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Loss Causation in Fraud-on-the-Market Cases Post-
Dura Pharmaceuticals

Ann Morales Olazábal†

ABSTRACT: As a critical matter, class action securities fraud plaintiffs employing the fraud-on-the-market theory of reliance must still plead and eventually prove loss causation and damages. The Supreme Court's April 2005 decision in Dura Pharmaceuticals v. Broudo disapproved of the Ninth Circuit's simple price inflation theory of pleading loss causation (namely that a plaintiff's loss occurs at the time she purchases stock at a price artificially inflated by fraud) without expressly sanctioning any of the other prevailing approaches to loss causation. This leaves open the question of precisely how courts should properly handle loss causation.

Consequently, this Article critically examines the Dura Court's rationale, along with what it did not say and its context, in an effort to frame the best view of loss causation under Section 10(b) and Rule 10b-5. The author provides an analysis of the history of the loss causation element, and of Supreme Court and significant circuit court precedent, as well as a review of relevant basic principles of corporate finance. Ultimately, considering the Dura Court's emphasis on the common-law roots of the securities fraud cause of action, the Article demonstrates that at least two avenues for proof of a fraud-on-the-market plaintiff's damages must be available. First, as has been the case since before Dura, the plaintiff can plead and prove a corrective disclosure that results in a reduction in value of the plaintiff's investment, thereby causally linking the fraud to post-transaction losses. But equally consistent with Dura is the author's view that where fraud artificially inflates the price paid for a security—assuming plaintiffs plead and prove the inflation has been removed from the value of the stock for any reason—the fraud premium paid is itself a recoverable loss, irrespective of post-transaction price movement.

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TABLE OF CONTENTS

I. Introduction ........................................................................................................ 339
II. Loss Causation: The Exotic and Ungainly Element ............................................ 343
   A Brief History of Loss Causation in 10(b) Cases ............................................... 343
   B. Loss Causation Codified ............................................................................. 347
   C. Commentators on Loss Causation ............................................................. 350
III. The Dura Case .................................................................................................. 352
   A. Facts and Procedural History ..................................................................... 352
   B. The Supreme Court Opinion ..................................................................... 354
IV. The Response to Dura and a Reasoned Analysis .............................................. 356
   A. The Opinion Itself ...................................................................................... 358
      1. The Nature of the Element: Causation’s Symbiotic
         Relationship with Damages ....................................................................... 358
      2. Identification of a “Theory” of Loss ......................................................... 362
   B. Prior Supreme Court Precedent .................................................................. 366
   C. Support from Corporate Finance Theory .................................................... 367
V. Decisions Applying Dura and Implications for Circuits .................................... 368
   A. Analysis of Extant Circuit Court Approaches ........................................... 369
      1. “Strict” Loss Causation (Second, Third, Fourth, and
         Eleventh Circuits) .................................................................................... 369
      2. An Ad Hoc Approach: The Seventh Circuit ............................................. 373
      3. “Some Causal Nexus” (Eighth and Ninth Circuits) .................................... 375
   B. Cases Since Dura ......................................................................................... 377
VI. Conclusion ......................................................................................................... 379
I. INTRODUCTION

As civil securities fraud under section 10(b) of the Securities Exchange Act of 1934 (the '34 Act) and related Rule 10b-5 has matured into the viciously fought "money race" that it is today, the predominant focus of the litigation in the area has progressed from one element of the claim to the next. Today's hotly litigated 10(b) element is loss causation, or the notion that the alleged fraudulent misrepresentation or omission "actually caused" the loss the plaintiff claims to have suffered. As we shall see, courts have for decades now struggled with pleading and proof of loss causation in 10(b) cases, particularly in class action fraud-on-the-market suits. Until now, given its analogy to proximate cause in common law tort actions, the precise contours of this element have remained understandably indistinct.

A number of different basic approaches to loss causation have arisen. The most rigid of these is what we might call strict loss causation, prevalent in a plurality of the circuit courts. In the typical fraud-on-the-market case involving a substantial drop in the price of a stock, these courts look for facts establishing that but for the circumstances concealed by the fraud, the plaintiffs' investment would not have lost the value they seek to recover. As a practical matter in most cases, this requires plaintiffs to demonstrate that a corrective disclosure resulted in a drop in the stock's price, which then serves as the starting point for pleading and proof of loss causation.

1. Codified at 15 U.S.C. § 78j(b) (2006) and 17 C.F.R. 240.10b-5 (2005), respectively. The U.S. Supreme Court has stated that "[t]he scope of Rule 10b-5...is coextensive with the coverage of § 10(b)...therefore [the Court] use[s] §10(b) to refer to both the statutory provision and the Rule," S.E.C. v. Zandford, 535 U.S. 813, 816 n.1 (2002) (citing United States v. O'Hagan, 521 U.S. 642, 651 (1997); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 214 (1976)). This Article follows the Court's lead.


3. See, e.g., Semerenko v. Cendant Corp., 223 F.3d 165, 185 (3d Cir. 2000): Where the value of the security does not actually decline as a result of an alleged misrepresentation, it cannot be said that there is in fact an economic loss attributable to that misrepresentation. In the absence of a correction in the market price, the cost of the alleged misrepresentation is still incorporated into the value of the security and may be recovered at any time simply by reselling the security at the inflated price.

See also Greenberg v. Crossroads Sys., 364 F.3d 657, 665-66 (5th Cir. 2004) (holding that plaintiffs
for establishing plaintiffs’ damages. This most closely describes the approach to loss causation taken by a plurality of courts in 10(b) cases, most notably the Third\(^6\) and Eleventh\(^5\) Circuits.\(^6\)

The Seventh Circuit’s precedents employ a somewhat less restrictive formula for assessing loss causation in 10(b) cases. The Second Circuit’s jurisprudence in the area has been admittedly somewhat confused, with a number of important cases viewing the element from the perspective of the “foreseeability” of losses,\(^7\) and most recently\(^8\) adopting the Seventh Circuit’s focus on the “materialization of the [undisclosed] risk.”\(^9\)

Finally, the Eighth and Ninth Circuits developed a relatively lax causation requirement, requiring plaintiffs to show “some causal nexus” between their loss and the defendants’ misconduct.\(^10\) In these courts, plaintiffs were not necessarily required to establish a direct link between the defendant’s fraud and the decline in the investment’s value. Instead, in fraud-on-the-market cases, plaintiffs could plead and later establish loss causation by simply demonstrating that the defendant’s fraud was in some way responsible for artificially altering the transaction price. Hence, the “some causal nexus” test sanctions complaints alleging simply that the plaintiffs invested at a stock price that was artificially inflated by the issuer’s purported fraud, and they were damaged as a result.\(^11\)

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5. Robbins v. Koger Props., Inc., 116 F.3d 1441 (11th Cir. 1997) ("Our decisions explicitly require proof of a causal connection between the misrepresentation and the investment's subsequent decline in value.").

