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THE PRIVATE SECURITIES FRAUD CLAIM: WHAT HAS DURA'S EFFECT BEEN ON THE STANDARD FOR LOSS CAUSATION AT SUMMARY JUDGMENT?

Elizabeth Skey*

INTRODUCTION

When Congress passed the Securities Act it "did not take away from the citizen 'his inalienable right to make a fool of himself.' It simply attempted to prevent others from making a fool of him." To this end, securities laws provided investors with protections by broadly prohibiting fraudulent activity in connection with the registration, sale, or purchase of a security. Regulators found that state "blue sky" laws enacted in the early twentieth century inadequately protected investors from promoters selling stock because state regulators had done little to counter the manipulation of stock prices or other deceptive practices leading up to the Stock Market Crash of 1929. To counter the rampant market abuses that led up to the 1929 Crash, the Securities Act of 1934 was developed to promote the disclosure of information, and to prevent fraud. The Securities Exchange Act of 1934 (Act), and the Securities and Exchange Commission (SEC), are charged with the protecting investors,

* Santa Clara School of Law, J.D. 2009; University of San Diego, B.A. 2003. Many thanks to the Law Review editors for their comments and critique. Thanks to Jim Maroulis, Esq. for his help in transforming this from an idea into a comment. A final thank you to my husband Michael and my family for their love, encouragement and support.

2. DONNA M. NAGY ET AL., SECURITIES LITIGATION AND ENFORCEMENT 3 (2d ed. 2007).
3. Id. at 2.
4. Id. at 3.
maintaining fair, orderly, and efficient markets, and facilitating capital formation.\(^5\) The Act and Commission govern private actions for damages in shareholder class action lawsuits.\(^6\)

One SEC regulation in particular, known as Rule 10b-5, is particularly notable because it creates and regulates federal civil liability between private parties in transactions involving securities, which are otherwise exempt from federal securities regulation.\(^7\) Section 10(b) of the Securities Exchange Act forbids the "use or employ[ment of], in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance."\(^8\) In a private action for damages under this section, Rule 10b-5 provides that the necessary elements include: (1) a material misrepresentation or omission, (2) scienter,\(^9\) (3) a connection with the purchase or sale of a security, (4) reliance, (5) economic loss, and (6) loss causation.\(^10\) Thus, it is unlawful to make materially false statements, or omit material facts, creating misleading statements in connection with the purchase or sale of any security.\(^11\) The statute requires plaintiffs to bear "the burden of proving" that the defendant's fraudulent misrepresentations "caused the loss for which the plaintiff seeks to recover."\(^12\) Thus Congress intended, under the statute, to permit private securities fraud actions only when plaintiffs adequately allege and prove the elements of loss causation.\(^13\) However, because of the unresolved nature of loss causation, the requirement has recently become an area of significant litigation.

Loss, in the securities fraud context, is the presumption that the stock market operates on the "efficient market theory."\(^14\) Efficient markets have multiple participants that

\(^7\) See 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5.
\(^8\) 15 U.S.C. § 78j(b).
\(^9\) Scienter is defined as, "A mental state consisting in an intent to deceive, manipulate, or defraud." BLACK'S LAW DICTIONARY (8th ed. 2004).
\(^11\) 17 C.F.R. § 240.10b-5(b).
\(^13\) Dura, 544 U.S. at 346.
\(^14\) Madge S. Thorsen et al., Rediscovering the Economics of Loss Causation,
trade on a stock price in reasonable reliance that the price reflects all public information.\textsuperscript{15} Theoretically, the market reacts to all available information to assess the present value of future cash flows of the corporation or firm that in turn, set the stock price.\textsuperscript{16} Fraud infuses false information—material to the effect on the stock—into the substantive information underlying the stock price.\textsuperscript{17} The overall stock price becomes artificially inflated or deflated through the valuation of both the underlying and fraudulent information.\textsuperscript{18} Thus the loss, in a securities fraud case, is the decrease in stock value attributable to the “corrective disclosure” admitting the prior fraud.\textsuperscript{19}

Prior to the Supreme Court’s decision in \textit{Dura Pharmaceuticals, Inc., v. Broudo},\textsuperscript{20} there were two distinct approaches that circuit courts took to establish loss causation: the price inflation approach and the price decline approach.\textsuperscript{21} The price inflation approach focused on the time when the plaintiff purchased stock and required a showing that the purchase price was artificially inflated because of the defendant’s misstatements or omissions.\textsuperscript{22} The Eighth and Ninth Circuits followed this approach.\textsuperscript{23} The price decline approach required plaintiffs to plead that the stock price was fraudulently inflated at the time of purchase, and that due to that inflation the plaintiff lost some or all of the

\textsuperscript{6} J. BUS. & SEC. L. 93, 95 (2006).
\textsuperscript{15} Id.
\textsuperscript{16} Id.
\textsuperscript{17} Id. at 96.
\textsuperscript{18} Id.
\textsuperscript{19} Id. at 108 (quoting \textit{In re IPO Sec. Litig.}, 297 F. Supp. 2d 668, 673 (S.D.N.Y 2003)).
\textsuperscript{21} Paul J. Geller, \textit{Loss Causation in the Post-Dura World, in} \textit{SEcurities Litigation & Enforcement Institute 2006, at} 259, 263 (2006). The price inflation approach was followed by the Eighth and Ninth Circuits. \textit{Id.} This approach focuses on the moment the plaintiff purchased his security and requires a showing that the purchase price was artificially inflated due to the defendant’s misconduct. \textit{Id.} The plaintiff did not need to allege a subsequent price decline. \textit{Id.} The price decline approach was followed by the Second, Third, Seventh, and Eleventh Circuits. \textit{Id.} Plaintiff needed to show that the stock price was fraudulently inflated at the time of purchase, and also that plaintiff suffered a loss of his overpayment, usually by alleging a corrective price decline after revelation of the fraud. \textit{Id.}
\textsuperscript{22} Id.
\textsuperscript{23} Id.
overpayment.\textsuperscript{24} Proof of this was demonstrated by showing a corrective price decline after revelation of the fraud, and was utilized by the Second, Third, Seventh, and Eleventh Circuits.\textsuperscript{25}

The Supreme Court's decision in \textit{Dura Pharmaceuticals, Inc.} established a standard for loss causation at the pleadings stage.\textsuperscript{26} However, the standard at the summary judgment stage is not well defined.\textsuperscript{27} As a result, litigation proceeding beyond the pleadings stage is being left in limbo and the various circuits are interpreting the \textit{Dura} decision to establish different standards.\textsuperscript{28} The different standards are creating uncertainty for companies facing securities suits, as well as encouraging plaintiffs to forum shop for the most favorable standard.\textsuperscript{29}

This comment will look at the recent evolvement of the standard for loss causation in the securities litigation. Part I of this comment examines the pre-\textit{Dura} standard for loss causation, the Supreme Court's interpretation of the standard with the \textit{Dura} decision, and the cases interpreting the standard in the wake of \textit{Dura}. Part II identifies the issues facing the Supreme Court with the varying post-\textit{Dura} standards. Part III analyzes the various circuit standards and identifies their strengths and weaknesses. Part IV recommends that the Supreme Court adopt a combination of the Seventh and Fifth Circuit's standards for loss causation at summary judgment.

\section{I. BACKGROUND}

\subsection{A. The State of the Law Prior to Dura}

Prior to \textit{Dura}, courts had difficulty determining a standard for loss causation because the various circuits followed various standards. Several circuits required a securities fraud plaintiff invoking the fraud-on-the-market theory to plead and prove a causal connection between the alleged fraud and the investment's subsequent decline in

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{24} \textit{Id.}
\item \textsuperscript{25} \textit{Id.}
\item \textsuperscript{26} \textit{Dura Pharm., Inc. v. Broudo}, 544 U.S. 336, 342 (2005).
\item \textsuperscript{27} \textit{See id.} at 347-48.
\item \textsuperscript{28} \textit{See infra Part I.B.}
\item \textsuperscript{29} \textit{See infra Part I.B.}
\end{itemize}
\end{footnotesize}
Meanwhile, other circuits merely required plaintiffs to allege that the price on the date of purchase was inflated due to the misrepresentation. The Dura Court rejected the latter approach when it held that the Ninth Circuit approach was inadequate.

Before the decision in Dura, the various circuits relied on the two competing standards, the price decline approach and the price inflation approach, to define the requirements for establishing loss causation at the summary judgment stage. The Supreme Court's decision in Dura has sparked debate as to whether the standard for loss causation at summary judgment needs to be evaluated in light of Dura. Before Dura was decided, however, courts in the Seventh and Ninth Circuits relied on two markedly different standards for loss causation, which are illustrated in the following subsections.

