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UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

In re Lockheed Martin Corp.
Securities Litigation

CASE No. CV 99-00372 MRP

MEMORANDUM OF DECISION AND ORDER
RE:

1. Motion for to Dismiss Plaintiffs' Consolidated Third Amended Complaint
2. Request for Judicial Notice
3. Motion to Strike Portions of Plaintiffs' Consolidated Third Amended Class Action Complaint

THIS DOCUMENT RELATES TO ALL
ACTIONS

I. Background

A. Factual Background

This is a class action brought on behalf of purchasers of Lockheed Martin Corporation ("Lockheed" or "Company") stock between August 13, 1998 and December 23, 1998 (the "Class Period"), against

1 Lockheed and six of its officers and directors. The individual
2 defendants and their alleged positions during the Class Period are as
3 follows:

4 Vance Coffman: CEO, Chairman of Board of Directors, and
5 member of Executive Committee.

6 Marcus Bennett: Executive Vice President, Chief
7 Financial Officer, and director.

8 James Blackwell: Vice President of Lockheed and Chief
9 Operating Officer ("COO") of Lockheed's Aeronautics
10 Sector.

11 Thomas Corcoran: Vice President of Lockheed and COO of
12 Lockheed's Space and Strategic Missiles Sector.

13 Norman Augustine: director and member of the Executive
14 and Finance Committees of Lockheed.

15 Vincent Marafino: director and member of the Audit and
16 Ethics and Finance Committees of Lockheed.¹

17 (Consolidated Third Amended Complaint, September 13, 2002, ¶ 28
18 ("CTAC" or "Complaint").)

19 Assuming the truth of Plaintiffs' allegations, *see Brody v.*
20 *Transitional Hospitals Corp.*, 280 F.3d 997, 998 (9th Cir. 2002), the
21 facts in this case are: beginning with an August 13, 1998 conference
22 call with market professionals, Lockheed announced that it expected to
23 sign a significant F-16 order with the United Arab Emirates ("UAE") by
24 year-end 1998. The contract was anticipated to be for 80 F-16s, each
25 equipped with "Block 60" technology, which included advanced
26 electronic warfare systems with full software codes and extra large
27 fuel tanks that substantially increase the flying range of the
28 aircraft. (CTAC ¶ 73.)

At about the same time, the Company assured shareholders and

¹ Each individual defendant will be referred to as an Individual Defendant. The Individual Defendants and Lockheed will collectively be referred to as the Defendants.

1 analysts that its C-130J airplane program was poised for success and
2 that the Company expected to deliver its first 25-30 C-130Js to the
3 United States Air Force ("USAF") during the third and fourth quarter
4 of 1998, to be followed by robust deliveries of these planes going
5 forward. (CTAC ¶ 47.)

6 Based in large part on these anticipated successes, Lockheed
7 expressed publicly during the Class Period that it anticipated strong
8 third and fourth quarter 1998 results and that Lockheed would have 10%
9 Earnings Per Share ("EPS") growth in the fourth quarter and for 1998.
10 On December 23, 1998, however, Lockheed publicly disclosed that it
11 would be unable to meet its prior forecast. Instead, Lockheed
12 announced that its fourth quarter 1998 EPS would be at least 10% lower
13 than its fourth quarter 1997 EPS and that 1998 revenues would be flat
14 compared with 1997 revenues. Responding to the news, Lockheed share
15 prices dropped from \$95-3/4 to \$82 per share.

16 Plaintiffs' core theory is that both the F-16 and C-130J
17 forecasts were, when made, known to be false or misleading and that
18 these statements artificially inflated Lockheed's share price during
19 the class period. With respect to the F-16 statements, Plaintiffs
20 conclude that Defendants must have known them to be false or
21 misleading when made because of the UAE's insistence on obtaining the
22 Block 60 technology. "Much of the technology was not currently being
23 used by the USAF or Israel and would not enter the U.S. arsenal for at
24 least five years." (CTAC ¶ 73.) Moreover, attempts by Saudi Arabia
25 and Egypt to purchase F-15 jet fighters with similar technology had
26 been denied by the Pentagon. Thus, transfer of the technology to the
27 UAE in the near term was "extremely unlikely." (CTAC ¶ 74.) Further
28 complicating the situation is that the F-16 contract would have also

1 required prior Congressional approval. According to Plaintiffs,
2 Lockheed knew from its experience that "Pentagon and Congressional
3 approval would normally take 6-8 months," thereby making the five
4 month projection (from August 1998 to December 1998) overly ambitious
5 and unrealistic.

6 Similarly, Plaintiffs allege that throughout the Class Period,
7 Defendants knew that Lockheed would not and could not deliver any, let
8 alone 30, C-130J airplanes in 1998. (CTAC ¶ 57.) In support of this
9 allegation, Plaintiffs proffer statements from a former Lockheed
10 flight engineer who worked on the C-130J throughout 1998 and who had
11 responsibility for assuring compliance with all required
12 certifications. According to the engineer, as of August 1998, the FAA
13 certification (required by the USAF contract) had not been granted and
14 the C-130J deliveries "had slipped by over 18 months." (CTAC ¶ 65.)
15 Moreover, Lockheed was still, in late 1998, flight testing various
16 models of the C-130J; this testing was required to "certify" that each
17 C-130J complied with performance and reliability specifications.
18 Finally, each C-130J aircraft was required to pass a functional test,
19 referred to as "squawking out" the plane. Lockheed allegedly knew
20 that individual aircraft had not been "squawked out" by late 1998 and
21 that "more than 30 C-130Js could not be operationally tested,
22 evaluated, qualified, and 'squawked out' by the third or fourth
23 quarter of 1998." (CTAC ¶ 67.)

