guarantees of objectivity dictated by both

motive component,[28] although Judge Pollack clearly took issue with the sources from which this information was gleaned.[29] But a plaintiff alleging fraud against an analyst would have to demonstrate that analyst's opinions were somehow different from the prevailing views.[30] In other words, if an analyst overrated a stock in order to positively influence his or her firm's investment banking business, then what would be the motive of other analysts, unconnected to the investment banking activities of that company, who issued buy recommendations for those same stocks? The fact that during December of 2000, "sell" recommendations equaled less than 2% of analysts' recommendations[31] indicates that over-enthusiasm and overvaluation were contagious and pervasive, and therefore extremely difficult to blame on any particular underwriting relationship with the particularity necessary to successfully plead securities fraud past the complaint stage.

Further, demonstrating the opportunity component of the scienter element would seem to require facts that constitute a

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firm policies and industry regulations, an analyst who makes a conservative sell recommendation that ultimately impacts the financial stability and value of a company doing business with that firm must necessarily suffer for his or her caution. *See* Kessler, *supra* note 8 (who recalls his experiences as an analyst, and the consequences of making an overly-conservative recommendation); *see also* Rueda, *supra* note 5, at 56-57; *infra* note 50 and accompanying text.

28. *See* Rueda, *supra* note 5, at 56-57 (illustrating the inherent conflicts in the analyst/investment banker relationship and the potential for abuse).

29. The complaints heavily quoted media descriptions of Meeker, her influence, and her compensation - estimated at $15 million by some accounts. *See e.g.*, Complaint at 3-4, Thomson v. Morgan Stanley Dean Witter & Co., No. 01-CIV-7071, 2001 WL 958925 (S.D.N.Y. 2001); *see also* Rueda, *supra* note 5, at 57 n.240. The repeated use of such sources was described by Judge Pollack as "gross and unrestrained" impropriet[y]. Thomson v. Morgan Stanley Dean Witter & Co., No. 01-CIV-7071, 2001 WL 958925, at *2 (S.D.N.Y. 2001).

30. *See* Jebsen, *supra* note 26.

31. Rueda, *supra* note 5, at 72); *Analyzing The Analysts: Are Investors Getting Unbiased Research From Wall Street?: Hearing Before the House Subcomm. on Capital Markets, Insurance and Government Sponsored Enterprises of the House Committee on Financial Services,* 107th Cong. (June 14, 2001) (opening statement of Full Committee Chairman Michael G. Oxley) ("I am distressed by the statistic that, as the markets were crashing last year, less than 2% of analyst recommendations were to sell.").

strong showing that those investing to their detriment were influenced solely by the analyst – that the recommendations alone held sway over investors to such an extent that they served as the primary source for those making such investment decisions – and that the analyst therefore had the opportunity to effect market changes by issuing recommendations.[32] As indicated above, the pervasiveness of industry analysts and the glut of market information during the Internet boom makes this very difficult to demonstrate.

Plaintiffs in the *Morgan Stanley Cases* attempted to do just that, with extensive quotations from Congressmen[33] and newspaper and magazine articles[34] intended to demonstrate the considerable influence Meeker wielded over the investment choices of the masses, as well as the concern with which commentators and the media viewed the apparent conflicts of interest in her relationship with Morgan Stanley.[35] But it was precisely the commentators quoted, as well as the prolific use of media sources, that prompted Judge Pollack's ire.[36] This seriously calls into question the ability of

32. Larry Dignan, *Want to Sue Over Bad Stock Advice? You're Not Alone*, CNET INVESTOR, Aug. 20, 2001 (quoting Professor Coffee, who described the "big hurdle" faced by the plaintiffs in these cases in proving Meeker's influence over the masses).