1. *The Seventh Circuit Approach*

Pre-Dura, plaintiffs in the Seventh Circuit relied on the price decline approach, which was the standard established in *Caremark, Inc. v. Coram Healthcare Corp.*, to anticipate the extent of loss causation that must be established at summary judgment. In *Caremark*, Corham negotiated with Caremark to buy its home infusion business. Caremark accepted the terms of the transaction based on Coram's representation that it would focus on the home infusion market. Without Caremark's knowledge, Coram was negotiating simultaneously to merge with Lincare, a provider of respiratory services. When the planned merger with Lincare was announced, Coram's stock value dropped along

30. Geller, supra note 21, at 263.
32. Dura, 544 U.S. at 343.
33. Geller, supra note 21, at 263.
36. Id. at 647.
37. Id.
38. Id.
with the value of Coram’s notes.\textsuperscript{39} Caremark stated that had it known of the merger negotiations, it would have revalued the notes on the date of closing.\textsuperscript{40} Caremark further claimed damages due to the difference in the note value as represented.\textsuperscript{41}

The court in \textit{Caremark} held that the requirement of loss causation for a 10b-5 claim required that plaintiffs allege that they were in fact injured by the misstatements or omissions of which they complained.\textsuperscript{42} Described as “nothing more than the standard common law fraud rule,” this definition of loss causation did not require the plaintiff to plead that all its loss was attributed to the misstatement or omission.\textsuperscript{43} This standard appeared to run counter to the requirement that securities fraud be plead with particularity.\textsuperscript{44} The price decline approach utilized by the Seventh Circuit was also followed by the Second, Third, Seventh, and Eleventh Circuits.\textsuperscript{45}

\textbf{2. The Ninth Circuit Approach}

In the Ninth Circuit, a plaintiff needed to prove both transactional causation\textsuperscript{46} and loss causation to establish a securities fraud claim.\textsuperscript{47} The violation required that the plaintiff engaged in the securities transaction, and that some misrepresentation or omission by the defendant caused the harm.\textsuperscript{48} Plaintiffs established their case by stating the alleged misrepresentation and inferring that the misrepresentation caused the harm.\textsuperscript{49} To establish a loss

\textsuperscript{39} \textit{Id.}
\textsuperscript{40} \textit{Id.}
\textsuperscript{41} \textit{Caremark}, Inc. v. Coram Healthcare Corp., 113 F.3d 645, 647 (7th Cir. 1997).
\textsuperscript{42} \textit{Id. at} 649.
\textsuperscript{43} \textit{Id. at} 649 (citation omitted).
\textsuperscript{44} \textit{See generally} FED. R. CIV. P. 9(b). Rule 9(b), which is the pleading standard in securities litigation, requires that certain facts be plead with particularity, thus requiring plaintiffs to detail specific information prior to conducting any formal discovery. \textit{Id.}
\textsuperscript{45} Geller, supra note 21, at 263.
\textsuperscript{46} Transactional causation, much like traditional causation, is demonstrated through a showing that the plaintiff would not have purchased the stock but for the fraud. Merritt B. Fox, \textit{After Dura}: \textit{Causation in Fraud-on-the-Market Actions}, 31 J. Corp. L. 829, 831 (2006).
\textsuperscript{47} \textit{See} McGonigle v. Combs, 968 F.2d 810, 819–21 (9th Cir. 1992).
\textsuperscript{48} \textit{Id.}
\textsuperscript{49} \textit{Id. at} 821.
causation defense at the summary judgment stage, defendants needed to prove, "as a matter of law, that the depreciation of the value of [a plaintiff's] stock resulted from factors other than the alleged false and misleading statements."\(^{50}\) Summary judgment was proper only if defendants demonstrated that no rational jury could find that the market was misled.\(^{51}\) This standard was extremely generous to plaintiffs, and contravened Congressional intent to permit private securities fraud actions for recovery when plaintiffs adequately allege and prove the traditional elements of causation and loss.\(^{52}\) Securities regulations were not intended to provide investors with broad insurance against market losses, but were meant instead to protect individuals against those economic losses that misrepresentations actually cause.\(^{53}\)

In Provenz v. Miller, the Ninth Circuit relied upon the decision in McGonigle v. Combs\(^{54}\) to hold that, once plaintiffs established loss causation by simply alleging that the false and misleading statements touch upon the reasons for the investment's decline in value, the defendants bore a heavy burden to dispute the allegations.\(^{55}\) In McGonigle v. Combs, investors in a private placement sued the co-owners of Spendthrift, as well as its consultants, attorneys, investment bank, accounting firm and commercial bank, alleging fraudulent and negligent misrepresentation and violation of Washington's and Kentucky's Blue Sky laws.\(^{56}\) The court held that the plaintiffs failed to satisfy the loss causation requirement because they did not show that the existence of the allegedly omitted facts reduced the proper valuation of their investment.\(^{57}\) The court determined there was not enough of a causal connection between the material

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50. Provenz v. Miller, 102 F.3d 1478, 1492 (9th Cir. 1996).
51. Id.
53. Id. at 345.
54. McGonigle v. Combs, 968 F.2d 810 (9th Cir. 1992).
55. Provenz, 102 F.3d at 1492.
56. McGonigle, 968 F.2d at 815–16. State Blue Sky laws are laws which attempt to curtail “speculative schemes which have no more basis than so many feet of ‘blue sky,’” they aim “to stop the sale of stock in fly-by-night concerns, visionary oil wells, distant gold mines and other like fraudulent exploitations.” Hall v. Geiger-Jones Co., 242 U.S. 539, 550 (1917) (citations omitted).
57. McGonigle, 968 F.2d at 820.
misrepresentation and the loss. One major distinction between Provenz and McGonigle is that the burden previously placed on the plaintiff in McGonigle, was shifted to the defendant in Provenz.

The Provenz plaintiffs alleged that the value of their stock was artificially inflated because the defendants recognized revenue before it was earned and failed to disclose to the market information about their products and forecasts. The court held that the defendants had not provided enough evidence to establish that they were entitled to a loss causation defense. The court further held that plaintiffs could establish loss causation by simply alleging that the false and misleading statements touch upon the reasons for the investment’s decline in value, placing a heavy burden on defendants to dispute those allegations. The court determined that the defendants bore the heavy burden of proof, and that they needed to prove that the depreciation in the stock’s value resulted from other factors, and not from the alleged false and misleading statements. The Provenz decision left the Ninth Circuit with the lowest burden on plaintiffs pleading loss causation, and highest standard for defendants to overcome to succeed in dismissing the action at summary judgment. This ran counter to Congress’ intent in eliminating the ability for strike suits to proceed, and created a ripe issue for Supreme Court review.

Three years after Provenz, the Ninth Circuit relaxed its standard even further with its decision in Binder v.
Gillespie.\textsuperscript{67} In Binder, the Ninth Circuit followed the price inflation approach when it held that the loss causation requirement was satisfied when the plaintiff showed that the misrepresentation "touches upon the reasons for the investment's decline in value."\textsuperscript{68} The standard relied on the idea that the plaintiff needed to show that the fraud caused, or at least had something to do with, the decline in the investment's value after the securities transaction.\textsuperscript{69} This standard was even more relaxed than the previous Ninth Circuit standard, which required plaintiffs to show that allegedly admitted facts reduced the proper valuation of an investment.\textsuperscript{70}

B. The Decision in Dura and Its Impact

The various standards the courts were using led to the inability for plaintiffs and defendants to anticipate the outcome of proceedings in various circuits.\textsuperscript{71} The result of the split was a variation in the federal securities laws between circuits, which led to the Supreme Court's decision.\textsuperscript{72} The Supreme Court explained its decision in Dura with the understanding that the statute requires plaintiffs to bear "the burden of proving" that the defendant's misrepresentations "caused the loss for which the plaintiff seeks to recover."\textsuperscript{73} Thus, under the statute, the Supreme Court held that Congress intended to permit private securities fraud actions only when plaintiffs adequately allege and prove the elements of loss causation.

In Dura, plaintiffs filed a securities fraud class action, alleging that Dura Pharmaceuticals, Inc. and some of its managers and directors made misrepresentations about FDA approval of a new asthmatic spray device.\textsuperscript{74} However, the complaint failed to adequately establish a causal connection between the spray device misrepresentation and the economic loss.\textsuperscript{75} Consequently, the Supreme Court ruled that an

\begin{itemize}
  \item[67.] Binder v. Gillespie, 184 F.3d 1059 (9th Cir. 1999).
  \item[68.] \textit{Id.} at 1066 (citation omitted).
  \item[69.] \textit{Id.}
  \item[70.] \textit{Id.}
  \item[71.] \textit{Id.}
  \item[72.] \textit{Id.}
  \item[73.] \textit{Id.} at 345-46.
  \item[74.] \textit{Id.} at 339.
  \item[75.] \textit{Id.} at 340.
\end{itemize}
investor claiming securities fraud under the Securities Exchange Act could not satisfy the requirement of proving that the fraud caused an economic loss simply by alleging that the price of the security on the date of purchase was inflated because of a misrepresentation.  

While *Dura* was a pleadings case, the Court also discussed the loss causation proof requirement. The Court discussed in dicta that:

> When the purchaser subsequently resells... shares, even at a lower price, that lower price may reflect, not the earlier misrepresentation, but changed economic circumstances, changed investor expectations, new industry-specific or firm-specific facts, conditions, or other events, which taken separately or together account for some or all of that price. ... Other things being equal, the longer the time between purchase and sale, the more likely that this is so, i.e., the more likely... other factors caused the loss.

The Court made the distinction that touching upon a loss does not equal causing a loss, effectively overruling the Ninth Circuit's standard. The *Dura* decision recognized that when a purchaser resells shares, even at a lower price, that lower price could reflect a number of things including changed economic circumstances, changed investor expectations, new industry-specific or firm-specific facts, conditions, or events other than the misrepresentation and later disclosure.