24 According to the Complaint, Defendants had ample motive to
25 deceive the investing public. First, Lockheed wished to acquire
26 COMSAT, a commercial satellite company, using a combination of cash
27 and common stock as consideration. To preserve the value of the
28 acquisition to the participants, Defendants needed to maintain

1 Lockheed's share prices at previous levels. Second, Defendants wanted
2 to maintain a high share price to discourage what they perceived as a
3 takeover threat by certain foreign defense contractors. Finally, the
4 Individual Defendants had personal pecuniary interests in maintaining
5 Lockheed share price. They allegedly took advantage of the false
6 expectations to sell 268,659 shares of Lockheed shares at an aggregate
7 of over \$28 million (CTAC ¶ 23) and were also motivated by their
8 compensation structure to generate strong financial results by
9 whatever means possible (CTAC ¶¶ 124-125).

10 Based on these allegations, Plaintiffs allege that the Defendants
11 have each violated § 10(b) and Rule 10b-5 of the Securities and
12 Exchange Act of 1934 and that the Individual Defendants have each
13 violated § 20(a) of the Securities and Exchange Act of 1934.

14

15 **B. Procedural Background**

16 Plaintiffs have now filed three complaints in this action. On
17 October 3, 2000, the Court dismissed the initial complaint, but
18 granted Plaintiffs leave to amend with respect to certain allegations.
19 Plaintiffs filed a Consolidated Second Amended Complaint ("CSAC") on
20 December 15, 2000, which was again dismissed on July 22, 2002. See
21 Mem. of Dec. re: Def.'s Mot. to Dismiss Pl.'s Cons. Sec. Amended Class
22 Action Compl., July 22, 2002 ("July 2002 Order").

23 The July 2002 Order granted Plaintiffs leave to amend with
24 respect to four broad issues. First, Plaintiffs were granted leave to
25 amend to allege how the executive committee was involved in Lockheed's
26 day-to-day operations during the Class Period, if at all, and how the
27 defendants Augustine and Marafino each participated in these
28 operations. See July 2002 Order at 7. Second, Plaintiffs were

1 granted leave to amend to include facts indicating that Augustine,
2 Marafino, Corcoran, and Blackwell were directly involved in the
3 preparation of the allegedly misleading statements. See July 2002
4 Order at 12. Third, Plaintiffs were granted leave to amend to show
5 that the Defendants actually knew that the allegedly misleading
6 statements regarding the F-16 contract were false or misleading when
7 made. See *id.* at 15. Finally, with respect to the C-130J forecasts,
8 Plaintiffs were granted leave to amend the complaint 1) to demonstrate
9 that the anonymous "engineers" and "Lockheed employees" described in
10 paragraph 47 of the CSAC were in positions to gain personal knowledge
11 regarding the facts attributed to them, 2) to disclose the basis for
12 Plaintiffs' knowledge regarding the statements by Parrish and the
13 briefing by Bullock, and 3) to plead facts indicating that Defendants
14 actually knew that the statements regarding the C-130J program were
15 false or misleading when made. See *id.* at 21-22. Leave to amend with
16 respect to the LM21 program and the satellite launches was denied.
17 Plaintiffs filed their Consolidated Third Amended Complaint on
18 September 13, 2002.

19 The following motions, all submitted by Lockheed, are before the
20 Court: Motion to Dismiss Plaintiffs' Consolidated Third Amended Class
21 Action Complain, Request for Judicial Notice, and Motion to Strike
22 Portions of Plaintiffs' Consolidated Third Amended Class Action
23 Complaint. For the reasons set forth below, the Motion to Dismiss is
24 GRANTED and the Consolidated Third Amended Complaint is hereby
25 dismissed in its entirety with prejudice. The Motion to Strike and
26 the Request for Judicial Notice are DENIED because the granting of the
27 Motion to Dismiss renders moot the issues set forth in those papers.
28

1 knowledge . . . that the statement was false or misleading," 15 U.S.C.
2 § 78u-5(c)(1)(B). Thus, for forward-looking statements, Plaintiffs
3 must state with particularity facts giving rise to a strong inference
4 of actual knowledge.

5 In considering a motion to dismiss, the Court considers "whether
6 the total of plaintiffs' allegations, even though individually
7 lacking, are sufficient to create a strong inference that defendants
8 acted with deliberate or conscious recklessness," and not merely
9 whether each individual allegation is sufficient. *Lipton v.*
10 *Pathogenesis Corp.*, 284 F.3d 1027, 1038 (9th Cir. 2002). In so doing,
11 the Court takes into account "all reasonable inferences to be drawn
12 from the allegations, including inferences unfavorable to the
13 plaintiffs." *Gompper v. VISX, Inc.*, 298 F.3d 893, 897 (9th Cir.
14 2002). If the allegations could equally and plausibly support an
15 inference showing the absence of fraud, then Plaintiffs have not met
16 their burden. *See id.* at 896-97.

17 18 **III. Discussion**

19 **A. Forward-Looking Statements**

20 Preliminarily, the Court disagrees with Plaintiffs' contention
21 that Defendant's statements regarding the C-130J and F-16 programs
22 were not forward-looking statements. Although the Court has
23 previously ruled that the statements are forward-looking statements as
24 defined by the PSLRA, 15 U.S.C. § 78u-5(c), Plaintiffs continue to
25 argue that two factors take the statements outside of the safe-harbor.
26 First, they argue that Lockheed did not provide the meaningful
27 cautionary statements required by the PSLRA. Second, they argue that
28 Lockheed's statements were not forward-looking; rather they were

1 | premised on and concerned the then-current success of the Company.
2 | Neither argument withstands scrutiny.