6. \textit{See also} Gasner v. Bd. of Supervisors, 103 F.3d 351, 360 (4th Cir. 1996) ("A direct or proximate relationship between the loss and the misrepresentation must be shown.") (citation omitted); Huddleston v. Herman & MacLean, 640 F.2d 534 (5th Cir. 1981), \textit{aff'd in part, rev'd in part on other grounds}, 459 U.S. 375 (1983); \textit{cf}. Greenberg, 364 F.3d at 657 (discussing “causation” and the effect on the price of a corrective disclosure in the context of considering the materiality of a statement for purposes of applying the fraud-on-the-market presumption).

7. \textit{See, e.g.}, Rothman v Gregor, 220 F.3d 81, 95-96 (2d Cir. 2000); AUSA Life Ins. Co. v. Ernst & Young, 206 F.3d 202, 212 (2d Cir. 2000); \textit{cf}. Emergent Inv. Capital Mgmt., LLP v. Stonepath Group, Inc., 343 F.3d 189, 198 (2d Cir. 2003); Suez Equity Investors v. Toronto Dominion Bank, 250 F.3d 87, 97-98 (2d Cir. 2001); Castellano v. Young & Rubicam, Inc., 257 F.3d 171, 187 (2d Cir. 2001).


10. Gebhardt v. ConAgra Foods, Inc., 335 F.3d 824 (8th Cir. 2003); Knapp v. Ernst & Whinney, 90 F.3d 1431 (9th Cir. 1996); Gray v. First Winthrop Corp., 82 F.3d 877 (9th Cir. 1996); \textit{In re} Control Data Corp. Sec. Litig., 933 F.2d 616 (8th Cir. 1991). This approach was also followed by some courts outside the Eighth and Ninth Circuits. \textit{See, e.g.}, \textit{In re} Initial Pub. Offering Sec. Litig., 241 F. Supp. 2d 281 (S.D.N.Y. 2003).

Loss Causation Post-Dura

The Southern District of California case *In re Dura Pharmaceuticals Securities Litigation*\(^{12}\) exemplified this type of bare bones artificial price inflation pleading. Though the district court rejected the price inflation allegations as insufficient,\(^{13}\) the Ninth Circuit Court of Appeals reversed, expressly ruling that "loss causation . . . merely requires pleading that the price at the time of purchase was overstated and sufficient identification of the cause."\(^{14}\) Defendants' petition for certiorari review, to the surprise of some, was granted.\(^{15}\) Though a number of commentators viewed a reversal of the Ninth Circuit's ruling as fairly inevitable, it also was widely expected that the Supreme Court's decision would clear up the confused state of loss causation jurisprudence in the circuits.\(^{16}\)

In its April 2005 decision in *Dura Pharmaceuticals v. Broudo*,\(^ {17}\) the Supreme Court unanimously rejected the Ninth Circuit's price inflation approach to pleading and proof of loss causation in fraud-on-the-market cases brought under 10(b). But the Court did so in a characteristically minimalist way, declining to articulate a clear loss causation standard for 10(b) cases despite the apparent conflict among the various circuit court approaches. The task at hand is to establish exactly what *Dura* did and did not say, and to identify the most plausible applications of the opinion. Accordingly, this Article\(^ {18}\) ultimately demonstrates that there are at least two ways in which plaintiffs can properly plead and prove that the defendants' conduct caused damages in an artificial price inflation case. In the first scenario, the plaintiffs can follow the more traditional route and show a corrective disclosure followed by a drop in the stock's price, thereby linking the reduction in value of the plaintiff's investment to the matter misrepresented. Alternatively, plaintiffs who purchased stocks at artificially inflated prices can plead and later prove securities arena have also advocated in favor of this position. See Merritt B. Fox, *Demystifying Causation in Fraud-on-the-Market Actions*, 60 BUS. LAW. 507 (2005); Michael J. Kaufman, *Loss Causation: Exposing a Fraud on Securities Law Jurisprudence*, 24 IND. L. REV. 357 (1991).

13. *Id.* at *32.
16. See, e.g., John C. Coffee, Jr., *Loss Causation After “Dura”*: Something for Everyone, N.Y. L.J., May 20, 2005 (noting that *Dura Pharmaceuticals* "was expected to be a major case in which the U.S. Supreme Court would define the operative principles of ‘loss causation’") [hereinafter Coffee, *Something for Everyone*]; Cornell Law School Legal Information Institute, liibulletin: Supreme Court Oral Argument Previews, http://www.law.cornell.edu/supct/cert/03-932.html (opining that the *Dura* opinion "will provide needed clarity regarding §10(b) securities fraud pleading requirements").
18. As such, this Article builds on significant work predating the *Dura* opinion by a number of noted scholars who have considered the loss causation conundrum in the context of fraud-on-the-market actions arising under 10(b). See Fox, *supra* note 11; Kaufman, *supra* note 11; John C. Coffee, Jr., *Causation by Presumption? Why the Supreme Court Should Reject Phantom Losses and Reverse Broudo*, 60 BUS. LAW. 533 (2005) [hereinafter Coffee, *Phantom Losses*]; Andrew L. Merritt, *A Consistent Model of Loss Causation in Securities Fraud Litigation: Suiting the Remedy to the Wrong*, 66 TEX. L. REV. 469 (1988).
that the defendants' conduct caused the artificial price inflation, and they thereafter suffered losses when the inflation was removed—irrespective of whether caused by defendants' fraud. Both of these methods of showing loss causation in fraud-on-the-market cases are consistent with *Dura*.

In order to place *Dura* in proper legal context, this Article analyzes the development of loss causation jurisprudence in fraud-on-the-market cases in terms of the judiciary's struggle to fashion a clear and coherent method of pleading causation and ultimately calculating damages.

First, this Article discusses the unique concept of loss causation generally, briefly exploring the genesis and highlights of its somewhat checkered history in the circuit courts of appeal, as well as its codification in the Private Securities Litigation Reform Act of 1995 (PSLRA) with attendant legislative history. This history provides the intellectual footing for a reasoned consideration of the debate.