33. *See e.g.*, Complaint at 2, Thomson v. Morgan Stanley Dean Witter & Co., No. 01-CIV-7071, 2001 WL 958925 (S.D.N.Y. 2001) (quoting for nearly an entire page the opening remarks of Congressman Paul E. Kanjorski at the hearings entitled "Analyzing the Analysts: Are Investors Getting Unbiased Research From Wall Street?") (citation omitted).

34. *See e.g.*, *id.* at 1 (quoting a FORTUNE MAGAZINE article). Newspaper and magazine quotes appear frequently throughout, and large portions of the articles are quoted. See e.g., , Complaint at 2-5, Thomson v. Morgan Stanley Dean Witter & Co., No. 01-CIV-7071, 2001 WL 958925 (S.D.N.Y. 2001) (quoting for nearly 4 pages a NEW YORK TIMES article), at 20 (quoting a FORTUNE MAGAZINE article), at 21, 23 (quoting THE STREET.COM articles), and numerous other references to media publications.

35. *See e.g.*, *id.*

36. "Almost all of the complaint is an unrestrained litany of and puts in issue the selected speeches of social engineering politicians and articles, reports or news items from FORTUNE MAGAZINE; THE NEW YORK TIMES; THE NEWS TRIBUNE OF TACOMA, WASHINGTON; AFX NEWS; THESTREET.COM; THE NATIONAL POST; SUNDAY BUSINESS; the SEATTLE POST- INTELLIGENCER; THE

any plaintiff to plead with particularity that an analyst had the opportunity to commit fraud without using media sources to demonstrate the analyst's widespread influence.

III. WHY A HEIGHTENED REQUIREMENT?

The Private Securities Litigation Act was promulgated in 1995[37] in large part to preclude frivolous lawsuits brought by disgruntled investors not satisfied with the regulatory mechanisms for dealing with disputes.[38] Congress had not provided for a civil suit remedy when enacting the legislation governing securities fraud.[39] Nevertheless, private causes of action under Section 10(b)[40] and Rule 10(b)(5)[41] have been accepted by the courts, which therefore enjoy a certain degree of leeway in interpreting the requirements for a finding of securities fraud.[42] The intent, or scienter prong of a claim of securities fraud has been interpreted in

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SAN DIEGO UNION-TRIBUNE; the SUNDAY TIMES OF LONDON; THE NEW YORK POST; the NEW YORK OBSERVER; the cover of BARRON'S; *60 Minutes II*; THE AMERICAN PROSPECT; THE INVESTMENT DEALERS' DIGEST; THE WALL STREET JOURNAL; the LOS ANGELES TIMES; and the CHICAGO TRIBUNE." Judge Milton Pollack, Thomson v. Morgan Stanley Dean Witter & Co., No. 01-CIV-7071, 2001 WL 958925, at * 2 (S.D.N.Y. 2001).

37. Private Securities Litigation Reform Act, 15 U.S.C. § 78u-4(b)(1) *et seq.* (2000).

38. The chief aim of the PSLRA was to expedite dismissals of frivolous suits at the pleading stage and prior to discovery, to preclude plaintiffs from extracting large settlements from firms anxious to avoid the disclosure/discovery process, and to minimize the expenses involved with a lawsuit that has progressed to that stage. Guido, *supra* note 24. Professor Henry T.C. Hu points out the cost/benefit analysis conducted by attorneys when bringing such suits, noting that the preparation and due diligence costs of preparing a more particularized complaint are much higher, and temper an attorney's willingness to litigate. Jebsen, *supra* note 26.

39. However, rather than object to such suits, the SEC in fact welcomes private civil litigation as a supplement to its own enforcement activities. Guido, *supra* note 24, at 501.

40. 15 U.S.C. § 78j(b) (2000).

41. 17 C.F.R. § 240.10b-5 (2001).

42. Guido, *supra* note 24, at 504.

a number of ways, resulting in a lack of uniformity that the PSLRA was designed to remedy.