3 | The Court rejects the position that because Lockheed did not make
4 | meaningful cautionary statements, the statements fall outside the
5 | safe-harbor. Assuming, *arguendo*, that meaningful cautionary
6 | statements were lacking, the PSLRA protects forward-looking statements
7 | if they *either* are accompanied by meaningful cautionary statements or
8 | were made without actual knowledge that the statements were false or
9 | misleading. See, e.g., *In re Splash Tech. Holdings Secs. Litig.*, 160
10 | F. Supp. 2d 1059, 1069 (N.D. Cal. 2001); *In re Boeing Sec. Litig.*, 40
11 | F. Supp. 2d 1160, 1167 (W.D. Wash. 1998); *In re Amylin Pharm., Inc.*
12 | *Sec. Litig.*, 2002 U.S. Dist. LEXIS 19481, *23-25 (S.D. Cal. 2002).

13 | Plaintiffs also argue that although a promise to sign a contract
14 | for 80 F-16s, for example, might appear to be forward-looking, it is
15 | in fact, necessarily based on certain facts being *currently* true.
16 | Thus, a forecast with respect to future contracts for F-16s signals to
17 | the public facts relating to the current status of the F-16 program
18 | such as the fact that the F-16 is an actual plane that exists and that
19 | Lockheed is in or plans to engage in negotiations with others. As
20 | these statements depend on present facts and allow the investing
21 | public to infer such present facts, Plaintiffs argue that they are not
22 | entitled to the protection accorded forward-looking statements by the
23 | PSLRA.

24 | While the Court agrees that statements based on current fact are
25 | actionable, it is unwilling to stretch that principle into one in
26 | which predictions of future events become actionable merely because
27 |
28 |

1 they happen to have some basis in present facts.³ To accept
2 Plaintiffs' position would be to carelessly intermingle the two
3 related - but analytically distinct - issues of whether 1) a statement
4 is forward-looking and 2) if so, whether the forward-looking statement
5 is nevertheless actionable because the speaker knew that the statement
6 was false or misleading when he made it. For example, Plaintiffs cite
7 *In re 2THEMART.COM, Inc. Sec. Litig.*, 114 F. Supp. 2d 955 (C.D. Cal.
8 2000), for the proposition that the statement at issue in that case
9 was "not forward-looking because it was undermined by the factual
10 omissions that the preliminary contract had not been signed." (Opp'n.
11 at 6.) In so doing, Plaintiffs imply that if a plaintiff merely
12 provides vague allegations that there were omissions, the protections
13 for forward-looking statements do not apply.

14 This position reflects the law neither of the Ninth Circuit nor
15 of *2THEMART.COM*. See *In re Clorox Co. Secs. Litig.*, 238 F. Supp. 2d
16 1139, 1145 (N.D. Cal. 2002) ("Here, the relevant statement was
17 forward-looking. Rose was estimating the time it would take for
18 Clorox to clear out the excess inventory. Although her statement was
19 based on existing knowledge, it was quite clearly a prediction of

20
21 ³ Plaintiffs' observation that Lockheed's statements about
22 the future had an immediate effect of driving up the market price
23 of Lockheed stock is of no legal or logical moment. Under almost
24 any established theory of the market, the price of a company's
25 stock reflects certain expectations about the future condition of
26 the company. See, generally, Ronald J. Gilson & Reinier H.
27 Kraakman, *The Mechanisms of Market Efficiency*, 70 Va. L. Rev.
28 549, 561 (1984) (noting that securities prices ultimately turn on
expectations about future earnings). Hence, the fact that the
stock price changes immediately does not, by logic, imply that
the statement was about the current condition of the company.
Indeed, if the stock price never adjusted for statements about
the future of the company, then the protection for forward-
looking statements would be irrelevant since no investor would
ever be able to show damages based on forward-looking statements.

1 future events."). Instead, the proper analysis is to begin by
2 determining whether a statement is forward-looking. If the statements
3 are forward-looking, the burden is then on Plaintiffs to show that
4 Defendants had actual knowledge that the statements were false or
5 misleading. See 15 U.S.C. § 78u-5(c)(1)(B). Plaintiffs, in asking
6 first whether there were omissions, and then asking whether the
7 statement is forward-looking, put the proverbial cart before the
8 horse. To accept Plaintiffs' position would be to discard a statutory
9 framework that provides protection for forward-looking statements,
10 replacing it instead with the notion that mere allegations of
11 omission, not even rising to the level of actual knowledge, would make
12 such statements actionable.

13 Here, the Court proceeds by first asking whether the statements
14 speak of future or contingent events. To this question, the Court
15 answers, "yes." The focus then becomes whether the statements are
16 nonetheless actionable because of actual knowledge of the false or
17 misleading nature of the statements at the time they were made. It is
18 to this second issue that the Court now turns its attention.