Next, a detailed examination of the *Dura* case assesses the important underlying facts and the rationales of both the district and circuit courts, providing a clear analysis of the case as presented to the Supreme Court, as well as a synopsis of the Court's ruling. This is followed by a critical analysis of the *Dura* opinion and its implications, arguing that a properly defined class of plaintiffs under 10(b) can limit their damage request to the amount of price inflation paid when they purchased the subject stock if an ultimate deflation of the stock price is pled and the cause of the artificial inflation adequately articulated and proven. This conclusion is supported by both the spirit and the letter of the *Dura* decision and prior Supreme Court precedent based on the efficient markets hypothesis, some of the more well-reasoned circuit court cases on the topic, the legislative history of loss causation's codification, basic principles of corporate finance, and the common law of deceit. Finally, in examining the cases decided since *Dura*, this Article scrutinizes other extant circuit court positions for consistency with *Dura* 's rationale and the underlying policies of the federal securities laws. This Article concludes with an explanation of the most tenable reconciliation of existing case law with the Supreme Court's guidance in *Dura* for fraud-on-the-market cases brought under 10(b).
A Brief History of Loss Causation in 10(b) Cases

Today, loss causation is one of six elements that securities fraud plaintiffs asserting claims under 10(b) must allege and prove. (The others, as articulated by the Supreme Court in Dura, are: 1) a material misrepresentation or omission; 2) scienter; 3) a connection with the purchase or sale of a security; 4) reliance, otherwise known as "transaction causation;" and 5) economic loss.) But early federal securities fraud cases did not indulge a proximate causation analysis, instead viewing the traditional reliance element as sufficiently demonstrating a nexus between the defendant's fraud and the plaintiff's purchase or sale of the security—"but for" the defendant's conduct, the plaintiff would not have engaged in this particular transaction. The 1974 Second Circuit opinion in Schlick v. Penn Dixie Cement Corp. was seminal in separating the traditional causation element into two parts, resulting in discrete analysis of loss causation. Schlick involved allegations that Penn Dixie, which had acquired majority stock ownership in Continental, manipulated Continental's stock price so as to unfairly depress the exchange ratio offered to...
Continental stockholders when Penn Dixie merged with it. A class of plaintiffs brought an action alleging both 10(b) and proxy violations. The suit was dismissed "for want of the necessary causal connection." In reversing the dismissal, a panel of the Second Circuit noted the need for plaintiffs to plead "loss causation—that the misrepresentations or omissions caused the economic harm—and transaction causation—that the violations in question caused the appellant to engage in the transaction in question." In fact, the Schlick court ruled that loss causation had been adequately pled based on simple allegations that following the merger, class members were forced to sell their Continental shares to Penn Dixie based on an exchange ratio that was adversely affected by Penn Dixie's manipulation of Continental's share price, and accordingly that they had sustained injury.

The idea of splitting the then-traditional 10(b) causation element into two distinct inquiries was not without its detractors. Judge Frankel's brief concurring opinion in Schlick questioned the wisdom of amplifying the causation element in this fashion:

I concur in the result... With all deference, however, I am unable to join completely in the opinion because of those portions which employ the concepts of "loss causation" and "transaction causation." While these terms have had some scholarly currency, I am not convinced at this time that the Circuit ought to be committed to their employment or to their still uncertain implications.

In hindsight Judge Frankel had a valid point. The implications of adopting a separate loss causation requirement have proven to be enormously problematic; subsequent courts uneasily incorporated loss causation into their 10(b) analyses. Ultimately, before Dura was decided, the Fifth Circuit's 1981 opinion in Huddleston v. Herman & MacLean was cited as the progenitor of most of the 10(b) loss causation cases in the district and circuit courts. In Huddleston, the defendants had raised nearly $4.4 million from investors for the construction of the Texas International Speedway (TIS). Thirteen months after the offering, the corporation went bankrupt. Investors sued, alleging inter
Loss Causation Post-*Dura*

*alia* that the prospectus understated the cost of construction and the working capital position of the racetrack entity. The district court failed to instruct the jury on reliance and causation, taking the position that these were matters of law. On appeal, the Fifth Circuit found this to be error and remanded the case for retrial:

> The plaintiff must prove not only that, had he known the truth, he would not have acted, but in addition that the untruth was in some reasonably direct, or proximate, way responsible for his loss. The causation requirement is satisfied in a Rule 10b-5 case only if the misrepresentation touches upon the reasons for the investment's decline in value.

***

[Defendants] claim that the failure of TIS and the consequent economic loss of the plaintiff's investment are attributable to the materialization of the risk described in the prospectus such as bad weather conditions and lack of spectator attendance at the racetrack. To prevail in their Rule 10b-5 action, the plaintiffs must establish that their economic loss was proximately caused by the fraudulent misstatements and omissions in the prospectus.

A critical review of the case reveals that the court in *Huddleston* did not assess the contours of the loss causation element in any meaningful way. In actuality the case stands more for the proposition that loss causation is indeed an element of the judicially-developed 10(b) cause of action rather than articulating any concrete standard for a finding of loss causation. In fact, the amorphous "reasonably direct" and "touches upon" language set out above has been quoted by courts employing both the strictest and loosest of loss causation formulations, as well as those that fall somewhere in between. Suffice to say that in the twenty years between *Schlick* and the enactment of the PSLRA, the loss causation decisions in the courts have not adhered to a consistent standard. This is true for at least two reasons.

First, this multiplicity of results is due to the wide assortment of suits brought under 10(b). Over the years, the statutory claim has been fleshed out by common law in "securities fraud" cases brought against issuers and other market professionals, by both sellers and buyers, the latter being individuals, institutions, or large corporate entities. These plaintiffs have sought a variety of different remedies in situations involving either individual reliance or fraud-on-the-market. In fact, the permutations of the basic components of a 10(b) case alone are numerous. Moreover, in addition to the typical misrepresentation or omission case, 10(b) jurisprudence also includes suits based on insider trading, market manipulation, and most recently, research analyst bias. The wide scope

32. *Id.* at 549.
33. *Id.* (emphasis added).
34. *See, e.g.*, Binder v. Gillespie, 184 F.3d 1059, 1066 (9th Cir. 1999) (quoting the "touches upon" language); Robbins v. Koger Props., 116 F.3d 1441, 1447 (11th Cir. 1997) (quoting the "reasonably direct" language); *In re Phillips Petroleum Sec. Litig.*, 881 F.2d 1236, 1244 (3d Cir. 1989) (quoting the "touches upon" language); Ackerman v. Schwartz, 733 F. Supp. 1231, 1246 (N.D. Ind. 1989) (same).
of the cause of action’s applicability has resulted in a muddled set of precedents with elements occasionally being confused and conflated, illogically applied, or analogized.

With respect to loss causation in particular, it is important to distinguish the conventional use of loss causation in an individual reliance case from its application in fraud-on-the-market or “open market” cases brought by classes of purchasers relying in some way on market price(s) to establish reliance and ultimately their losses. More narrowly, within the context of this latter category, courts have drawn a distinction between on the one hand a relatively simple fraud and its unexpected and devastating exposure, and on the other, the more complex, multifarious, or longer-lasting frauds. Notably, these latter frauds tend to unravel over time by way of a series of disclosures or events that prove the stock issuer’s prior statements to have been false, during or by the end of which period the stock’s price has plummeted.