The Supreme Court's decision in *Dura* held that several proof requirements must be satisfied to maintain a private securities fraud claim. First, the "relevant truth" must have started to "leak out" before a shareholder can claim recovery for losses. Second, a plaintiff must prove that the defendant's misrepresentation or omission proximately caused the plaintiff's loss. Third, inflation caused by the

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76. *Id.* at 342.
78. *Id.* at 342–43.
79. *See id.* at 343.
81. *See Dura*, 544 U.S. at 342.
82. *Id.*
83. *Id.* at 346.
alleged fraud can be dissipated in many ways (i.e., not only through specific disclosure), thus plaintiffs must show that there was a subsequent decline in price after the specific fraud was disclosed.\textsuperscript{84}

Since the decision in \textit{Dura}, many circuits (the Ninth Circuit in particular) have established new "loss causation" standards using \textit{Dura} as their guideline. The Ninth Circuit had been utilizing the standard promulgated by \textit{Provenz} and \textit{McGonigle} until the Supreme Court issued the \textit{Dura} ruling.\textsuperscript{85} Because the holding in \textit{Dura} establishes a higher standard for loss causation at the pleading stage, it logically follows that, in future decisions, there will be a similar, if not more stringent, standard needed at summary judgment. The cases that immediately followed \textit{Dura} clarified those standards to some extent.

**C. The Circuit Cases Interpreting \textit{Dura} With Various Outcomes**

1. \textit{The Seventh Circuit's Formulaic Approach to Loss Causation}

Some courts have interpreted \textit{Dura} liberally, applying it beyond the pleadings stage.\textsuperscript{86} The approach taken by the Seventh Circuit,\textsuperscript{87} is that loss causation may be proved by demonstrating that a loss was proximately caused by disclosure of the fraud, and that the specific cause of the loss must be demonstrated in detail.\textsuperscript{88} In \textit{Tricontinental Industries, Ltd. v. PricewaterhouseCoopers, LLP}, the plaintiff corporation and stock owner sued the corporation that acquired it, claiming negligent misrepresentation, common-law fraud and securities fraud.\textsuperscript{89} Tricontinental alleged

\textsuperscript{84} \textit{Id.} at 342.

\textsuperscript{85} \textit{Id.} at 336; see also \textbf{LEWIS D. LOWENFELS \\ ALAN R BROMBERG, BROMBERG AND LOWENFELS ON SECURITIES FRAUD AND COMMODITIES FRAUD} § 7:515 (2d ed. 2008).

\textsuperscript{86} \textit{See, e.g., Tricontinental Indus., Ltd. v. PricewaterhouseCoopers, LLP, 475 F.3d 824, 844 (7th Cir. 2007); McCabe v. Ernst & Young, LLP, 494 F.3d 418 (3d Cir. 2007); In re Gilead Scis. Sec. Litig., 536 F.3d 1049 (9th Cir. 2008).}

\textsuperscript{87} \textit{See generally Tricontinental Indus., Ltd. v. PricewaterhouseCoopers, LLP, 475 F.3d 824, 844 (7th Cir. 2007); Ray v. Citigroup Global Mkts., Inc., 482 F.3d 991, 994–95 (7th Cir. 2007); In re Motorola Sec. Litig., 505 F. Supp. 2d 501, 536 (N.D. Ill. 2007).}

\textsuperscript{88} \textit{See Tricontinental, 475 F.3d at 844; Ray, 482 F.3d at 994–95.}

\textsuperscript{89} \textit{Tricontinental, 475 F.3d at 827.}
PricewaterhouseCoopers, LLP (PwC) had negligently misrepresented statements about the financial worth of its client, Anicom, Inc. (Anicom) during Anicom’s acquisition of Tricontinental’s assets. Tricontinental merely alleged that Anicom’s 1998 and 1999 financial statements exposed it to misrepresentations and caused its losses. Tricontinental stated in its complaint that Anicom’s disclosure in 2000 that it was in the process of investigating its 1998 and 1999 financial statements for irregularities, suggested problems with the 1997 statement. The defendants moved to dismiss the complaint on the grounds that the plaintiffs had not adequately pleaded loss causation. The district court agreed, found in favor of defendants, and dismissed the complaint.

The Seventh Circuit affirmed the district court’s holding, stating that the plaintiffs failed to plead the circumstances in sufficient detail to satisfy loss causation. The court felt Tricontinental needed to allege that the 1997 audit contained a material misrepresentation, causing a loss to Tricontinental when the misrepresentation became “generally known.” The “statement” pointed out by Tricontinental did not indicate any problems or irregularities in the 1997 audited financial statements, and therefore was insufficient to state a claim for securities fraud. Thus, the Seventh Circuit held that the district court did not err when it dismissed Tricontinental’s 10b-5 claim.

In another decision following the Seventh Circuit, In re Motorola Securities Litigation, the court examined the post-Dura standard for loss causation. In Motorola, plaintiffs alleged that the company made materially false and misleading statements and omitted material facts behind the financing of a deal with Telsim, a Turkish

90. Id.
91. Id. at 844.
92. Id. at 843.
93. Id. at 831.
94. Id. at 832.
95. Tricontinental Indus., Ltd. v. PricewaterhouseCoopers, LLP, 475 F.3d 824, 844 (7th Cir. 2007).
96. Id. at 843.
97. Id. at 843–44.
98. Id. at 844.
99. Id. at 535–39.
telecommunications corporation. The Motorola court then went on to analyze the corrective disclosures alleged by plaintiffs. Several disclosures did raise factual issues as to whether the disclosures established loss causation and were therefore improper for summary judgment. However, the Motorola court analyzed the causal connection between $1.7 billion in undisclosed financing of Telsim by Motorola, and a subsequent drop in stock price following the disclosure that there would be shortfall in sales revenue and earnings attributed to general economic downturn and inventory correction. The court held that this particular disclosure did not meet the standard for loss causation at summary judgment and dismissed the disclosure from the action.

In Ray v. Citigroup Global Markets, Inc., another decision illustrating the Seventh Circuit's interpretation of Dura, investors in a wireless data services corporation brought a securities fraud claim against Citigroup Global Markets, the Citigroup parent-corporation, and John Spatz, an investment advisor employed by Citigroup. The plaintiffs included more than one hundred retail investors who purchased millions of dollars worth of SmartServ Online, Inc. (SSOL) stock. The plaintiffs asserted in their complaint that the defendants fraudulently induced the plaintiffs to purchase SSOL stock by making misrepresentations, though defendants knew of SSOL's contract problems and knew it was a risky investment. Had plaintiffs been told the truth, they claimed, they would have sold the acquired shares and would have refrained from purchasing more. The plaintiffs claimed that Spatz's and Citigroup's misrepresentation were the cause for SSOL's share price decline, because SSOL never had the contracts, revenues or funding as Spatz claimed. Plaintiffs asserted that this information demonstrated the loss in SSOL's share value was proximately caused by the

101. See id. at 513.
102. Id. at 561.
103. Id. at 547.
104. Id.
105. Ray v. Citigroup Global Mkts., Inc., 482 F.3d 991, 992 (7th Cir. 2007).
106. Id.
107. Id. at 993.
108. Id.
109. Id. at 994.
alleged misrepresentations. The Seventh Circuit disagreed, holding that plaintiffs did not introduce enough evidence to substantiate the loss causation element. However, other courts, such as the Ninth Circuit, have followed Dura more conservatively.

2. The Ninth Circuit's Alternative Interpretation of Dura As Applied to Summary Judgment

The Ninth Circuit, with the standard established by In re Daou Systems, Inc., and In re Gilead Securities Litigation, took an alternative interpretation of Dura. In these cases, the courts held that a plaintiff does not need to show the misrepresentation or omission is the only reason for the price drop, but it must be a "substantial" cause.

In In re Daou Systems, Inc., plaintiffs claimed Daou Systems, Inc. (Daou) fraudulently inflated the prices of its stock by reporting revenues before they were earned. The pleadings included the progress account, the approximate amount by which earnings and revenues were overstated, the dates of some of the related transactions and the identities of the customers and companies involved in the transactions. The Ninth Circuit permitted the claims to proceed, reiterated the decision in Dura, and added that a plaintiff "is not required to show 'that a misrepresentation was the sole reason for the investment's decline in value . . . . As long as the misrepresentation is one substantial cause of the investment's decline in value, other contributing forces will not bar recovery under the loss causation requirement . . . .'

More recently, the Ninth Circuit evaluated loss causation at the pleading stage with its decision in In re Gilead Sciences

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110. Id. at 994–95.
111. Ray v. Citigroup Global Mkts., Inc., 482 F.3d 991, 996–97 (7th Cir. 2007).
112. In re Daou Sys., Inc., 411 F.3d 1006 (9th Cir. 2005).
114. Id. at 994, 1025.
115. Daou, 411 F.3d at 1012.
116. Id. at 1018–19.
117. Id. (quoting Robbins v. Koger Props., Inc., 116 F.3d 1441, 1447 n.5 (11th Cir. 1997)) (citations omitted).
Securities Litigation. In Gilead, plaintiffs filed suit against a biopharmaceutical company specializing in the development and marketing of treatments for life-threatening diseases, including an antiretroviral agent used to treat HIV. Plaintiffs alleged that Gilead and its officers fraudulently promoted and marketed the drug with off-label, false and misleading statements in violation of FDA regulations. Plaintiffs pointed to statements made through company press releases that attributed that gains were due to an increase in prescriptions, when in reality the increase was due to wholesaler stockpiling and were thus one time increases. The company also failed to disclose a warning letter it received from the FDA regarding the off-label marketing that plaintiffs believed led to the wholesaler stockpiling.