19

20 **B. F-16 Contract**

21 In the July 2002 Order, the Court acknowledged that Plaintiffs
22 had pled facts raising a specter that the statements regarding the F-
23 16s were misleading. See July 2002 Order at 13. However, since the
24 statements regarding the F-16 contract are forward-looking, Plaintiffs
25 must demonstrate that Defendants actually knew that the
26 forward-looking statements were false or misleading when they were
27 made and must plead facts sufficient to establish such knowledge in
28 order to survive a motion to dismiss. See *In re Splash Tech. Holdings*

1 Secs. Litig., 160 F. Supp. 2d at 1069. Although Plaintiffs had
2 repeatedly failed to plead facts sufficient to demonstrate Defendants'
3 knowledge, the Court granted leave to "amend the complaint to show
4 that the Defendants actually knew that the allegedly misleading
5 statements were false when made." July 2002 Order at 15. The CTAC
6 incorporates few changes to the F-16 allegations, and the changes that
7 have been made are clearly insufficient to meet the PSLRA's
8 requirements.

9 Preliminarily, the allegations are legally insufficient because
10 Plaintiffs' allegations about why Defendants had actual knowledge of
11 the alleged facts are based solely upon conjecture. Plaintiffs
12 attribute the knowledge not to any inside sources, documentation, or
13 available public information; rather, Lockheed is claimed to have
14 knowledge of the alleged facts because of its position as "the primary
15 contractor for the manufacture of the F-16 fighter aircraft," (CTAC ¶
16 73), and because "Boeing's F-15 was a major competitor to Lockheed's
17 F-16," (CTAC ¶ 74). If these types of logical inferences and
18 generalizations were sufficient to meet the PSLRA's requirements,
19 plaintiffs could effectively manufacture support in any case to
20 overcome the PSLRA's requirements.

21 In any event, Plaintiffs' allegations suffer from another
22 shortcoming. Although Plaintiffs continue to allege that numerous
23 sources of information existed that demonstrate the false or
24 misleading nature of the F-16 statements, they muster facts sufficient
25 only to allege that a portion of this information was known to
26 Lockheed. Even if the Court were inclined to agree that this entire
27 latter set of information was actually known to Lockheed, the Court
28

1 would still find that information insufficient to demonstrate that
2 Lockheed knew that its statements were false or misleading when made.

3 The items of information that Plaintiffs actually claim were
4 known by Lockheed show only that the Block 60 technology was
5 cutting-edge, not that Defendants knew that the United States would
6 not allow sale of such technology to the UAE. That the United States
7 would not have the technology for five years can be attributed to the
8 advanced nature of the technology; but it can equally be attributed
9 to budgetary constraints, a lack of faith in the technology, or simply
10 bureaucratic red tape. Plaintiffs plead no facts that persuade the
11 Court to prefer one inference to another. Nor does the Pentagon's
12 denial of Boeing's request to sell similar technology to Saudi Arabia
13 and Egypt serve to indicate that Defendants knew the false or
14 misleading nature of their statements. The F-15 and F-16 are entirely
15 different aircrafts with presumably different capabilities and
16 intended uses. Under any circumstance, the Court would be wont to
17 accept such a tenuous chain of reasoning from the Plaintiffs; the
18 reasons for rejecting such reasoning are enhanced where, as here, the
19 heightened pleading requirements of the PSLRA apply.

20
21 **C. C-130J Contract**

22 In the July 2002 Order, the Court dismissed all allegations with
23 respect to the C-130J because Plaintiffs failed to allege that
24 Defendants actually knew that the statements regarding the C-130J
25 program were false or misleading when made. Like the F-16 pleadings
26 in the CTAC, Plaintiffs' pleadings in the CTAC with respect to the C-
27 130J remain insufficient under the PSLRA because they fail to properly
28

1 demonstrate that facts known to Lockheed made the statements false or
2 misleading when made.

3 A recurrent theme in the C-130J evidence proffered by Plaintiffs
4 is not what the allegations say, but what has (presumably) been
5 carefully filtered out. For example, Plaintiffs allege that as of
6 August 1998, FAA certification had not been granted; they do not say
7 that as of August 1998, Lockheed knew that certification would not be
8 granted by year end. Moreover, the C-130J deliveries "had slipped by
9 over 18 months," but Plaintiffs do not allege what was the original
10 delivery date. Are Plaintiffs alleging that the original target date
11 was December 1998 and that the 18 month delay would put the target
12 delivery date at June 2000? Or perhaps the initial date was June
13 1997, and the 18 month delay would mean delivery on December 1998?

14 Allegations that individual aircraft had not been "squawked out"
15 by late 1998 are equally ambivalent. Plaintiffs do not allege either
16 the total number of C-130Js in production at the time, or the total
17 number of C-130Js that had not been "squawked out" by late 1998.
18 Thus, Plaintiffs' allegations are entirely consistent with a scenario
19 in which Lockheed was building 35 airplanes, five of which had not
20 been "squawked out." This hypothetical scenario would, of course, do
21 nothing to prove the actual falsity of the Lockheed statements
22 regarding its ability to deliver 25-30 airplanes. Indeed, even if
23 Lockheed had only 25 airplanes, none of which had been "squawked out"
24 by "late 1998," nothing in the CTAC alleges that Lockheed knew that
25 the "squawking" process for 25-30 airplanes could not be completed in
26 the interim between "late 1998" and December 31, 1998; rather, the
27 CTAC only alleges that "more than 30 C-130Js" could not be completed
28 by December 31, 1998. (CTAC ¶ 67.) Since Lockheed is only alleged to

1 have promised 25-30 airplanes, allegations with respect to "more than
2 30 C-130Js," even if true, would be irrelevant.