Secondly, the varied assortment of rulings on the question of loss causation is the likely result of the element’s obvious connection to the loss or damages sought by plaintiffs. Depending on the precise nature of the claim being made and the damages being sought, the contours of loss causation will be different. In fraud-on-the-market cases, the damage measure most commonly used is “out-of-pocket” losses, defined as the difference between the price paid for the stock and its fraud-free value as of the date of purchase. The problem with this measure is rooted in the fact this fraud-free value on the date of purchase is hard to pin down. As a result, courts have approached damages in a number of different ways, ranging from the simple substitution of a stock’s value on the date of disclosure of the fraud for the “true” value of the stock on its date of purchase, all the way to complex financial analysis involving event studies that

35. See Fox, supra note 11.
36. According to Professors Cornell and Morgan, most 10b-5 claims consist of “a series of exaggerations, omissions, and misleading statements which are corrected, or merely revealed for what they are, in a series of subsequent statements that convey additional information as well. Rarely is one outright lie revealed through one correction.” Bradford Cornell & R. Gregory Morgan, Using Finance Theory to Measure Damages in Fraud on the Market Cases, 37 UCLA L. Rev. 883, 889 (1990). Opinions in 10(b) cases abound with references to frauds that leak out slowly. See, e.g., Isquith v. Caremark Int’l, Inc., 136 F.3d 531, 533 (7th Cir. 1998) (noting in passing that “the investing public got wind of Caremark’s troubles, and the market value of its shares headed south”) (emphasis added); see also cases discussed in Cornell & Morgan, supra, at 889-94. Contrasting, Cornell and Morgan describe a hypothetical uncomplicated fraud as follows: Corporation C reports it has discovered X barrels of oil when in reality it has discovered no oil. When the falsity of C’s report is revealed, the disclosure results in the stock dropping to its true value. Id. (truncating an example set forth in Judge Sneed’s concurrence, Green v. Occidental Petroleum Co., 541 F.2d 1335, 1345 n.6 (9th Cir. 1976) (Sneed, J., concurring)); see also Jay W. Eisenhofer, Geoffrey C. Jarvis & James R. Banko, Securities Fraud, Stock Price Valuation, and Loss Causation: Toward a Corporate Finance-Based Theory of Loss Causation, 59 BUS. LAW. 1419, 1419-20 (2004) (calling the simple scenario where the stock price drops in response to a corrective disclosure a “classic securities fraud case”).
38. Id. at 1180; see also Cornell & Morgan, supra note 36.
parse an issuer's disclosures and other market conditions affecting a stock's price, comparing a price line to a value line for the stock during a class period. These diverse approaches to damage valuation in both fraud-on-the-market and other cases have, in their own way, contributed to very different approaches to loss causation in the federal courts.

As a further consequence of the intertwined nature of loss causation and damages, the seemingly muddled precedential history of the element has also been exacerbated by the courts' and 10(b) litigants' often wooly use of the word "loss." That 10(b) plaintiffs must prove their damages is undeniable. Clearly, plaintiffs have suffered a loss when their stock's price plummets. But the amount of the decrease in value of the investment (loss) in any given case may or may not be the same as the amount of damages (losses) the plaintiffs seek to recover. Thus, to require a plaintiff to "prove that his or her loss was caused by the defendant" is an ambiguous statement; its proper interpretation and application is totally dependent upon precisely what loss the plaintiff seeks to recover in the form of damages.

In 1995, against this heterogeneous backdrop, the loss causation element was codified in a single sentence of the PSLRA. Predictably, this changed the landscape only slightly, but an understanding of the statute's history and context is certainly helpful to a proper conception of the issue sub judice in Dura.

B. Loss Causation Codified

Though it did not limit its application to fraud-on-the-market cases, the PSLRA sought primarily to curtail plaintiffs' bar-driven class action "stock drop" suits, thought by many to have been brought too often for their perversely incentivized settlement value. Many, if not most, of these strike suits were fraud-on-the-market cases brought in the wake of the Supreme Court's decision in Basic v. Levinson, which eliminated the individual reliance element for securities trading on an efficient market. In that context, and as a part of the PSLRA's broad package of reforms, the loss causation

39. See generally Daniel R. Fischel, Use of Modern Finance Theory in Securities Fraud Cases Involving Actively Traded Securities, 38 BUS. LAW. 1, 17-19 (1982); Eisenhofer et al., supra note 36, at 1424-28 (2004); see also Green, 541 F.2d at 1344-45 (discussing price and value lines).
41. According to its legislative history, the loss causation provision of the PSLRA "codifies the requirement under current law that plaintiffs prove that the loss in the value of their stock was caused by the Section 10(b) violation and not by other factors." S. REP. NO. 98, 104th Cong., at 7 (1995), as reprinted in 1995 U.S.C.C.A.N. 679, 686.
element was codified in the '34 Act as follows: “In any private action arising under this title, the plaintiff shall have the burden of proving that the act or omission of the defendant alleged to violate this title caused the loss for which the plaintiff seeks to recover damages.” Of course, like the PSLRA’s heightened pleading standards for scienter, which avoided establishing precisely what types of facts adequately will allege or eventually establish scienter, the corresponding loss causation provision fails to clarify what properly suffices to plead or prove the causation element.

The straightforward language of the statute does put the burden of proof on the plaintiffs to show that their damages were “caused by” defendants’ securities violations. Notably, the PSLRA’s brief legislative history on this topic is Schlick-like, purporting to place only a relatively limited initial burden on the plaintiff. Both the Senate and House committees that studied the bill contemplated this to be followed by a shifting of the burden to the defendant to disprove causation as to some, or perhaps all, of the losses alleged:

The Committee also requires plaintiff to show that the misstatement or loss [sic] alleged in the complaint caused the loss incurred by the plaintiff. For example, the plaintiff would have to prove that the price at which the plaintiff bought the stock was artificially inflated as a result of the misstatement or omission. The defendant would then have the opportunity to prove any mitigating circumstances, or that factors unrelated to the fraud contributed to the loss.

The Conference Report provided no indication as to what the effect would or should be of a defendant’s proof of “mitigating circumstances” or proof that a factor or factors “unrelated to the fraud contributed to the loss.”

The legislative history appears to focus on loss causation in fraud-on-the-market cases, though not explicitly so. It seems to contemplate at times the simple or classic stock drop case and at others a scenario involving either a more long-lived or well-disguised fraud or at least a more complex disclosure thereof. Nonetheless, two things are clear: first, that even in passing the defendant-friendly PSLRA, Congress seemed to assume that allegations of artificial price inflation would suffice to establish a presumption of loss causation—at least at the pleading stage; second, that such a presumption

46. This is consistent with Professor Merritt’s suggestion that a fair balancing of the interests behind the federal securities laws might be achieved by placing the burden on the defendants to disprove loss causation. Merritt, supra note 18, at 516-17.
48. See, e.g., Scattergood v. Perelman, 945 F.2d 618 (3d Cir. 1990); In re Control Data Corp. Sec. Litig., 933 F.2d 616 (8th Cir. 1991).
Loss Causation Post-*Dura*

would be rebuttable by the defendant.\(^49\)

In scenarios where the defendant did not rebut the plaintiff's showing of causation in its entirety, the PSLRA also attempted to allay concerns about the overcompensation that initial selling "panic" created in the typical damage calculations. Accordingly, the PSLRA attempted to place a limit on the damages recovered in 10(b) actions by preventing plaintiffs from taking advantage of market overcorrection in those cases where there was a corrective disclosure revealing fraud.\(^50\) The relevant provision provides, *in toto*:

(e) Limitation on damages.