In the complaint, the plaintiffs claimed there was a causal relationship between the increases in sales resulting from the off-label marketing, the FDA letter's effect on subsequent drug orders as well as the letter's effect on the overall stock price. The Gilead plaintiffs specifically pointed to a press release disclosing the failure to report the wholesale stockpiling on October 28, 2003, and a subsequent decline in stock price on the following day, October 29, 2003. The Ninth Circuit held that the facts, if taken as true, plausibly established loss causation and permitted the claim to go forward. The court held that so long as plaintiffs establish plausible loss causation by demonstrating facts that would raise a reasonable expectation that discovery would reveal evidence of loss causation, dismissal at the pleadings stage would be inappropriate. Still, some circuits have gone even further in their interpretation of Dura, as demonstrated by the Fifth Circuit.

118. In re Gilead Scis. Sec. Litig., 536 F.3d 1049, 1056–57 (9th Cir. 2008).
119. Id. at 1050–51.
120. Id. at 1051.
121. Id. at 1052.
122. Id. at 1052–53.
123. Id. at 1057.
124. In re Gilead Scis. Sec. Litig., 536 F.3d 1049, 1056 (9th Cir. 2008).
125. Id. at 1057.
126. Id. at 1058.
3. The Fifth Circuit’s Recent Decisions Addressing Loss Causation

The Fifth Circuit established the highest standard to date, with its holdings in Ryan v. Flowserve Corp., \(^{127}\) Huddleston v. Herman & MacLean, \(^{128}\) and Oscar Private Equity Investments v. Allegiance Telecom, Inc. \(^{129}\) In Ryan v. Flowserve Corp., plaintiffs asserted that Flowserve, a manufacturer of pumps, seals, and valves went on a massive acquisition binge and as a result, were in need of equity infusion, in violation of the company’s debt covenants. \(^{130}\) Plaintiffs then asserted that various defendants issued “overly optimistic predictions... to conceal the fraud.” \(^{131}\) The defendants moved for summary judgment on the grounds that plaintiffs had failed to satisfy the burden of loss causation. \(^{132}\) Defendants asserted that plaintiffs could not demonstrate the causal connection between the alleged misstatements and the corresponding losses caused by those misstatements. \(^{133}\)

In Oscar, defendant Allegiance was a national telecommunications provider that sold local and long distance telephone services, broadband access, web-hosting and telecom equipment. \(^{134}\) Plaintiffs alleged that several of Allegiance’s executives fraudulently misrepresented Allegiance’s line-installation count in three quarter announcements. \(^{135}\) When plaintiffs moved for class certification, the Fifth Circuit took an interlocutory appeal to establish whether certification was proper. \(^{136}\) The Fifth Circuit determined that the court could not infer lost causation from just one of several negative announcements; rather, the circuit found that loss causation required empirical proof that the corrective disclosure was more than

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131. Id.
132. Id.
133. Id.
134. Oscar Private Equity Invs., 487 F.3d at 262.
135. Id. at 263.
136. Id. at 262.
just present.\textsuperscript{137} The Third Circuit further endorsed this approach with its decision in \textit{McCabe v. Ernst & Young, LLP}.\textsuperscript{138}

4. \textit{The Third Circuit's Holdings Addressing the Issue}

The Third Circuit has followed the Fifth Circuit's interpretation, with its decision in \textit{McCabe v. Ernst & Young, LLP}.\textsuperscript{139} In \textit{McCabe}, principals of Applied Tactical Systems (ATS) sued the auditors of Vertex, the company acquiring ATS, for securities fraud, common law fraud, and negligent misrepresentation.\textsuperscript{140} The plaintiffs claimed that there were merger-related stock registration defaults and threatened litigation associated with the information that had been omitted from the merger's financial statements and documentation.\textsuperscript{141} The defendants moved for, and were granted, summary judgment at the district court level.\textsuperscript{142} The district court held that the plaintiffs suffered no damages resulting from the alleged fraud, thus summary judgment was appropriate as there was no loss causation; plaintiffs appealed.\textsuperscript{143} The Third Circuit exercised \textit{de novo} review\textsuperscript{144} to evaluate the expert testimony presented by both parties as to whether the alleged omissions in fact caused the plaintiff's economic loss.\textsuperscript{145} The \textit{McCabe} court found that the district court had not erred in finding in favor of the defendants on summary judgment.\textsuperscript{146}

5. \textit{The Second Circuit's Evaluation of the Post-Dura Cases}

The Second Circuit also rendered a standard for loss causation at summary judgment. The circuit court as well as district court decisions have established clear guidelines on

\begin{itemize}
\item \textsuperscript{137} \textit{Id.} at 271.
\item \textsuperscript{138} \textit{McCabe v. Ernst & Young, LLP}, 494 F.3d 418, 420 (3d Cir. 2007).
\item \textsuperscript{139} \textit{Id.} at 428–29.
\item \textsuperscript{140} \textit{Id.} at 422.
\item \textsuperscript{141} \textit{Id.} at 421.
\item \textsuperscript{142} \textit{Id.} at 423.
\item \textsuperscript{143} \textit{Id.}
\item \textsuperscript{144} \textit{De novo} is the proper standard of review for summary judgment appeals. \textit{See, e.g., Slagle v. County of Clarion}, 435 F.3d 262, 263 (3d Cir. 2006).
\item \textsuperscript{145} \textit{McCabe v. Ernst & Young, LLP}, 494 F.3d 418, 434–38 (3d Cir. 2007).
\item \textsuperscript{146} \textit{Id.} at 438–39.
\end{itemize}
loss causation. In Lentell, the plaintiffs alleged that Merrill Lynch issued false and misleading reports, recommending that investors purchase shares of 24/7 Real Media, Inc., and Interliant, Inc. though analysts did not believe those companies were good investments. Plaintiffs further alleged that Merrill Lynch’s analysts issued the falsely optimistic recommendations to cultivate the Firm’s investment-banking business. The Second Circuit states that fraud is the proximate cause of an investment loss if the risk that caused the loss was within the potential risks concealed by those misstatements or omissions.

The Southern District of New York was one of the first courts to examine loss causation at summary judgment. The recent Internet Law Library, Inc. v. Southridge Capital Management, LLC decision was guided by the previous Lentell standard. In January of 2001, the CEO and several shareholders of the Internet Law Library (INL) filed suit against Southridge Capital Management, LLC (Southridge) claiming fraud, misrepresentation of material facts, and manipulation of INL’s stock arising from several financial transactions. Defendants counterclaimed, alleging that the plaintiffs failed to disclose the criminal records of two of INL’s executives. Here, the court evaluated granting summary judgment sua sponte to the INL counterclaim defendants if there was no showing of a genuine issue of material fact.

The INL court found insufficient evidence for a reasonable jury to conclude that the counterclaim defendants had, through their failures to disclose, caused the economic

148. Lentell, 396 F.3d at 165–66.
149. Id.
150. See id. at 172–75; see Initial Pub. Offering Sec. Litig., 399 F. Supp. 2d at 266.
152. Id. at *3.
153. Id. at *1 n.1.
154. Id. at *4.
155. Id. at *2 (citing SHL Imaging, Inc. v. Artisan House, Inc., 117 F. Supp. 2d 301, 305 (S.D.N.Y. 2000)).
156. Id.
loss.\textsuperscript{157} Thus, Southridge failed to provide sufficient evidence to prove that the concealment of the criminal convictions by INL in fact caused the loss, when the concealed information prevented the financial transaction from occurring.\textsuperscript{158}

The various standards throughout the different circuits demonstrate a need for clarification of the issue. Without a clear-cut resolution, plaintiffs are forum shop circuits with the most liberal standards, and companies are unsure of what to expect in securities suits. Clarification on the standard would provide guidance for companies and plaintiffs seeking to pursue and defend potential fraud.

II. IDENTIFICATION OF THE LEGAL PROBLEM

The plaintiff in a securities claim bears "the burden of proving that the act or omission of the defendant . . . caused the loss for which the plaintiff seeks to recover damages."\textsuperscript{159} However, few circuits are clear as to what the standard of proof requires at summary judgment. The effect of causational uncertainty in securities fraud cases is the increased potential for "strike suits."\textsuperscript{160} "Strike suits" are inequitable claims with a low probability of success, but they have the ability to compel a defendant to settle for large amounts of money in excess of the claim's actual value.\textsuperscript{161} Because of the severe stigma attached to the defendants charged with a securities fraud violation, there are strong incentives to settle strike suits, giving further improper incentives for plaintiffs to bring those so-called strike suits.\textsuperscript{162} To avoid these situations, the standard for loss causation must be clearly defined, so that plaintiffs and defendants can rely on those standards to limit the potential for strike suits.

\textsuperscript{157} Internet Law Library, Inc. v. Southridge Capital Mgmt., LLC, No. 01-CV-6600, 2007 WL 1222583 at *4 (S.D.N.Y. Apr. 25, 2005). The court looked at the fact that the criminal convictions were more than five years old at the time of the financial transactions. \textit{Id.}

\textsuperscript{158} \textit{Id.} at *4.


\textsuperscript{161} See \textit{id.} at 864--65; \textit{see also} Surovitz v. Hilton Hotels Corp., 383 U.S. 363, 371 (1966) (discussing the filing of strike suits as methods of coercion).