3 The remaining C-130J allegations in the CTAC suffer from similar
4 defects. For example, although Plaintiffs allege that training
5 infrastructures were not established until 1999, they do not allege
6 that the establishment of such infrastructures was a condition to
7 C-130J aircraft delivery. Further, allegations stemming from Gene
8 Elmore's statement are insufficient:

9 According to a June 17, 1998 Wall Street Journal
10 article, Gene Elmore the C-130J line manager at
11 Lockheed's Marietta plant told Coffman repeatedly in
12 October and November of 1998 that seven C-130J
airplanes were at "high risk" of missing the year-end
delivery dates. This "high risk," however, was not
disclosed to shareholders during the Class Period.

13 (CTAC ¶ 68.) The Court assumes that the article was actually printed
14 in 1999, and not 1998. In either case, the allegation again does not
15 show that Lockheed's statements were known to be false or misleading
16 when they were made. Plaintiffs do not establish why Mr. Elmore
17 believed the C-130Js were at "high risk" of missing delivery dates or
18 whether Coffman (or any other members of Lockheed's senior management)
19 agreed, or had reason to agree, with Mr. Elmore's assessment. See,
20 e.g., *Nursing Home Pension Fund v. Oracle Corp.*, 2002 U.S. Dist. LEXIS
21 25416, *26 (N.D. Cal. 2002) ("Providing the Court with information
22 that Sanderson or Ellison had access to 'up to the minute' global
23 roll-ups without providing what the details actually were cannot
24 satisfy the pleading requirements of the PSLRA. Nor does the fact
25 that these confidential witnesses, from their knowledge of the several
26 regional, national, or global databases, thought that sales 'went
27 dead,' 'fizzled out,' 'dried up,' and 'stopped' establish that
28 Ellison, Sanderson or Henley knew of this information or thought the

1 same thoughts."); *In re Nike, Inc. Sec. Litig.*, 181 F. Supp. 2d 1160,
2 1168 (D. Ore. 2002).

3 Just as importantly, if the C-130J statements were made prior to
4 October and November of 1998, Mr. Elmore's warnings could not have
5 made those earlier statements false or misleading when made.

6 With these large and unexplained gaps, the Court finds that
7 Plaintiffs have not met their burden of alleging "with specificity
8 that the defendants made false or misleading statements with
9 deliberate or conscious recklessness." *See Lipton*, 284 F.3d at 1035.⁴
10

11 **D. Individual Defendants: Applicability of *America West***

12 The allegations against the Individual Defendants fail for two
13 reasons. Initially, they fail because the pleading inadequacies fatal
14 to Plaintiffs' claims against the Company are likewise fatal to the
15 claims against the Individual Defendants because the latter derive
16 from the same set of facts. Nothing in the Complaint suggests that
17 any of the Individual Defendants had access to facts in addition to
18 what is pled with respect to the Company's knowledge of the C-130J
19 program (CTAC ¶¶ 47-71; 90-91) or the F-16 program (CTAC ¶¶ 72-77).
20 As a threshold matter, then, Plaintiffs have failed to allege any
21 facts suggesting that the Individual Defendants can be held liable.

22 The allegations also fail because Plaintiffs do not plead facts
23 sufficient to support a strong inference of scienter on the part of
24 the Individual Defendants. Although Plaintiffs had failed on two
25

26 ⁴ Because Plaintiffs have failed to plead any facts
27 demonstrating that there was any information that tends to show
28 the statements with respect to the C-130J and F-16 were false or
misleading when made, the Court need not and does not intimate
any view on whether Plaintiffs have properly identified their
sources.

1 previous occasions to show scienter, they now contend that the amended
2 pleadings, taken together with *No. 84 Employer-Teamsters Joint Counsel*
3 *Pension Trust Fund v. America West Holding Corp. et al.*, No. 01-16725
4 D.C. No. CV 99-00399-OMP (9th Cir. 2003) ("America West"), which was
5 issued by the Ninth Circuit after the present Motion was filed,
6 fortifies the CTAC against the PSLRA requirements.

7 8 **1. America West**

9 The Court assumes familiarity with the *America West* case and will
10 recite only those details necessary to address the questions here
11 presented. In *America West*, the District Court "concluded that the
12 stock sales by the officers, directors, and controlling shareholders
13 were not suspicious and failed to raise a strong inference of
14 scienter." *Id.* at 2102. "[T]he District Court found it dispositive
15 that none of the officers or directors [except one] who allegedly
16 engaged in insider trading made any of the false or misleading
17 statements." *Id.*

18 The Ninth Circuit Court of Appeals reversed. In so doing, it
19 first stated that "[a]n insider's silence as to the statements is not
20 dispositive." *Id.* "Rather, it is merely another factor that should
21 be considered in determining whether a strong inference of scienter
22 has been raised." *Id.* The Ninth Circuit then determined that the
23 amount and percentage of shares sold, the timing, and the prior
24 trading histories made the stock sales by the individual defendants
25 there "unusual and suspicious" and enough to "give rise to a strong
26 inference of scienter." *Id.* at 2103-06.

27 The Ninth Circuit also held that plaintiffs had sufficiently
28 alleged scienter with respect to the individual defendants' knowledge

1 of the false or misleading nature of their statements. Although some
2 of the defendants in *America West* argued that the issues regarding
3 maintenance, safety, and the FAA investigation never rose to the level
4 of Board discussions or communications with shareholders, the Ninth
5 Circuit rejected the argument as "patently incredible." *Id.* at 2111
6 n.21. Considering that the FAA had indicated penalties of up to \$11
7 million and that the defendant company was contemplating repurchasing
8 authorization for millions of dollars worth of stock, the Ninth
9 Circuit found that the plaintiffs there had sufficiently raised a
10 strong inference of deliberate recklessness. *Id.* at 2111-12.