(1) In general. Except as provided in paragraph (2), in any private action arising under this title [15 U.S.C. §§ 78a et seq.] in which the plaintiff seeks to establish damages by reference to the market price of a security, the award of damages to the plaintiff shall not exceed the difference between the purchase or sale price paid or received, as appropriate, by the plaintiff for the subject security and the mean trading price of that security during the 90-day period beginning on the date on which the information correcting the misstatement or omission that is the basis for the action is disseminated to the market.

(2) Exception. In any private action arising under this title [15 U.S.C. §§ 78a et seq.] in which the plaintiff seeks to establish damages by reference to the market price of a security, if the plaintiff sells or repurchases the subject security prior to the expiration of the 90-day period described in paragraph (1), the plaintiff's damages shall not exceed the difference between the purchase or sale price paid or received, as appropriate, by the plaintiff for the security and the mean trading price of the security during the period beginning immediately after dissemination of information correcting the misstatement or omission and ending on the date on which the plaintiff sells or repurchases the security.

(3) Definition. For purposes of this subsection, the "mean trading price" of a security shall be an average of the daily trading price of that security, determined as of the close of the market each day during the 90-day period referred to in paragraph (1).

This provision does nothing to clarify the measure of damages in 10(b) cases. Hence, it sheds little light on the question of loss causation other than to suggest that in some fraud-on-the-market cases, a plaintiff may have sold or

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49. *Cf.* Harris v. Am. Inv. Co., 523 F.2d 220, 226-27 (8th Cir. 1975) (holding that appropriate date for calculating plaintiffs' loss was date of the public discovery of the fraud). *See generally* Barry Reder, *Measuring Buyer's Damages in 10b-5 Cases*, 31 Bus. Law. 1839, 1846-50 (1976) (arguing that gross loss measure ignores other factors impacting stock price that are unrelated to fraud, including overall economic and industry effects).

50. Congress's Conference Report on the Private Securities Litigation Reform Act describes the measure of damages in securities fraud cases as "complex and uncertain," and assumes that the typical measure is "the difference between the price the investor paid for the security and the price of the security on the day the corrective information gets disseminated to the market" (in other words, the expedient out-of-pocket measure). H.R. Conf. Rep. No. 104-369, at 42 (1995), as reprinted in 1996 U.S.C.C.A.N. 730, 741. It then discusses the need to reduce plaintiffs' recovery by losses caused by an amount representing effects of other market conditions, by using a "look back" or rebound period to calculate a "mean trading price" if the plaintiff sells or repurchases the securities during the 90-day period following the corrective disclosure. *Id.*
purchased the stock in a time of panic. Moreover, it does not require plaintiffs to point to a corrective disclosure. Rather, it merely attempts to eliminate defendants' liability for damages that may have been caused by panic selling after a corrective disclosure. Interestingly, it does not mandate that other market effects be removed from a plaintiffs' recovery. Thus, by negative implication, the provision appears to support fraud-on-the-market plaintiffs' recovery of the entire investment's loss in value as long as this amount does not exceed the difference between the purchase price and the mean trading price during the look-back period.

C. Commentators on Loss Causation

The stage would not be entirely set for the decision in *Dura* without a short discussion of the salient commentators' views on causation. Until the Supreme Court agreed to hear the *Dura* case, the element of causation had not garnered much scholarly attention. However, notably, two authors had grappled with the subject, both drawing conclusions that would support the Ninth Circuit's price inflation theory.

In 1988, Professor Andrew Merritt argued against restricting a defrauded buyer's recovery for 10(b) violations to the difference between the price paid for the security and the value of the security at the time of the initial transaction, even when subsequent market and other economic forces deprived the plaintiff of the entire value of the investment. As such, he proposed that the burden be placed on defendants to prove that their misrepresentations did not "touch upon the reasons for the plaintiff's loss" in any way, echoing *Huddleston*. Professor Merritt's proposal would also allow recovery for losses subsequent to the initial transaction that the defendants' misrepresentations did touch, and would go so far as to permit recovery of even unrelated market losses by any plaintiff who was able to demonstrate that the defendant's misrepresentations induced him to purchase a security that he would not otherwise have purchased, even if the price was reduced.

Shortly thereafter, in 1991, Professor Michael Kaufman argued that loss causation should be abandoned as an element of the 10(b) claim, as it simply amounts to a question of damages that is either (1) obvious—if it requires the plaintiff to prove defendant caused the loss as measured at the time of the

51. As Professor Thompson points out, the "cap" does not even accomplish its mission of excluding from plaintiff's damages any panic effect when its provisions are applied in a declining market. Thompson, *supra* note 37, at 1198.

52. *Id.* at 1193-96 (illustrating by way of numerical examples how PSLRA's cap confounds effort to remove market effects from fraudulently inflated stock price); *see also* Merritt, *supra* note 18, at 485-87.


54. *Id.*
Loss Causation Post-\textit{Dura}

transaction, or (2) wrong—if it requires the plaintiff to prove the defendant caused the full post-transaction decline in value.\textsuperscript{55} Instead, he posited that the element should be replaced with:

a plain definition of recoverable loss, one that recognizes that the ultimate post-transaction decline in the value of an investment is relevant in a securities fraud action only to the extent that it provides evidence of recoverable loss, a loss which occurs and is fixed only at the time of the transaction.\textsuperscript{56}

Thereafter the loss causation element lay essentially fallow in the academic domain.\textsuperscript{57} In the period immediately before the Supreme Court heard the \textit{Dura} case, a group of legal scholars advanced a corporate finance-based theory basically consistent with the theories of Professors Kaufman and Merritt.\textsuperscript{58} Additionally, two other prominent authors looked at the subject in companion articles. In the first, Professor Merritt Fox argued that because reliance is presumed under \textit{Basic v. Levinson} in fraud-on-the-market cases, the traditional notion of loss causation—transaction causation’s “twin”—is misplaced, and the only relevant causation question should be whether the defendant’s conduct inflated the security’s purchase price.\textsuperscript{59} Presuming that material misrepresentations or omissions will always cause price inflation,\textsuperscript{60} Professor Fox then went further, suggesting that loss causation in fraud-on-the-market cases could be established by a simple allegation of materiality, and that this new presumption is consistent with \textit{Basic}. Professor Fox’s theory would have made pleading causation even easier than that permitted by the Eighth and Ninth Circuit’s “some causal nexus” test.\textsuperscript{61}