Unfortunately, the PSLRA failed to provide the clarity necessary to foster a uniform standard for scienter.[43] Post-PSLRA, circuit courts have split in interpreting the scienter element, but the Second Circuit has remained consistent in its requirement that, absent a strong showing of conscious misbehavior, motive and opportunity must be pled under a heightened standard at the pleading stage.[44]

IV. THE INVESTOR: A HAPLESS VICTIM?

Shareholders can traditionally minimize risk by remaining informed about the financial picture of the companies in which they invest and by diversifying their investments.[45] The recent dot-com boom made the former inconsequential and the latter unwise.[46] With the market focused on technology and Internet companies, some investors assumed diversification could be achieved by investing in several of these concerns. Further, the need to diversify was seriously outweighed by the desire for the considerable returns being achieved in those industries during the height of the dot-com boom.[47] Cross-industry diversification

43. *Id.* at 502 (discussing the confusion created by the PSLRA and the resulting lack of agreement among the circuits as to what constitutes scienter sufficient for a securities fraud claim to survive the pleading stage).

44. *Id.* at 509 (though Guido asserts that the Second Circuit has interpreted its own scienter requirement in an increasingly lenient fashion with regards to motive and opportunity).

45. "One of the major lessons of modern portfolio theory is that risk-averse investors should diversify in order to eliminate their exposure to unique risk." Peter H. Huang & Michael S. Knoll, *Corporate Finance, Corporate Law and Finance Theory*, 74 S. CAL. L. REV. 175, 176 (Nov. 2000).

46. "[A] 2% dividend [does not] seem worth much attention when investors could double their money in a few years or less . . . . " Ruth Simon & Jeff D. Opdyke, *Nasdaq's Big Lesson for Investors is That Diversification Still Matters: Internet Bubble's Blowout Reminds Shareholders to Spread Out Risk by Broadening Their Portfolios*, WALL ST. J., Jan. 2, 2001, at R1.

47. "Who needed to think about having a well-balanced portfolio when the

seemed too conservative, even foolish, when the returns on Internet company stocks were exceeding 1600%.[48]

Responsible investors can satisfy their duty or desire to investigate the companies in which they invest by relying on analysts. Analysts are in the best position to understand a company's performance and have the information necessary to do so.[49] Further, analysts are trained and educated to know more about markets and economics in general, and, more importantly, about the specific industries they cover, than the average investor. Investors therefore cannot be held wholly to blame for blindly placing their trust and finances behind one whose role and profession consists of interpreting the financial health of a company and recommending whether its stock should be bought or sold.

Or can they? Judge Pollack's analogizing the stock market to a gambling pit is most accurate when applied to the recent dot-com phenomenon. Those cautioning that technology and Internet stock values were severely over-inflated and doomed to crash were deemed nay-sayers and their warnings went unheeded.[50] It is fair to

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Nasdaq Composite Index was up a remarkable 795% during the 1990's?" *Id.*

48. For example, Amazon.com shares, once trading at $24 per share, soared to $400 per share before dropping to $9 per share in late November 2001. Goodley, *supra* note 9, at 30.

49. The Supreme Court reiterated the importance with which the SEC viewed the role and expertise of analysts in Dirks v. SEC, 463 U.S. 646, 659 (1983). "The SEC expressly recognized that '[t]he value to the entire market of [analysts'] efforts cannot be gainsaid; market efficiency in pricing is significantly enhanced by [their] initiatives to ferret out and analyze information, and thus the analyst's work redounds to the benefit of all investors.'" *Id.* (citation omitted). However, Regulation FD significantly undermined the premise that an analyst's receipt of market information before it became public was necessary for a healthy market by expressly prohibiting this practice. *See* SEC Regulation FD, 17 C.F.R. 243.100-103 (2001).