11 Plaintiffs argue that *America West* supports their Complaint in
12 two essential aspects.⁵ First, Plaintiffs argue that *America West*
13 demonstrates that the Court committed error in calculating the
14 percentage of shares that Defendants sold. Specifically, Plaintiffs
15 allege that vested, but unexercised, options should not be included in
16 calculating the percentage of shares sold, *see id.* at 2104 n.16, and
17 that non-selling Defendants should not have been included in the
18 calculations. Second, they argue that the Court required too much in
19 the July 2002 Order when it found that the Plaintiffs had not
20 demonstrated active involvement by certain Individual Defendants
21 sufficient to infer that they had knowledge about the false or
22 misleading nature of the statements at issue.

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24
25
26 ⁵ Plaintiffs also argue that *America West* counsels that the
27 mere fact that the people making the false or misleading
28 statements did not also sell stock is not dispositive. *Id.* at
2103. As the Court does not disagree with this point, no further
discussion is warranted.

1 **2. Share Calculations**

2 *Silicon Graphics* and *America West* condone different approaches to
3 determine the percentage of shares sold. In *Silicon Graphics*, the
4 Ninth Circuit held that in determining the proper proportions of stock
5 sales, the lower court did not err in taking into account vested but
6 unexercised options:

7 When evaluating stock sales, we have held that the
8 proportion of shares actually sold by an insider to the
9 volume of shares he could have sold is probative of
10 whether the sale was unusual or suspicious. In this
11 case, we see no reason to distinguish vested stock
12 options from shares because vested stock options can be
13 converted easily to shares and sold immediately.
14 Actual stock shares plus exercisable stock options
15 represent the owner's trading potential more accurately
16 than the stock shares alone.

17 *Silicon Graphics*, 183 F.3d at 986-87. The *America West* court departs
18 from the method used in *Silicon Graphics* by deriving its percentages
19 using only the common stock and exercised options. See *America West*,
20 No. 01-16725 at 2104 n.16.

21 The differences in methodologies, however, do not support
22 Plaintiffs' contention that the Court should not consider the vested
23 but unexercised options. Neither *Silicon Graphics* nor *America West*
24 state a rule mandating that vested options should or should not be
25 included. Rather, the *Silicon Graphics* court pointed out that in most
26 instances, it is more appropriate to take into account vested options
27 because the occasions are rare where there is a true economic
28 distinction between vested and unexercised options and exercised
29 shares. The decision, however, left open the possibility that
30 different situations might mandate different approaches. See *Silicon*
31 *Graphics*, 183 F.3d at 986 ("In this case, we see no reason to
32 distinguish") (emphasis added). While the *America West* court

1 chose a different methodology, it did not repudiate the logic set
2 forth in *Silicon Graphics*. In the absence of more guidance by the
3 *America West* court, this Court can only speculate as to why *America*
4 *West* deviated from *Silicon Graphics*.

5 There are, of course, many possible good reasons to do so. For
6 example, the calculations in *America West* were provided by the
7 plaintiffs, *America West*, No. 01-16725 at 2103, and it is conceivable
8 that neither the defendants there nor the court chose to challenge
9 that assumption. Alternatively, it may have been that the number of
10 vested options in *America West* was so insignificant as to make the
11 dispute academic. Finally, there may have been restrictions on the
12 ability to exercise the options or to subsequently sell the issued
13 shares such that the vested options did not fully represent the
14 owner's trading potential. Each of these possibilities are, of
15 course, persuasive reasons not to include vested options and the
16 *America West* court's decision not to include vested options is not
17 actually inconsistent with *Silicon Graphics*.

18 Ultimately, the weakness of Plaintiffs' position lies not in the
19 law as set forth in *Silicon Graphics* or *America West*. The tension
20 between the two cases is an illusory one and both cases leave room to
21 ignore vested options where there is reason to do so. Rather, the
22 weakness of Plaintiffs' position is that Plaintiffs do nothing to show
23 that inclusion of vested options in this case distorts, rather than
24 reflects, economic reality. Without more explanation in the *America*
25 *West* opinion itself or by the parties, the Court is unwilling to read
26 so much into the *America West* case as to assume that it lays down a
27 new rule regarding vested options.

1 Similarly, the Court is unwilling, without more, to accept
2 Plaintiffs' reading of *America West* as standing for the proposition
3 that those who did not sell should not be included in the percentage
4 calculations. The *America West* opinion included a chart that shows
5 the percentage of shares sold by nine individual defendants. From
6 this fact alone, Plaintiffs would have the Court infer that *America*
7 *West* mandates a substantial departure from prior Ninth Circuit case
8 law suggesting that non-selling insiders can be taken into account.
9 See, e.g., *Lipton*, 284 F.3d at 1037; *Ronconi*, 253 F.3d at 436. As
10 with the issue over unexercised options, the Court is unwilling to
11 infer merely from the fact that the particular chart included in the
12 opinion, without more, represents a mandate or authority for the Court
13 to ignore those defendants that did not sell.