At the other end of the spectrum, Professor Fox’s colleague, noted Columbia Law professor John Coffee, called for an outright rejection of the artificial price inflation theory of pleading. Professor Coffee based his argument primarily on the “the limited institutional competence of judges and

\begin{itemize}
\item \textsuperscript{55} Kaufman, \textit{supra} note 11, at 359.
\item \textsuperscript{56} Id.
\item \textsuperscript{57} \textit{But see}, e.g., David M. Brodsky & Jeff G. Hammel, \textit{The Fraud on the Market Theory and Securities Fraud Claims}, N.Y. L.J., Oct. 4, 2003, at 4 (arguing that the loss causation standard must require a direct link between the fraud and the reduction in value in the investment, or else transaction causation and loss causation will be collapsed); Lawrence A. Steckman & Robert E. Conner, \textit{Loss Causation Under Rule 10b-5, A Circuit-by-Circuit Analysis: When Should Representational Misconduct Be Deemed the Cause of Legal Injury Under the Federal Securities Laws?}, 1 SEC. ARB. 375 (1998) (focusing on loss causation in cases against banks, attorneys, accountants, and brokers).
\item \textsuperscript{58} See Eisenhofer et al., \textit{supra} note 36 (using corporate finance principles applicable to stock valuation to show that it should be enough to establish loss causation that a plaintiff demonstrate she overpaid for the stock as a result of the fraud, and the price of the stock declined as a result of any disclosure of diminished future cash flow expectations, even if the share price decline occurred prior to an explicit disclosure of the fraud).
\item \textsuperscript{59} Fox, \textit{supra} note 11, at 514 (citing \textit{Basic}, Inc. v. Levinson. 485 U.S. 224, 245 (1988)).
\item \textsuperscript{60} See also Michael J. Kaufman, \textit{No Foul, No Harm: The Real Measure of Damages under Rule 10b-5}, 39 CATH. U. L. REV. 29 (1989) (arguing “materiality of the misstatement or omission constitutes both the degree of the disparity and the amount of the damages”).
\item \textsuperscript{61} Fox, \textit{supra} note 11, at 514, 520 n.52.
\end{itemize}
juries to infer losses. The artificial price inflation approach, according to Professor Coffee, also should be rejected because it allows for the recovery of "phantom" losses—ones that have not yet materialized—converting the 10(b) claim into a form of insurance for investors.

Against this backdrop, the Dura case can be critically assessed. What follows is an in-depth discussion of the suit, viewed through the lenses of the courts that decided it, from district to Supreme Court.

III. THE DURA CASE

A. Facts and Procedural History

The class action suit was brought by plaintiffs in the Southern District of California following the collapse of the price of defendant Dura Pharmaceuticals' stock. Plaintiffs alleged that during a fourteen-month class period commencing on April 15, 1997, Dura Pharmaceuticals and several of its officers and directors (collectively "Dura") misrepresented four things: first, the quality and effectiveness of its sales force; second, the status of development, testing, and prospects for FDA approval of a new asthma medication delivery system known as Spiros; third, the success of its Rondec product line; and fourth, sales levels of its major drugs, including its respiratory antibiotic, Ceclor CD, and corticosteroid, Nasalide.

According to the complaint, on February 24, 1998—the last day of the class period—Dura revised its 1998 revenue estimates downward, attributing the decrease to slowed sales of Ceclor CD and Nasalide and to a decision to nearly double its sales force. Within a 24-hour period following the announcement, Dura's stock price dropped 47%. Thereafter in April 1998, the company revealed excess inventory and channel-stuffing practices indicating that Ceclor and Nasalide sales had actually been declining for quite some time. Then in November 1998, it revealed that the FDA had denied new drug approval for the Spiros. At that point Dura's stock price declined somewhat.

62. Coffee, supra note 19, at 534.
63. Id. at 538.
64. Id. at 539.
65. Further proceedings in the case after the Supreme Court's remand are outside the scope of this Article.
67. Id. at *6.
68. The Securities and Exchange Commission has defined "channel stuffing" as "the pulling forward of revenue from future fiscal periods by inducing customers—through price discounts, extended payment terms or other concessions—to submit purchase orders in advance of when they would otherwise do so." In re Sunbeam Corp., Exchange Act Release No. 44305, at 15 (May 15, 2001).
Loss Causation Post-Dura

but it almost completely recovered within a week.\footnote{Dura Pharm., Inc. v. Broudo, 544 U.S. 336, 339 (2005).}

After permitting amendment once, the district court dismissed the complaint with prejudice. Attacking the four sets of allegations in pairs, the court first found that the scienter element had been inadequately pled with regard to the sales force and major drug (Ceclor CD and Nasalide) sales allegations.\footnote{Id. at *31-32.} The remaining basis for the trial court’s dismissal, and the sole basis of the later appeal to the Supreme Court, was lack of loss causation with respect to the purported misrepresentations about Rondec and Spiros.\footnote{Dura, 544 U.S. at 340.}

The lone allegation in the amended complaint about the plaintiffs’ purported economic loss was that “[i]n reliance on the integrity of the market, [the plaintiffs] . . . paid artificially inflated prices for Dura securities,’ and the plaintiffs suffered ‘damages’ thereby.”\footnote{In re Dura, 2001 U.S. Dist. LEXIS 25907, at *15-21, *39-42.} Finding this insufficient to establish loss causation, the district court reasoned that plaintiffs had not explained how misrepresentations regarding Spiros “touched” upon the reasons for” the stock’s price decline, since the complaint made no allegation that the FDA’s failure to approve the device “had any relationship to the February price drop.” In a similar fashion and using nearly identical language, the trial court found that the Rondec allegations failed to support a finding of loss causation, noting:

Plaintiffs have not alleged how the [later $28 million] write-down ‘touched upon’ the February 1998 drop in Dura’s stock price. The . . . announcement that precipitated the drop in Dura’s stock price concerned a revenue shortfall due to slower Ceclor CD and Nasarel/Nasalide sales and the immediate need to increase the size of Dura’s sales force. . . . There are no allegations indicating the announcement contained any information about Dura’s investment in Rondec.\footnote{Id. at 32.}

Instead, the court concluded that the straightforward and apparently singular reason for the decline in stock price was the revenue shortfall predicted by the company, which the company attributed to slower drug sales and increase of the sales force. Thus, the court held that plaintiffs failed properly to allege loss causation.\footnote{Broudo v. Dura Pharm., Inc., 339 F.3d at 935.}

On appeal, the Ninth Circuit panel summarized the district court’s loss causation reasoning as follows: “[B]ecause the February 24 announcement did not mention the Albuterol Spiros device, any omissions or misleading statements about this device could not be said to have caused the decline in price.”\footnote{Broudo v. Dura Pharm., Inc., 339 F.3d at 935.} Having cast aside the rationale below in that manner, the court unsurprisingly reversed, holding \textit{inter alia} that “the [second amended complaint] satisfied the loss causation element . . . with respect to the Albuterol
Spiros device." According to the opinion, the Eighth and Ninth Circuits have long held that plaintiffs in fraud-on-the-market cases may establish loss causation by simply showing that they purchased stock at a price that was inflated "because of" the alleged misrepresentation or omission. The court further held that plaintiffs' injury occurs and damage is to be measured "at the time of the transaction." Consequently, the court ruled that plaintiffs need not aver that a corrective disclosure and subsequent drop in stock price occurred. With the Ninth Circuit's foregoing declaration of the loss causation element firmly in place, the plaintiffs' amended complaint should have survived the motion to dismiss. Dura's petition for certiorari to the U.S. Supreme Court was accepted on June 28, 2004.