50. Henry Blodget, once considered an industry "superstar," came to prominence in 1998 when he predicted that Amazon.com's share price would rise from $240 to $400. Goodley, *supra* note 9, at 30. Jonathan Cohen, Internet analyst at Merrill Lynch, was more conservative with his predictions, and cautioned the stock's price could fall as much as $190, to $50 per share. *Id.* Though Blodget's prediction was met with skepticism and ridicule, when Amazon.com's price did in fact jump to $400, he replaced Cohen as Internet

say that, when the media has widely reported that a company such as Amazon has "never turned a profit,"[51] and investors continued to buy its stock at $300 and higher per share,[52] the investor must know that the buy is a gamble. Gambling is exactly the point. Many investors in the dot-com boom were trying to make exponential returns in a short time – the proverbial "get-rich quick" scheme. Once the market went sour, the lack of cross-industry diversification resulted in stunning losses to many, who then looked to the analysts for accountability.[53]

V. OTHER THEORIES OF LIABILITY

Whether or not analyst liability suits can prevail, or even survive a dismissal motion, the investment banking and underwriting practices of Wall Street's investment houses will not escape further scrutiny. In addition to heightened regulatory and Congressional attention,[54] a large class-action suit based on an antitrust theory is currently pending in the Southern District[55] which, if successful, promises to throw an even brighter spotlight onto these practices.

Additionally, analysts could conceivably be held liable under a

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analyst for Merrill Lynch. *Id.*

51. Rueda, *supra* note 5, at 73. In fact, Amazon was losing ninety cents per share at the time it was trading near the $300 mark. *Id.*

52. *Id.* Amazon.com's share price eventually rose to $400. Goodley, *supra* note 9, at 30.

53. *See* Rueda, *supra* note 5, at 26.

54. *See, e.g., Analyzing The Analysts: Are Investors Getting Unbiased Research From Wall Street?: Hearing Before the House Subcomm. on Capital Markets, Insurance and Government Sponsored Enterprises of the House Committee on Financial Services,* 107th Cong. (June 14, 2001) (opening statement of ranking democratic member Paul E. Kanjorski); Patty Reinert, *Senate to Subpoena Enron Execs, Auditors,* HOUSTON CHRON., Jan. 3, 2001; Margaret Kane, *Analyst Hearing Could Change Wall Street,* CNET NEWS.COM, June 15, 2001; Rachel Konrad & Margaret Kane, *Congress Getting Into Analyst Blame Game,* CNET NEWS.COM, June 11, 2001.

55. *See* Complaint, *In re* Initial Pub. Offering Antitrust Litig., No. 01-CIV-2014 (S.D.N.Y. filed Jan. 2, 2002) (alleging that several large brokerage houses engaged in a price-fixing scheme when setting up their underwriting selling group and participation agreements, in violation of antitrust laws).

theory of insider trading. Prior to Regulation FD,[56] analysts were privy to a company's financial performance data well before the information was made public; such information formed the analysts' recommendation to buy, sell, or hold that company's stock.[57] Under *Dirks v. SEC*,[58] in order for an individual to be found guilty of insider trading for disclosing material, non-public information, he or she must have derived some pecuniary benefit from such disclosure.[59] An argument can be made that an analyst whose compensation was tied to investment banking activities necessarily derived a financial benefit from the use of material, non-public information gleaned while wearing an analyst's hat for that firm.

Whatever the theory, the fallout from the anomalous market conditions created by the Internet is far from over, but in relation to analysts, the point may be moot. According to one commentator, as a result of the Internet stock fiasco and Regulation FD, analysts have lost much of their power, credibility, and usefulness.[60]

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56. SEC Regulation FD, 17 C.F.R. § 243.100(a) (2001). "The Regulation [FD] prohibits a company, or persons acting on such company's behalf, from selectively disclosing material inside information regarding such company or its securities." Marc I. Steinberg, *Insider Trading, Selective Disclosure, and Prompt Disclosure: A Comparative Analysis*, 22 U. PA. J. INT'L EC. L. 635, 650 (2001).