\textsuperscript{162} Feinstein, \textit{supra} note 160, at 865.
Prior to *Dura*, there were two separate approaches that circuit courts took to establish loss causation: the price inflation approach and the price decline approach.\(^{163}\) The price inflation approach focused on the point at which the plaintiff purchased stock and required a showing that the purchase price was artificially inflated because of the defendant's misstatements or omissions.\(^{164}\) This approach was followed by the Eighth and Ninth Circuits.\(^{165}\) The second standard, the price decline approach, required plaintiffs to show the stock price was fraudulently inflated at the time of purchase, and that due to the inflation, the plaintiff lost some or all of the overpayment.\(^{166}\) The allegation was generally substantiated through showing a corrective price decline after revelation of the fraud, and this approach was followed by the Second, Third, Seventh, and Eleventh Circuits.\(^{167}\)

*Dura* evaluated the proof needed at the pleadings stage, but did not establish a clear guideline for lower courts to follow at the summary judgment stage.\(^{168}\) *Dura* did not articulate what specifically constituted a revelation of the alleged fraud.\(^{169}\) Also, the decision rejected the Ninth Circuit's price inflation approach, but did not adopt its own approach, or advocate another circuit's standard.\(^{170}\) The Court rejected the defendant's request for a rigid rule that loss causation could be established by specified corrective disclosures\(^{171}\) of the relevant truth connected to an economic

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\(^{163}\) Geller, *supra* note 21, at 263. The price inflation approach was followed by the Eighth and Ninth Circuits. *Id.* "This approach focuses on the moment the plaintiff purchased his security and requires a showing that the purchase price was artificially inflated due to the defendant's misconduct. The plaintiff does not need to allege a subsequent price decline." *Id.* The price decline approach was followed by the Second, Third, Seventh, and Eleventh Circuits. *Id.* Plaintiffs needed to "show that the stock price was fraudulently inflated at the time of purchase, and also that he lost some or all of his overpayment, usually by alleging a corrective price decline after revelation of the fraud." *Id.*

\(^{164}\) *Id.*

\(^{165}\) *Id.*

\(^{166}\) *Id.*

\(^{167}\) *Id.*

\(^{168}\) Madge S. Thorsen et al., *supra* note 14, at 123.


\(^{170}\) See *id.* at 342–46.

\(^{171}\) A corrective disclosure occurs when a disclosure is in fact misleading when made, and the speaker learns of this and corrects the statement. *Backman v. Polaroid Corp.*, 910 F.2d 10, 16–17 (1st Cir. 1990). Companies are under a duty to make corrective disclosures once the original statement is found to be misleading. *Id.*
loss prior to recovery. In addition, in the cases following *Dura*, no circuit courts or district courts have adopted a rigid definition of the type of corrective disclosures necessary to prove loss causation. Because the Supreme Court refused to accept the Ninth Circuit's liberal standards, but failed to establish specific guidelines, many circuits are now reaching the issue, and are interpreting *Dura* to establish varied standards of the proof necessary for loss causation at summary judgment. The various standards create inconsistency throughout the circuits and leave parties guessing as to how to properly plead or defend securities fraud claims. Thus it is important to create a uniform standard of loss causation at summary judgment to avoid that uncertainty. This comment will evaluate the separate standards, and make recommendations for courts to follow based on the analysis.

III. ANALYSIS

As previously stated, a private action for damages under the Securities Exchange Act section 10(b) and Rule 10b-5, includes the following elements: (1) a material misrepresentation or omission, (2) scienter, (3) a connection with the purchase or sale of a security, (4) reliance, (5) economic loss, and (6) loss causation. The statute insists that securities fraud complaints:

[1] specify each statement alleged to have been misleading, [2] the reason or reasons why the statement is misleading, . . . [3] state with particularity all facts on which that belief is formed . . . [and] [4] state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.

The statute states that plaintiffs bear "the burden of proving that . . . [the defendant's misrepresentations] caused the loss for which the plaintiff seeks to recover damages." Thus, under the statute, Congress intended to permit private

173. Geller, supra note 21, at 264.
174. *See infra* Part III.
175. *Dura*, 544 U.S. at 342.
177. § 78u-4(b)(4).
securities fraud actions only when plaintiffs adequately allege and prove the elements of loss causation.

Pursuant to Rule 56(c) of the Federal Rules of Civil Procedure, courts may grant summary judgment when the pleadings and record evidence "show that there is no genuine issue as to any material fact and the movant is entitled to judgment as a matter of law."178 The court must view all evidence in the light most favorable to the non-moving party, and all inferences must be drawn in the non-moving party's favor.179 Alternatively, the moving party can meet its burden by showing that its opponent failed to present sufficient evidence to establish an essential element of the case where the opponent bears the burden of proof.180

To survive a motion for summary judgment in securities fraud cases, plaintiffs must provide an event study,181 or similar analyses, to show whether any loss was caused by the defendant's conduct as opposed to other market factors.182 They must do more than show the alleged fraud touched upon the stock price; plaintiffs must show that their loss directly relates to the alleged fraud.183 Plaintiffs bear the burden of establishing every element of a securities claim, a heavy burden in a summary judgment motion.184 Alternatively, a defendant need only establish that a plaintiff is unable to proffer factual or legal support for any necessary element of a claim to overcome summary judgment.185 A court will only grant summary judgment if, after considering the parties' briefs, pleadings, depositions and affidavits, "there is no genuine issue as to any material fact, and . . . the movant is entitled to judgment as a matter of law."186

178. FED. R. CIV. P. 56(c).
181. Oscar Private Equity Invs. v. Allegiance Telecom, Inc., 487 F.3d 261, 271 (5th Cir. 2007). An event study showing loss causation is an empirically-based showing that the corrective disclosure was more than just present at the scene. Id.
182. Id.
184. Id. at 345–46.
186. FED. R. CIV. P. 56(c).
A. The Seventh Circuit's Liberal Standard

Several circuit courts have interpreted *Dura* at the summary judgment phase, and have formulated various standards for loss causation. The Seventh Circuit requires defendants, at both the pleading and summary judgment stages, to "apportion and quantify which part of [the company's] loss is attributable to disclosures . . . and which part might [be] attributable to other factors."\(^{187}\) *Tricontinental Industries, Ltd. v. PricewaterhouseCoopers, LLP*\(^{188}\) illustrates the Seventh Circuit's liberal approach to loss causation. In *Tricontinental*, the plaintiff corporation and stock owner sued the corporation that acquired it, claiming negligent misrepresentation, common-law fraud and securities fraud.\(^{189}\) *Tricontinental* alleged PricewaterhouseCoopers, LLP (PwC) had negligently misrepresented statements about the financial worth of its client, Anicom, Inc. (Anicom) during Anicom's acquisition of Tricontinental's assets.\(^{190}\) Although *Tricontinental*’s complaints were dismissed at the pleadings stage,\(^{191}\) its loss causation analysis was useful in creating the Seventh Circuit's standard.

*Tricontinental*, in its reply brief, maintained that the Supreme Court’s decision in *Dura* did not require the precision in pleadings that the district court required in its dismissal.\(^{192}\) The Seventh Circuit disagreed, stating that "*Dura* stress[ed] that the complaint must ' "specify" each misleading statement,' and that there must be 'a causal connection between the material misrepresentation and the loss,' not simply that the misrepresentation ' "touch[ed] upon" a later economic loss . . . .'"\(^{193}\)

*Tricontinental* was a pleading case, but another Seventh Circuit decision utilized similar reasoning in directly addressing the issue of loss causation at summary

\(^{187}\) *In re Motorola Sec. Litig.*, 505 F. Supp 2d 501, 551 (N.D. Ill. 2007).
\(^{188}\) *Tricontinental Industries, Ltd. v. PricewaterhouseCoopers, LLP*, 475 F.3d 824 (7th Cir. 2007).
\(^{189}\) *Id.* at 827.
\(^{190}\) *Id.*
\(^{191}\) *Id.*
\(^{192}\) *Id.* at 843.
\(^{193}\) *Id.* (quoting *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 343 (2005)) (citations omitted).
In Ray v. Citigroup Global Markets, Inc., plaintiffs asserted that the company and an investment advisor’s misrepresentations were the cause for a share price decline. A group of disappointed investors who lost millions of dollars after the shares they had purchased of SmartServ Online, Inc. (SSOL) collapsed in value, sued John Spatz, an investment advisor, his employer, Citigroup Global Markets, Inc., and the employer’s parent company, Citigroup, Inc. (collectively, Citigroup) because SSOL never had the contracts, revenues or funding as Spatz, in his capacity as advisor, claimed. Plaintiffs asserted that this information demonstrated the loss in share value was proximately caused by the alleged misrepresentations. The Seventh Circuit disagreed, holding that plaintiffs did not substantiate their loss causation claim.