14 15 3. Inferring Actual Knowledge on Individual Defendants

16 Plaintiffs attempt to bolster their scienter claims against
17 Augustine and Marafino by pointing to allegedly insider trading
18 executed at suspicious times. "'[U]nusual' or 'suspicious' stock
19 sales by corporate insiders may constitute circumstantial evidence of
20 scienter" *Silicon Graphics*, 183 F.3d at 986 (citation
21 omitted). However, insider stock sales are only suspicious when they
22 are "dramatically out of line with prior trading practices at times
23 calculated to maximize the personal benefit from undisclosed inside
24 information." *Id.* (quoting *In re Apple Computer Sec. Litig.*, 886 F.2d
25 1109, 1117 (9th Cir. 1989)). "Among the relevant factors to consider
26 are: (1) the amount and percentage of shares sold by insiders; (2) the
27 timing of the sales; and (3) whether the sales were consistent with
28 the insider's prior trading history." *Id.* (citing *Provenz v. Miller*,

1 102 F.3d 1478, 1491 (9th Cir. 1996)). "[L]arge numbers do not
2 necessarily create a strong inference of fraud." *In re Vantive Corp.*
3 *Secs. Litig.*, 283 F.3d 1079, 1093 (9th Cir. 2002). Finally, "[o]ne
4 insider's well timed sales do not support the 'strong inference'
5 required by the statute where the rest of the equally knowledgeable
6 insiders act in a way inconsistent with the inference that the
7 favorable characterizations of the company's affairs were known to be
8 false when made." *Ronconi*, 253 F.3d at 436.

9 The July 2002 Order dismissed the allegations against both
10 Marafino and Augustine because Plaintiffs had failed to allege that
11 either was involved in the day-to-day operations of the Company. See
12 July 2002 Order at 7. As noted in the July 2002 Order, by the
13 beginning of the Class Period, "both Augustine and Marafino had
14 retired from their positions as Lockheed executive officers." July
15 2002 Order at 5. While the CSAC alleged that Augustine and Marafino
16 served as board members and members of the Executive Committee, the
17 Court concluded that the "duties of an ordinary board member generally
18 do not include participation in executive activities." *Id.* at 5.
19 "Similarly, asserting that the men are members of Lockheed's executive
20 committee, without describing the duties of the committee or how these
21 defendants participated in it, does not demonstrate active involvement
22 in day-to-day operations." *Id.* The July 2002 Order gave Plaintiffs
23 leave to amend solely with respect to whether Augustine and Marafino
24 maintained involvement in day-to-day Company operations.

25 In the CTAC, Plaintiffs in part continue on the discredited
26 strategy of focusing on Marafino's and Augustine's duties prior to the
27 Class Period. (CTAC ¶¶ 114, 117.) Reliance on pre-class period
28 duties has already been rejected and merits no further discussion or

1 consideration by the Court. See *id.* at 5 ("The additional facts
2 pertaining to Marafino and Augustine refer almost exclusively to their
3 pre-class period accomplishments and affiliations with the company.
4 Plaintiffs must demonstrate day-to-day involvement during the Class
5 Period - when the insider trading allegedly took place.") (citations
6 omitted).

7 To the extent that the CTAC contains more detailed allegations
8 with respect to the Class Period, such allegations are wholly
9 conclusory and insufficient under *Silicon Graphics*. For example,
10 Plaintiffs allege that as a member of the Finance Committee, Augustine
11 "reviewed the financial condition of the Company, and reviewed and
12 made recommendations regarding the Company's budget." (CTAC ¶ 116.)
13 Further, Plaintiffs allege that Augustine had more active involvement
14 with the Company than an ordinary director "due to his skill and
15 knowledge of Lockheed's ongoing business and the industry." (CTAC ¶
16 114.)

17 The allegations with respect to Marafino are pled with similar
18 lack of detail. It is alleged that as a member of the Finance
19 Committee, "Marafino received regular updates regarding the status of
20 the Company's major projects" and that due to his various roles within
21 the Company, "Marafino was well aware of the true states of affairs
22 regarding the Company's C-130J deliveries, the F-16 contract
23 negotiations with the UAE and third and fourth quarter 1998 financial
24 results." (CTAC ¶ 118.)

25 The pleadings in the CTAC with respect to Augustine and Marafino
26 clearly do not meet *Silicon Graphic's* mandate that Plaintiffs "state
27 with particularity facts giving rise to a strong inference of the
28 required state of mind, i.e., at least deliberate recklessness."

1 | *Silicon Graphics*, 183 F.3d at 985. Plaintiffs here have done no more
2 | than to "set forth a belief that certain unspecified sources will
3 | reveal, after appropriate discovery, facts that will validate [their]
4 | claim." *Id.* Contrary to *Silicon Graphics's* mandate that the
5 | Plaintiffs provide, for example, "sources of [their] information, with
6 | respect to the reports, how [they] learned of the reports, who drafted
7 | them, or which officers received them," *id.*, no source, anonymous or
8 | named, is cited in the CTAC to support either the existence or
9 | substance of these "regular updates." Moreover, Plaintiffs have
10 | apparently found no one willing to corroborate their allegations of
11 | extensive day-to-day involvement by Augustine and Marafino. Such
12 | "unsubstantiated internal reports alone are insufficient to
13 | demonstrate such recklessness." *Id.*; *Vantive*, 283 F.3d at 1087-88; *In*
14 | *re Guess?, Inc. Secs. Litig.*, 174 F. Supp. 2d 1067, 1076 (C.D. Cal.
15 | 2001) ("The Court is provided no information as to who drafted these
16 | reports, what date the key reports or statements were made, what
17 | specifically the reports contained, or any other corroborating
18 | details. This is insufficient pleading.") (citations omitted). To
19 | hold otherwise would be to vitiate the core requirements of the PSLRA.