57. Dirks v. SEC, 463 U.S. 659 (1983) (outlining the value in the analysts' relationship with company insiders in evaluating and providing information through recommendations).

58. *Id.*

59. *Id.* at 663.

60. Kessler, *supra* note 8 (succinctly stating: "Say goodbye to analysts. The [SEC's] Regulation Full Disclosure has already wiped out much of their value . . . ."). He further predicted, "the [SEC] is only one or two regulations away from completely neutering the analyst trade." *Id.* Further trouble is bound to follow on the heels of the Enron fiasco, yet another instance of industry experts ignoring the writing on the wall. *Id.* Analysts from Goldman Sachs, Merrill, Lynch Pearce Fenner & Smith, UBS Warburg LLC, and Credit Suisse First Boston rated the stock a buy even after an announcement of the termination of a limited partnership whose import made a billion dollar institutional investor "shudder." *Id.* Analysts for Lehman Brothers Holdings, Inc. maintained a strong buy rating on Enron and recommended purchasing it "aggressively." *Id.* These ratings came on the heels of "inflated business

VI. CONCLUSION

The Internet and technology stock phenomenon was clearly an anomaly.[61] The losses for which accountability was sought in these cases were created by several unique ingredients that are unlikely to be replicated: a market sector that is not based on traditional and tangible ideas and methods of valuation; a veritable market frenzy, where investors were in a rush to snap up all things Internet, regardless of their actual value; investors' expectation of, and sense of entitlement to, exponential returns with no downturn; the unprecedented media exposure and celebrity bestowed on Internet stock analysts; and the impact a premature negative recommendation by an analyst could have on this house of cards. The resulting and unprecedented trust placed on analysts and the religiosity with which their recommendations were followed are not likely to continue.

Perhaps the fact that Judge Pollack was loathe to put the "opinions and economic philosophies"[62] of "newspapers, magazines, and social engineers"[63] on trial is a direct result of the convergence of these factors, as well as the extreme unlikelihood of their simultaneous recurrence. Further, his description of the Internet and technology market investors as "gamblers in the world's gaming pits"[64] sends a clear message. According to Judge Pollack, if the investors who lost money by listening to Meeker's recommendations "don't owe her any of their profits . . . [they can't expect] her to take their losses."[65]

While many small investors learned a painful lesson, the requirements of Section 10(b) and Rule 10(b)(5), heightened by

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valuations," "large insider stock sales," and the resignation of Enron's CEO after only six months on the job, in addition to the limited partnership announcement. *Id.*

61. Andreas Rueda refers to it as "one of the most remarkable speculative bubbles in recent memory." Rueda, *supra* note 5, at 21.

62. Thomson v. Morgan Stanley Dean Witter & Co., No. 01-CIV-7071, 2001 WL 958925 (S.D.N.Y. 2001).

63. *Id.*

64. *Id.*

65. Jebsen, *supra* note 26.

the Private Securities Litigation Reform Act will not be interpreted loosely to sustain a cause of action based on analyst liability, absent a strong showing of intent to defraud. SEC regulations (particularly Regulation FD), Congressional scrutiny, and investor skepticism will most likely cause analyst recommendations to become useless and ignored. In the meantime, the market has in effect righted the wrongs created by the Internet stock phenomenon.[66]

66. Amazon.com, although suffering from a significantly devalued stock price and trading at $12.61 per share as of January 22, 2002, was recently able to turn a profit for the first time in the company's history. *See* Larry Dignan, *Amazon Posts Its First Net Profit*, CNET NEWS.COM, Jan. 22, 2002, *available at* http://news.com.com/2100-1017-819688.html (last visited Jan. 22, 2002); *see also supra* notes 50-52 and accompanying text (discussing how Amazon.com once traded as high as $400 per share). Ironically, the penny per share net profit, determined in line with general accounting principals, was "well ahead of analyst's expectations." *See* Dignan, *supra* note 67.

Notes & Observations

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