In disagreeing with the Ray plaintiffs, the Seventh Circuit examined three ways in which the plaintiffs could have demonstrated loss causation: (1) the materialization of the risk standard, (2) the fraud on the market standard, and finally (3) the risk-free approach. The court

194. Ray v. Citigroup Global Mkts., Inc., 482 F.3d 991, 994 (7th Cir. 2007).
195. Id. at 994.
196. Id. at 992.
197. Id. at 994–95.
198. Id. at 996–97.
199. The materialization of the risk standard requires plaintiffs to prove that “it was the very facts about which the defendant lied which caused [the plaintiff’s] injuries.” Id. (quoting Caremark, Inc. v. Coram Healthcare Corp., 113 F.3d 645, 648 (7th Cir. 1997).
200. “The fraud on the market theory is based on the hypothesis that, in an open and developed securities market, the price of a company's stock is determined by the available material information regarding the company and its business . . . . Misleading statements will therefore defraud purchasers of stock even if the purchasers do not directly rely on the misstatements. . . . The causal connection between the defendants' fraud and the plaintiffs' purchase of stock in such a case is no less significant than in a case of direct reliance on misrepresentations.” Basic v. Levinson, 485 U.S. 224, 241–42 (1988) (quoting Peil v. Speiser, 806 F.2d 1154, 1160–61 (3d Cir. 1986)).
201. The risk-free approach is apparent when “a broker falsely assures [his customer] that a particular investment is 'risk-free.'” Ray v. Citigroup Global Mkts., Inc., 482 F.3d 991, 995 (7th Cir. 2007) (quoting Bastian v. Petren Res. Corp., 892 F.2d 680, 685–86 (7th Cir. 1990)). If the investment is risky, the risk materializes, and the investment is lost, “there can be no presumption that but for the misrepresentation the customer would have made an equally risky
determined very quickly that the record did not reveal evidence sufficient to meet the first standard, without rebuttal from plaintiffs, that the drop in the value of the SSOL shares was attributed to market forces. Plaintiffs also failed to show that the value of the stock declined at the moment the alleged misrepresentations were revealed, the requirement *Dura* instituted for the fraud on the market standard. Plaintiffs alleged that they discovered the investment advisor's lies in June of 2002, but by that point, the price of the shares had already collapsed. Thus, plaintiffs could not satisfy this second standard to survive summary judgment.

Plaintiffs finally asserted that the broker gave false assurances that the investment was risk-free. The risk-free theory requires that, but for the misrepresentation by the broker, the customer would not have made the investment. However, the court reiterated that very explicit language must be used before loss causation could be proved under this theory. The Seventh Circuit noted that the district court found no evidence that Spatz and Citibank fraudulently assured the plaintiffs that SSOL stock was risk free, or that the stock would survive the collapse of the market in that industry. Absent this evidence, the Seventh Circuit held that plaintiffs failed to prove loss causation adequately and that summary judgment in favor of the defense was appropriate.

One district court case that illustrates the Seventh Circuit's standard is the Northern District of Illinois case, *In
On a motion for summary judgment, the court examined the post-*Dura* standard for loss causation. There, plaintiffs alleged that Motorola made materially false and misleading statements and omitted material facts behind the financing of a deal with Telsim, a Turkish telecommunications corporation. The court held that plaintiffs needed to prove that each "corrective disclosure" was the catalyst for an earnings shortfall in order to be used as proof that the relevant truth was leaked to the market in support of loss causation.

The *Motorola* court fell under the jurisdiction of the Seventh Circuit, and thus, was under the guidelines set by *Caremark*. *Caremark* held that the burden rests with defendants, on summary judgment, to show that a price drop, occurring following a disclosure of information, did not result from that disclosure. The plaintiff's burden is to present sufficient evidence from which a reasonable jury could conclude that those price declines indeed resulted from such a disclosure. If a plaintiff meets this burden, "the trier of fact can determine the damages attributable to the fraudulent conduct." Thus, *Motorola* determined that the burden in the Seventh Circuit rested with the defendant, at both the pleading and summary judgment stages, to "apportion and quantify which part of its loss is attributable to disclosures . . . and which part might [be] attributable to other factors."

**B. The Ninth Circuit's Approach to Loss Causation at Summary Judgment**

The Ninth Circuit has issued several decisions following...

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213. *Id.* at 504.
214. *Id.* at 507-08.
215. A corrective disclosure is a disclosure that dissipates price inflation that had resulted from misrepresentations or omissions, even if disclosure did not specifically identify or explicitly correct previous representation or expressly disclose particular fraudulent scheme alleged by claimant. *Id.* at 536-37.
216. *Id.* at 545.
217. *Id.* at 550-51 (citing *Caremark*, Inc. v. Coram Healthcare Corp., 113 F.3d 645, 647 (7th Cir. 1997) (discussing how *Caremark* was not overruled by *Dura*, and was therefore still the standard in the Seventh Circuit).
218. *Caremark*, 113 F.3d at 647.
219. *Id.* at 650.
220. *Id.* at 649.
221. *In re Motorola Sec. Litig.*, 505 F. Supp. 2d 501, 551 (N.D. Ill. 2007).
Dura, which aim at creating a loss causation standard at summary judgment. No clear standard for loss causation at summary judgment has materialized in the Ninth Circuit, however, the decisions illustrating the loss causation standard at the pleadings stage are helpful to forecast how the circuit will rule when given the chance. The decision in Daou, in particular, provided guidance regarding the Ninth Circuit's standard.222 In Daou, The Ninth Circuit utilized the Dura decision and held that a "plaintiff is not required to show 'that a misrepresentation was the sole reason for the investment’s decline in value'. ... 'As long as the misrepresentation is one substantial cause of the investment’s decline in value, other contributing forces will not bar recovery under the loss causation requirement ...'."223 In doing so, the Ninth Circuit adopted a fairly low standard for plaintiffs to establish loss causation.

The Daou court held that plaintiff’s must prove the defendant’s misrepresentation proximately caused the plaintiff’s injury.224 While the plaintiffs did not need to show that the misrepresentation was the only reason for the share’s price drop, they did have to show that it was a substantial cause of the drop.225 Thus, plaintiffs succeeded when they alleged that they would not have purchased the securities but for the executive’s fraud through improper accounting, and that the drop in the stock price was the direct result of the misstatements and caused the plaintiff’s damages.226 Daou established the standard in the Ninth Circuit at the pleadings stage.227 The Ninth Circuit’s Daou decision is not significantly distinguishable from what was overruled in Dura to constitute a reliable standard. The decision rejects the idea that Dura requires a completely corrective disclosure at the pleadings stage, and permits a mere leakage of troubled information instead.228 This

222. See generally In re Daou Sys., Inc., 411 F.3d 1006 (9th Cir. 2005).
223. Id. at 1025 (quoting Robbins v. Koger Props., Inc., 116 F.3d 1441, 1447 n.5 (11th Cir. 1997)) (citations omitted).
224. Id.
225. Id.
226. Id.
227. See id. (holding that to prove loss causation, the plaintiff must demonstrate a causal connection between the deceptive acts that form the basis for the claim of securities fraud and the injury suffered by the plaintiff).
228. Thorsen et al, supra note 14, at 120.
approach is contrary to the fundamental purpose of summary judgment. The Ninth Circuit did however publish a recent ruling that could shed light on the loss causation standard it would require plaintiffs to meet at the summary judgment stage with its *Gilead* decision.229

In *Gilead*, the Ninth Circuit permitted a claim to go forward past the pleadings stage noting that a "limited temporal gap between the time a misrepresentation [was] publicly revealed and the subsequent decline in stock value [did not] render a plaintiff’s theory of loss causation per se implausible."230 The court made clear that loss causation was a matter of proof and that the extent of the warning impact must be demonstrated at the proof stage.231 Thus it would be appropriate for the Ninth Circuit to require more of a causal connection, demonstrating "proof" of loss causation at the summary judgment stage, after both parties have been given a chance to gather evidence. This would permit plaintiffs and defendants to gather evidence to support the case, but would prevent plaintiffs from proceeding beyond summary judgment who had not demonstrated an element of their claim. However, it is unclear what specific standard the Ninth Circuit would utilize to demonstrate loss causation at summary judgment because the Circuit has not issued a published or unpublished case on the summary judgment standard.

C. The Fifth Circuit’s Strict Standard

District courts in the Fifth Circuit have followed notably different standards than those in the Seventh and Ninth Circuits. The Fifth Circuit requires plaintiffs not only plead loss causation at the class certification level with some particularity, but also with in-depth expert analysis.232 In *Flowserve*, the Fifth Circuit held that loss causation required disclosure, and that defendants in a securities fraud case could not be held liable for a decline in a stock price before the alleged fraud was disclosed.233 *Flowserve’s* corrective

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229. See *In re Gilead Scis. Sec. Litig.*, 536 F.3d 1049, 1055–1057 (9th Cir. 2008).
230. *Id.* at 1058.
231. *See id.* at 1057–58.
233. *Id.* at 578.
disclosures had a negative effect on the price of Flowserve's stock, but did not show a corrective effect on the price and thus, were insufficient to show loss causation. The court determined that the plaintiffs' losses were not caused by the misstatements, but rather by negative information announced in the releases.

The Flowserve court utilized the Fifth Circuit's decision in Oscar Private Equity Investments v. Allegiance Telecom, Inc. Oscar evaluated loss causation at the class certification stage, however, its standard is utilized in various district courts to determine the standard at summary judgment, which has broadened the decision's impact. The Fifth Circuit in Oscar held that plaintiffs were required to prove that the defendants' alleged misrepresentations were "the proximate cause of the plaintiff's economic loss." The Oscar court determined that loss causation is a fraud-on-the-market prerequisite. The court held that loss causation must be established at the class certification stage by a preponderance of all evidence. This did not preclude reexamination of the evidence supporting loss causation at summary judgment, but established a standard requiring empirical proof that the corrective disclosure was more than "just present at the scene."