B. The Supreme Court Opinion

On April 30, 2005, the Supreme Court delivered a short opinion totaling less than eleven pages, holding that a plaintiff could not satisfy the PSLRA's loss causation and damage requirements merely by alleging and later establishing that the security's price on the date of the purchase was inflated because of the defendant's misrepresentations and/or omissions.

At the heart of the opinion, the Court disagreed with the Ninth Circuit's conclusion that a 10(b) plaintiff's "loss" is occasioned on the date of purchase. The Court reasoned that because a stock purchaser may sell the "shares quickly before the relevant truth begins to leak out," a defendant issuer's misrepresentation and the attendant price inflation do not inevitably lead to a loss; instead it "might mean a later loss." And, even if the plaintiff stock purchaser later resells the shares 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

77. Id. at 937.
78. Id. at 938 (citing Knapp v. Earnst & Whinney, 90 F. 3d 1431, 1438 (9th Cir. 1996); Gebhardt v. ConAgra Foods, Inc., 335 F.3d 824 (8th Cir. 2003); Equity Investors, L.P. & SEI v. Toronto-Dominion Bank, 250 F.3d 87, 97-98 (2d Cir. 2001)).
79. Id. (emphasis in original).
80. Id.
81. Id.
83. Dura, 544 U.S at 342.
84. The Court introduced this argument as follows:
[A]s a matter of pure logic, at the moment the transaction takes place, the plaintiff has suffered no loss; the inflated purchase payment is offset by ownership of a share that at that instant possesses equivalent value. Moreover, the logical link between the inflated share purchase price and any later economic loss is not invariably strong.

Id. (emphasis in original).
85. Id.
86. Id. at 342.
some or all of that lower price." Therefore, at the time of the transaction, "the plaintiff has suffered no loss," and the most that can logically be concluded "is that the higher purchase price will *sometimes* play a role in bringing about a future loss."*

In addition to this observation, the Court also pointed out that securities fraud actions are most like common law tort actions for fraud and deceit, which have always required the plaintiff to prove that he or she suffered an actual economic loss. Accordingly, the Court somewhat mundanely ruled—contrary to the Ninth Circuit’s finding—that a fraud-on-the-market plaintiff must "prove that the defendant's fraud caused an economic loss." Beyond that, the Court stated later: "We need not, and do not, consider other proximate cause or loss-related questions."*

Nonetheless, having noted that Dura’s petition attacked both the causation and damage elements of the complaint in the case, the Court’s opinion gives roughly equal time to each of these elements in 10(b) cases. Justice Breyer, writing for a unanimous Court, said that the Ninth Circuit’s ruling was unsubstantiated by the common law of deceit, citing to nineteenth- and early twentieth-century cases and authorities for the proposition that a plaintiff must prove that he suffered actual economic loss. Moreover, according to the Supreme Court, the Ninth Circuit’s view of loss causation was not in keeping with the “judicial consensus” set forth in the *Restatement (Second) of Torts*, which requires that a person who “misrepresents the financial condition of a corporation in order to sell its stock” becomes liable to a relying purchaser “for the loss” the purchaser sustains “when the facts . . . become generally known” and “as a result” share value “depreciates.”

In pointing out that the Ninth Circuit opinion lay impermissibly at odds with the loss causation views of other circuits, the Court mentioned Second, Third, Eleventh, and Seventh Circuit precedents on loss causation. It did

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87. *Id.* at 343.
88. *Id.* at 342.
89. *Id.* at 343.
90. *Id.* at 338.
91. *Id.* at 346.
92. *Id.* at 347.
93. *Id.* at 343-44 (citing Pasley v. Freeman, 3 T.R. 5:1, 100 Eng. Rep. 450, 457 (1789); Freeman v. Venner, 120 Mass. 424, 426 (1876); M. BIGELOW, LAW OF TORTS 101 (8th ed. 1907); 2 T. COOLEY, LAW OF TORTS § 348, at 551 (4th ed. 1932)). The only present-day authority identified in this string cite is W. KEETON ET AL., PROSSER AND KEETON ON LAW OF TORTS § 110, at 765 (5th ed. 1984), which the Court cites for the notion that "plaintiff 'must have suffered substantial damage,' not simply nominal damages, before 'the cause of action can arise.'" Incidentally, Keeton, et al. identify Pasley v. Freeman as the "parent of the modern law of deceit." PROSSER AND KEETON ON LAW OF TORTS § 105, at 728.
94. *Dura*, 544 U.S. at 344 (citing *RESTATEMENT (SECOND) OF TORTS* § 548A, cmt. b (1977)).
95. Emergent Capital Inv. Mgmt. LLC v. Stonepath, 343 F.3d 189, 198 (2d Cir. 2003).
not, however, go so far as to endorse or even to discuss the approaches taken by any of those courts, other than to note generally that, as a group, they require something more than a bare allegation of stock purchases at inflated prices.99

Having generally established what needs to be proven in a 10(b) case, the Court turned to the specifics of loss causation pleading in the 10(b) context, noting that nothing in the PSLRA or the Federal Rules of Civil Procedure imposes any stricture beyond notice pleading under Rule 8(a)(2), which requires only "a short and plain statement of the claim showing that the pleader is entitled to relief."100 In this respect, the plaintiffs' naked allegation that they had purchased their shares at artificially inflated prices did not put defendants on "fair notice of what the plaintiff's claim is and the grounds upon which it rests."101

The support for this conclusion came in two steps: first, the Court pointed out that since no corrective disclosure was pleaded, the Dura plaintiffs' complaint apparently relied solely on artificial price inflation on the date of plaintiffs' purchase. This did not specify "the relevant economic loss"102 because as the Court had already elucidated, an artificial inflation of price itself cannot constitute a loss lest some putative plaintiffs not actually be injured. Secondly, and in that regard, as a matter of policy the Court found the Ninth Circuit's price inflation approach to be contrary to the objectives of the securities laws, impermissibly threatening to turn the civil securities fraud action into "broad [investors'] insurance against market losses."103 Thus, the Ninth Circuit's decision was reversed, and the matter remanded.104

IV. THE RESPONSE TO DURA AND A REASONED ANALYSIS

The usual suspects weighed in almost immediately. Understandably, the defense bar has interpreted the Dura opinion as a major corporate victory. Richard A. Rosen opined that Dura requires a corrective disclosure or other event proving the falsity of prior issuer statements in addition to a relationship between that event or disclosure and the losses alleged.105 More specifically,
Rosen sanguinely posits that *Dura* "reinforces" two propositions: first, "a plaintiff must plead and prove that 'the truth became known' before the stock price drop from which the plaintiff claims a loss," and second:

a plaintiff who claims that the disclosure of the truth caused his losses must identify either the new information conveyed by the disclosure or the material investment risks that had been concealed by the issuer's false statements or omissions. The plaintiff must then tie the disclosure of new information, or the materialization of the concealed risk, to the subsequent movement of the stock price.