20 | *America West* does not mandate a different result. To the
21 | contrary, the *America West* court affirmed the principle that
22 | allegations with regard to "internal reports" must be accompanied by
23 | some "indicia of reliability." *America West*, No. 01-16725 at 2109
24 | n.20. The plaintiffs in *America West* went further than Plaintiffs
25 | here by identifying the person who directed the preparation of the
26 | reports. Even then, the court nevertheless found that that was not
27 | enough. Although the court noted that "requiring a plaintiff to
28 | provide specifics from the reports prior to discovery seems a bit

1 unfair," the Court was nevertheless bound by precedent and therefore
2 gave "the internal reports little or no weight" in its analysis.
3 *America West*, No. 01-16725 at 2109-10 n.20. In stark contrast,
4 Plaintiffs here provide far less than the *America West* plaintiffs.
5 The Court thus sees no alternative other than to apply the same
6 "unfair" stringent standard here.⁶ See *id.*

7 8 **E. Remaining Individual Defendants**

9 In the July 2002 Order, the Court ruled that the Individual
10 Defendants Augustine, Marafino, Corcoran, and Blackwell could not be
11 held liable since only Coffman and Bennett were alleged to have made
12 any of the statements at issue. In so doing, the Court found that the
13 group-published information doctrine did not survive the enactment of
14 the PSLRA. See July 2002 Order at 12. The CTAC alleges no new
15 information to suggest that Augustine, Marafino, Corcoran, and
16 Blackwell were directly involved in the preparation of the allegedly
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19 ⁶ The Court notes that neither party addresses another
20 relevant distinction between *America West* and the case at hand.
21 In *America West*, the "bad news" would have come from a source
22 outside of the company - the Federal Aviation Administration
23 ("FAA"). In its communications with the defendant company, it is
24 most likely that the FAA communicated directly with senior
management and/or the board. Additionally, while the FAA fine
might have been ultimately appealable, the FAA communications
would have left no dispute as to the amount of the initial
assessment.

25 By contrast, much of the bad news here would have originally
26 been discovered on the production floor and would have had to
27 percolate up to management. Moreover, the workers in the
28 production floor might not have access to the range of
information necessary for accurate situation analysis. Such
incomplete information might thus have led the production workers
to 1) not report such perceived problems up the ladder or 2) to
report those problems, and be reasonably ignored or overruled.

1 misleading statements and these defendants should thus be dismissed
2 with prejudice.

3 With respect to Bennett and Coffman, the Court has previously
4 dismissed all allegations except for those relating to reports
5 prepared by analysts Cal Von Rumohr and Howard Rubel. These two
6 remaining allegations have already been foregone by the Plaintiffs and
7 thus warrant no further consideration. See July 2002 Order at 25
8 ("Plaintiffs do not allege in the Second Consolidated Amended
9 Complaint that Defendants are liable for the reports of Von Rumohr and
10 Rubel, or that such reports were false or misleading in any way. The
11 new complaint appears to reference the reports only in the context of
12 providing factual background for other allegations.").

13 Thus, none of the Individual Defendants can be held liable for
14 statements by or to analysts.

16 **F. Overall Analysis**

17 Having found the individual allegations insufficient to satisfy
18 the heightened pleading requirements, the Court also finds that the
19 allegations taken as a whole are insufficient. At first glance, this
20 case appears complicated. There are multiple defendants, different
21 levels of selling by shareholders, and two different sets of
22 statements alleged to be false or misleading. At the core, however,
23 Plaintiffs' case must be based on the foundation that there existed
24 information or reasons for the Defendants to believe that the F-16 and
25 C-130J statements were false or misleading when made. Plaintiffs have
26 failed the task of pleading such knowledge and, not surprisingly, the
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1 pleadings as a whole fail to present even a facade of the conscious
2 wrongdoing required to survive the Motion to Dismiss.⁷

4 IV. Conclusion

5 Plaintiffs for the third time have failed to satisfy the PSLRA's
6 pleading requirements. Plaintiffs' entire case rests on the fact that
7 the statements with respect to the C-130J and F-16 programs were known
8 to be false or misleading when they were made. While Plaintiffs'
9 allegations might have sufficed to give the Court a basis to infer
10 that some wrongdoing occurred, the PSLRA requires much more. It
11 requires the Court to examine all reasonable inferences, both
12 favorable and unfavorable to the Plaintiffs' case. Applying that
13 standard, it seems obvious that the facts pled here do not lead only
14 to the inference that the Defendants knew the statements regarding the
15 C-130J and F-16 were false when they made them; rather, examining both
16 the individual allegations and the allegations as a whole, it appears
17 that the Defendants made some forecasts in 1998 which, while
18 aggressive, were nevertheless grounded in some realistic expectations.

19 Not all the expectations were borne out, and both Lockheed and
20 its numerous investors suffered as a result. Congress, however, has
21 made a determination that the losses suffered must be attributable to
22 facts and circumstances alleged in accordance with the requirements of
23 the PSLRA. The allegations here do not satisfy that standard.

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25
26 ⁷ The dismissal of the Section 10 claims renders moot the
27 Section 20(a) claims, since the latter requires that Plaintiffs
28 establish a strong inference of a primary violation of the
securities laws. See *Howard v. Everex Systems, Inc.*, 228 F.3d
1057, 1065 (9th Cir. 2000).

1 For the reasons stated, Plaintiffs' suit is hereby DISMISSED.
2 Because the Court believes that no further amendments could cure the
3 defects fatal to the first three complaints, the dismissal shall be
4 WITH PREJUDICE. See *Lipton*, 284 F.3d at 1038-39. The Motion to
5 Strike and the Request for Judicial Notice are each DENIED.

6 IT IS SO ORDERED.

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10 DATED: March 24, 2003


Honorable Mariana R. Pfaelzer

United States District Judge