It was not enough to demonstrate expert opinion without analysis to establish loss

234. Id. at 579.
235. Id.
236. Id. at 568–83 (citing Oscar Private Equity Invs. v. Allegiance Telecom, Inc., 487 F.3d 261, 264–71 (5th Cir. 2007).
237. See Oscar, 487 F.3d at 262.
239. Oscar, 487 F.3d at 272 (Dennis, J., dissenting).
240. Id. at 264. Fraud-on-the-market is a doctrine that supplies a blanket presumption that each class member has satisfied the reliance element of their 10b-5 claim. Id. The theory is that, in an efficient capital market, the market price reflects all public information; hence an investor who purchased a stock in such a market is harmed if the price reflects false information as a consequence of a material misrepresentation. Bell v. Ascendant Solutions, Inc. 422 F.3d 307, 310 n.2 (5th Cir. 2005).
241. Oscar, 487 F.3d at 268.
242. Id. at 269.
243. Id. at 271. Being more than "just present at the scene" requires plaintiffs to demonstrate that some or all of the drop was attributable specifically to the corrective disclosure; this can be done through expert in-depth analysis of the events. Id.
Those experts needed to examine the actual disclosures and documents and to give in-depth assessments. The court was unwilling to infer loss causation merely because one of several negative announcements could demonstrate loss causation.

With the decision in Oscar, and its choice to evaluate the standard for loss causation at the district court level for summary judgment, the Fifth Circuit has taken a markedly pro-defendant stance. By requiring that loss causation not only be pleaded at the class certification level with some particularity but also with in-depth expert analysis, the standard set is slightly higher than the one established in the Seventh Circuit. Because the Fifth Circuit takes a significantly different approach to loss causation at summary judgment phase than the other circuits, it is unclear whether its approach would be widely accepted.

D. The Second Circuit's Loss Causation Approach

The Second Circuit has not issued a ruling on a case outlining the standard for loss causation at summary judgment, but its decision in Lentell v. Merrill Lynch & Co., Inc. has been utilized in several district court cases to help establish a standard. In Lentell, the Second Circuit affirmed the district court's decision to dismiss the action for failure to state a claim, because plaintiffs failed to adequately plead loss causation. The court held that "a misstatement or omission is the 'proximate cause' of an investment loss if the risk that caused the loss was within the zone of risk concealed by the misrepresentations and omissions alleged by a disappointed investor." Thus, the Second Circuit required that the loss be both foreseeable and caused by the

244. Id.
245. Id. In depth assessments entail the opinions of expert analysts, including reference to post-mortem data regarding the market at issue; such as the use of basic principles of econometrics. Id.
246. Id.
248. Id.
250. Id. at 167, 178.
251. Id. at 173.
materialization of the concealed risk.\textsuperscript{252}

The Second Circuit, in \textit{Lentell}, distinguished an announcement's negative effect on the stock price from its corrective effect on the stock price in the context of loss causation.\textsuperscript{253} They reasoned that an event, such as a failure to meet earnings forecasts or a statement, did not mean that the event disclosed the alleged scheme to the market.\textsuperscript{254} In other words, a failure to meet earnings forecasts had a negative effect on stock prices, but not a corrective effect.\textsuperscript{255} Such a failure did not imply that defendants concealed a scheme to depress earnings estimates and drive up prices.\textsuperscript{256} It could not disclose the scheme; therefore, it cannot correct the artificial inflation caused by the scheme and cannot be used to adequately establish loss causation.\textsuperscript{257}

This standard has been interpreted in \textit{In re Initial Public Offering Securities Litigation}.\textsuperscript{258} In \textit{Initial Public Offering}, investors brought a securities fraud class action against Credit Suisse, issuers and underwriters, claiming that they conspired to artificially inflate aftermarket prices of securities by undervaluation of initial public offerings (IPO's) and deliberately issuing low revenue forecasting.\textsuperscript{259} The court disagreed with plaintiffs, holding that they failed to satisfy the loss causation standard.\textsuperscript{260} The plaintiffs alleged that "the defendants intentionally discounted earnings estimates and issued cautionary statements to excite the market and inflate prices when those estimates were beaten."\textsuperscript{261} The court held that "the single article [plaintiffs pointed], standing alone, was not specific enough to constitute actual disclosure of the alleged fraud."\textsuperscript{262} The lack of such disclosures, and accordingly, any sufficient allegations of loss causation, rendered the complaint insufficient under the \textit{Lentell} standard requiring plaintiffs to allege that "the

\textsuperscript{252} Id.
\textsuperscript{253} Id. at 174–75.
\textsuperscript{254} Id.
\textsuperscript{255} Lentell v. Merrill Lynch & Co., 396 F.3d 161, 175 (2d Cir. 2005).
\textsuperscript{256} Id. at 176.
\textsuperscript{257} Id. at 177–78.
\textsuperscript{258} In re Initial Public Offering Securities Litigation 399 F. Supp. 2d 261, 266 (S.D.N.Y. 2005).
\textsuperscript{259} See id. at 263–64.
\textsuperscript{260} Id. at 265–66.
\textsuperscript{261} Id. at 266.
\textsuperscript{262} Id. at 267.
misstatement or omission concealed something from the market that, when disclosed, negatively affected the value of the security.²⁶³

The Internet Law Library (INL) court loosely followed Lentell when it extended the standard to summary judgment, in which private securities causes of action require causal links between the alleged misstatement and the loss suffered by the plaintiff.²⁶⁴ The court also cited the IPO decision when it stated that the actual loss suffered by the plaintiff must "be foreseeable and . . . [have been] caused by the materialization of the concealed risk."²⁶⁵ Further, the risk that was concealed by the misstatement "must be within the zone of risks concealed by the misstatement."²⁶⁶ Conversely, if the causation chain is broken by an independent intervening event, loss causation is not established.²⁶⁷ The court held that the plaintiff failed to provide sufficient evidence to prove that the concealment of the criminal convictions by INL in fact caused the loss, when the concealed information prevented the financial transaction from occurring.²⁶⁸

Though the Second Circuit and the district courts under its jurisdiction appear to be following in the Fifth Circuit's footsteps, it has not set the same standard requirements for both the class certification stage and the summary judgment stage.²⁶⁹ The Second Circuit has no published decisions evaluating specifically loss causation at summary judgment. Thus, the Second Circuit would likely have less impact if the United States Supreme Court granted certiorari to address the issue.

²⁶³. Id. at 266 (quoting Lentell v. Merrill Lynch & Co., 396 F.3d 161, 173 (2d Cir. 2005)). This decision was also cited by the loss causation summary judgment decision in Flowserve. Ryan v. Flowserve Corp., 245 F.R.D. 560, 579 (N.D. Tex. 2007).


²⁶⁵. Id. at *3 (quoting In re Initial Pub. Offering Sec. Litig., 399 F. Supp. 2d 298, 306–07 (S.D.N.Y. 2005)).

²⁶⁶. Id.

²⁶⁷. Id.

²⁶⁸. Id. at *4.

E. The Third Circuit's Trend Towards a Stricter Standard of Loss Causation

The Third Circuit's approach requires that plaintiffs demonstrate that the allegedly fraudulent omissions proximately caused the economic loss.\(^{270}\) The Third Circuit identified its general standard for loss causation with the decision in \textit{McCabe v. Ernst \& Young, LLP}\(^{271}\). In \textit{McCabe}, principals of Applied Tactical Systems (ATS) sued the auditors of Vertex, the company acquiring ATS, for securities fraud, common law fraud, and negligent misrepresentation.\(^{272}\) The plaintiffs claimed that there were merger-related stock registration defaults and threatened litigation associated with the information that had been omitted from the merger's financial statements and documentation.\(^{273}\) The defendants moved for, and were granted, summary judgment at the district court level.\(^{274}\) The district court held that the plaintiffs suffered no damages resulting from the alleged fraud, thus summary judgment was appropriate as there was no loss causation; plaintiffs appealed.\(^{275}\)

In \textit{McCabe}, the Third Circuit evaluated the expert testimony presented by both parties as to whether the alleged omissions actually caused the plaintiff's economic loss.\(^{276}\) The court determined that "to survive summary judgment, . . . the ATS plaintiffs had to create a genuine issue [of material fact] as to whether [the] registration defaults and the [subsequent] threats of litigation . . . were a substantial factor in causing . . . economic loss."\(^{277}\) The court defined a "substantial factor" as including "considerations of materiality, directness, foreseeability and intervening causes."\(^{278}\) The \textit{McCabe} court found that the district court had not erred in finding in favor of the defendants on summary judgment.\(^{279}\)

The \textit{McCabe} court found that the factual record was "devoid of sufficient evidence to create a genuine issue as to

\(^{270}\) McCabe v. Ernst \& Young, LLP, 494 F.3d 418, 428 (3d Cir. 2007).
\(^{271}\) Id. at 424–25.
\(^{272}\) Id. at 422 n.1.
\(^{273}\) Id. at 421.
\(^{274}\) Id. at 423.
\(^{275}\) Id.
\(^{276}\) McCabe v. Ernst \& Young, LLP, 494 F.3d 418, 434–38 (3d Cir. 2007).
\(^{277}\) Id. at 436.
\(^{278}\) Id.
\(^{279}\) Id.
to survive summary judgment, a party must present more than just "bare assertions, conclusory allegations or suspicions" to show the existence of a genuine issue [of material fact.]"  The court noted that the plaintiff's expert focused only on the value of ATS at the time of the merger, but had no opinion on whether the alleged misrepresentations made by Ernst & Young proximately caused the price decline in Vertex shares after the merger.

Further, neither of the witnesses for ATS attributed the falling stock price or declining financial performance to the registration defaults. Evidence of that connection was required to create a genuine issue of fact, and ATS failed to provide it.

Conversely, Vertex provided an expert witness who demonstrated the Vertex stock price was unaffected by the registration default disclosures. Further, neither the plaintiff's nor defendant's expert reports demonstrated that the omissions proximately caused the economic loss. Thus, the plaintiffs failed to satisfy their burden, and summary judgment was appropriate.

The Third Circuit's requirement for a demonstration that the omissions proximately caused the economic loss is much like the Fifth Circuit's requirement that plaintiffs prove that the defendants' alleged misrepresentations were the proximate cause of the economic loss to qualify for certification. Thus, this could constitute the Third Circuit's relaxed endorsement of the Fifth Circuit's standard.

F. The Various Circuits' Standards as Compared to Each Other

The Third Circuit endorsed the Fifth Circuit's requirements for proof of proximate causation of economic

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280. Id.
281. Id. at 436–37 (quoting Podobnik v. U.S. Postal Serv., 409 F.3d 584, 594 (3d Cir. 2005).
282. McCabe v. Ernst & Young, LLP, 494 F.3d 418, 437 (3d Cir. 2007).
283. Id.
284. Id.
285. Id.
286. See id. at 438.
287. See id.
288. McCabe v. Ernst & Young, LLP, 494 F.3d 418, 428 (3d Cir. 2007).
In *Huddleston v. Herman & MacLean*, the Fifth Circuit held that the loss causation requirement was "satisfied in a Rule 10b-5 case only if the misrepresentation touche[d] upon the reasons for the investment's decline in value." The *McCabe* court held that the Fifth Circuit's approach was consistent with the Third Circuit's jurisprudence. In addition, the Second Circuit utilized similar language when it relied on the premise that "a misstatement or omission is the 'proximate cause' of an investment loss if the risk that caused the loss was within the zone of risk *concealed* by the misrepresentations and omissions alleged by a disappointed investor." By requiring proof of a proximate cause, the Second Circuit appears to align itself with the Third and Fifth Circuits. The trend towards the Fifth Circuit's approach, as furthered by the Third Circuit's direct endorsement, marks a shift against the Ninth Circuit's slightly more plaintiff-friendly standard, as articulated in *Daou*.

However, the Seventh Circuit has not taken as strong a position. By requiring the defendant to "apportion and quantify which part of its loss is attributable to disclosures . . . and which part might attributable to other factors," the Seventh Circuit appears to disagree with the fundamentals behind *Dura*, that the plaintiff must provide some indication of a causal connection between the loss and the alleged fraud. Because the Supreme Court held that that causal connection was the crutch of loss causation at the pleadings stage, it is natural to assume that the Supreme Court would require at least as much, if not more at summary judgment.

### IV. PROPOSAL

Both securities fraud plaintiffs and defendants would benefit from clear-cut guidelines establishing the standard for loss causation at summary judgment. Currently, defendants

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289. *Id.*
293. *See Tricontinental Indus., Ltd. v. PricewaterhouseCoopers, LLP*, 475 F.3d 824, 842–44 (7th Cir. 2007).
have no way of gauging the court's response to a summary
judgment motion, while plaintiffs struggle with a wild card
pleading standard. However, the pleading standard for the
Seventh Circuit's standard of evaluating loss causation at
summary judgment, as described in its decision in Ray, is the
most unambiguous post-Dura loss causation standard and
represents a middle-of-the-road approach. As previously
stated, the Ray court examined three ways plaintiffs can
demonstrate loss causation: (1) the materialization of the risk
standard, (2) the fraud on the market standard, and (3) the
risk-free approach. These three approaches, as
distinguished by the Seventh Circuit, allow the
compartmentalization of claims under each standard, giving
plaintiffs and defendants notice of what they need to allege
and substantiate at the summary judgment level.

It may be inappropriate to analyze market declines
thoroughly at the pleadings stage, before the discovery
process permits evidentiary support or comprehensive
understanding, but the summary judgment stage must be the
point where those facts are plead with particularity.
Plaintiffs have had the chance to effectively research the
issue and analyze information produced by the company, and
thus should be able to sufficiently state their case. Because it
is widely thought that the stock market promptly impounds
all publicly available information, plaintiffs must be able to
point to a corrective disclosure, and causally connect a
measurable amount of loss to that disclosure to survive
summary judgment.

The Fifth Circuit's requirement of "some empirically-
based showing that the corrective disclosure was more than just present at the scene,\textsuperscript{300} is clear. While it has not received broad attention and is more defendant-friendly than the \textit{Dura} decision, requiring empirical proof is appropriate at summary judgment because it should be a requirement that plaintiffs demonstrate a definite link in causation after they have had ample opportunities to gather evidence. If plaintiffs cannot demonstrate a link, then they have failed to establish an element of the case and summary judgment should be granted for defendants. The Seventh Circuit's holding also offers clear guidelines, by outlining the proof necessary to satisfy each separate claim, and follows the holding in \textit{Dura}.\textsuperscript{301} Therefore, as a standard, the Seventh Circuit's holding in \textit{Ray} as well as its reliance on \textit{Caremark}, should be coupled with the Fifth Circuit's standard for loss causation at summary judgment.

A combination of the two circuits would create a clear standard that would reflect Congress's intent. Plaintiffs would first be required to demonstrate loss causation with some particularity and in-depth expert analysis.\textsuperscript{302} Once this was established, the burden would rest with the defense to rebut this demonstration by apportioning and quantifying which parts of the loss was attributable to disclosures, and which part to other factors. This standard would accurately reflect the spirit of \textit{Dura}, which required plaintiffs to make the first showing, while also giving the defense a chance to respond which reflects the spirit of summary judgment.

\textbf{CONCLUSION}

It is reasonable to expect a securities fraud plaintiff to detail particular causes of a stock's loss at summary judgment. This creates a vehicle for valid fraud cases, while mitigating the dangers of strike suits,\textsuperscript{303} forcing defendants into settlement. The \textit{Dura} decision alleviated the risk of senseless harm to innocent companies and investors at the pleadings stage, and promulgated a legitimate private anti-

\textsuperscript{300}Oscar Private Equity Invs. v. Allegiance Telecom, Inc., 487 F.3d 261, 271 (5th Cir. 2007).
\textsuperscript{301}Ray, 482 F.3d at 994–95.
\textsuperscript{302}See supra Parts III.A, III.C.
\textsuperscript{303}Feinstein, supra note 160, at 864 (discussing the potential for plaintiff's abuse of the securities fraud claim).
fraud litigation system to restore investor confidence.\footnote{304}{Oleg Cross, Sidebar Comment, \textit{The Unlikely Tort of "Securities Fraud"}: Dura Pharmaceuticals v. Broudo, 2007 DUKE J. CON. LAW & PUB. POL'Y 220, 225 (2007), http://www.law.duke.edu/journals/djclpp/index.php?action=downloadarticle&id=45.} The Supreme Court in \textit{Dura} expressly left open the continued development of the law on causation,\footnote{305}{\textit{Dura Pharm., Inc. v. Broudo}, 544 U.S. 336, 346 (2005).} which the district and circuit courts have taken up with the recent flurry of litigation to try and develop a standard. However, the various circuits have disagreed upon an appropriate interpretation of \textit{Dura} at the summary judgment phase, thus we can expect that the Supreme Court may soon take up the issue to settle the split to create uniformity.

The standard for loss causation at summary judgment in a securities fraud case is far from established, and the various tests and standards utilized by the different circuit and district courts demonstrate that the issue will come to a head soon. While it is a complex issue, and there are few district court or circuit court decisions on point, the cases that do address loss causation at summary judgment provide strong guidance. Loss causation must clearly define what does and does not establish proof of a "causal connection" or "nexus" between the loss suffered by the plaintiff and the defendant's alleged misstatements to survive summary judgment.\footnote{306}{\textit{McGonigle v. Combs}}, 968 F.2d 810, 820 (9th Cir. 1992).

If the loss causation standard remains undefined, the causational uncertainty in securities fraud cases vastly increases the potential for "strike suits."\footnote{307}{\textit{Feinstein}, supra note 160, at 864.} With the current cases on appeal and the various standards coming out of the different circuits, the issue should be ripe for United States Supreme Court review. A combination of the Fifth and Seventh Circuit's standards would be the most appropriate standard to adopt. Requiring plaintiffs to demonstrate a causal connection through an empirical showing is appropriate after plaintiffs have been given access to evidence. However, giving defendants a chance to rebut that presumption by demonstrating independent causes for the loss, separate from any alleged fraud would avoid costly and unnecessary litigation. This would help to discourage strike suits while permitting meritorious suits to go forward and

\begin{itemize}
  \item \footnote{305}{\textit{Dura Pharm., Inc. v. Broudo}, 544 U.S. 336, 346 (2005).}
  \item \footnote{306}{\textit{McGonigle v. Combs}}, 968 F.2d 810, 820 (9th Cir. 1992).
  \item \footnote{307}{\textit{Feinstein}, supra note 160, at 864.}
\end{itemize}
would further the goals of Congress and of the private securities 10b-5 cause of action.