On the other side, conceding that naked artificial price inflation pleading no longer will suffice after *Dura*, the plaintiff's bar generally has taken comfort in the Court's exercise of judicial restraint in reversing the Ninth Circuit's approach. Plaintiffs' counsel have continued to battle in the district courts—often with complaints that originally pre-dated the *Dura* decision, distinguishing or further amending them—and have argued successfully in a handful of cases across the country that scant pleadings can still satisfy *Dura*.

There is plenty of room between the plaintiffs' and defense bars' view of the case within which to determine what the *Dura* decision means. A simple and straightforward reading establishes that plaintiffs in *Dura* simply miscast their class and failed to limit their stated losses to the artificial price inflation they alleged. This reading is amply supported by the opinion itself, extant Supreme Court precedent, scholarly commentary on damages and causation in fraud-on-the-market cases, basic principles of finance, the common law of deceit, and the thrust and purposes of the '34 Act in light of the PSLRA.


108. See, e.g., *In re Retek Inc. Sec.*, 2005 U.S. Dist. LEXIS 25986, at *8-9 (D. Minn. Oct. 21, 2005) (finding that despite the use of boilerplate complaint language identical to the *Dura* plaintiffs', case survives 12(c) motion for judgment on the pleadings based on *Dura* because "here plaintiffs' allegations include a straightforward scenario perfectly consistent with what *Dura* requires: an allegedly corrective disclosure followed by a drop in the stock price during the time that plaintiffs owned the securities"); *In re UnumProvident Corp. Sec. Litig.*, 396 F. Supp. 2d 858, 899 (E.D. Tenn. 2005) (holding that plaintiffs' allegations met the minimal burden imposed by *Dura* of putting defendants on "fair notice of what the plaintiff's claim is and the grounds upon which it rests," quoting *Dura*); *In re Parmalat Sec. Litig.*, 376 F. Supp. 2d 472, 510 (S.D.N.Y. 2005) (stating "loss causation does not, as the defendants would have it, require a corrective disclosure followed by a decline in price" and giving plaintiffs leave to amend). But see, e.g., *Porter v. Conseco*, 2005 U.S. Dist. LEXIS 15466, at *11-12 (S.D. Ind. July 14, 2005) (applying *Dura* and granting the individual defendants' motion to dismiss because "the truth about matters that plaintiffs allege were concealed or misrepresented did not come out publicly until months after the end of the class period").
A. The Opinion Itself

1. The Nature of the Element: Causation's Symbiotic Relationship with Damages

The case is very much about two entwined elements of a 10(b) suit: causation and economic losses. Though courts and commentators alike have pointed out what may be obvious to some—that loss causation and damages are different elements of the claim—there is no denying that they are fundamentally interrelated. In fact, the *Dura* Court cites the PSLRA as authority for both the damage element, which it calls "economic loss," and the loss causation element. Recall that the PSLRA's section 21D, under the definitive heading "Loss causation," provides: "[i]n any private action arising under [10(b)], the plaintiff shall have the burden of proving that the act or omission of the defendant alleged to violate this title caused the loss for which the plaintiff seeks to recover damages." Interestingly, nothing in the form, substance, or legislative history of the PSLRA indicates that this section was specifically meant to codify the damages element of a 10(b) case, other than the self-evident proposition that if a plaintiff must prove "loss causation," then in fact, they must also prove losses in the first instance. As economic loss is an inherent component of loss causation, a more detailed look at the jurisprudence surrounding 10(b) damages is in order.

It has always been somewhat axiomatic that the implied right of action under 10(b) requires a plaintiff to prove losses. But what a plaintiff must prove, that is, exactly what can be recovered, has remained elusive. A jaded view articulated by one court is that 10(b) damage jurisprudence is a "confused area of the law where the courts, forced to rely on their own wits, have created a myriad of approaches." Courts and commentators faced with the issue of damages often have looked to section 28(a) of the '34 Act, which simply provides: "No person permitted to maintain a suit for damages under the provisions of this title shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of." On its face, this provision does not appear to create a rule for damages nor to codify

110. See, e.g., Fox, *supra* note 11, at 512-13 (discussing form of loss and measure of damages as driving the loss causation inquiry).
112. Section 11 of the 1933 Act does not require proof of loss causation.
the damage element of a 10(b) claim, but instead to create a limitation on total recovery once a judgment has been obtained. Nonetheless, courts, including the Supreme Court, have assumed that Section 28(a) applies to 10(b) claims. Given the paucity of guidance the statute itself provides, observers have called the question of damages under 10(b) "extremely open-ended." One securities law scholar has aptly summed up the situation:

Section 10(b) and Rule 10(b)-5 specify no damage or rescission standards, prompting the courts to take an ad hoc approach that often uses the common law out-of-pocket measure as an initial reference point and allows appellate courts to exercise the discretion traditionally left to the trial courts in finding damages appropriate to the facts of the case.

The two Supreme Court cases addressing the question of 10(b) damages prove the point. In Affiliated Ute Citizens of Utah v. United States, the Court ruled that the measure of a damages awarded to a defrauded seller (where the purchaser resells plaintiff's shares at a profit) could include both out-of-pocket damages and disgorgement damages. A decade and a half later in Randall v. B.J. Loftsgaarden, the Court allowed a rescissionary measure of damages for a defrauded buyer, holding that such damages were not "limited to the net economic harm suffered." All the way along, lower courts have found various damage measures to be appropriate in a variety of 10(b) fact patterns, including but not limited to: out-of-pocket, rescissionary, benefit-of-the-bargain, unjust enrichment/constructive trust/disgorgement, and consequential

115. Merritt, supra note 18, at 485-86. Professor Merritt argues that section 28 does not preclude an award of gross loss damages to plaintiffs injured by fraud.


120. Affiliated Ute Citizens, 406 U.S. at 155 (citing Myzel v. Fields, 386 F.2d 718, 748 (8th Cir. 1967); Janigan v. Taylor, 344 F.2d 781, 786 (1st Cir. 1965)); In our view, the correct measure of damages under § 28 of the [Exchange] Act ... is the difference between the fair value of all that the ... seller received and the fair value of what he would have received had there been no fraudulent conduct, ... except for the situation where the defendant received more than the seller's actual loss. In the latter case, the damages are the amount of the defendant's profit.


122. Id. at 663.
damages. Thus, while the remedial nature of the implied 10(b) cause of action is crystal clear, the precise remedy available to a particular securities fraud plaintiff appears to be dependent on both the type of 10(b) fact scenario presented and the court in which the case is pending.

In fraud-on-the-market cases, because rescission is not feasible, the applicable measure of damages has generally been "out-of-pocket" losses. These are calculated as the difference between the price the plaintiff paid for the stock and the stock's "true" value at the time of purchase. Judge Sneed, in his oft-cited concurrence in Green v. Occidental Petroleum, explained out-of-pocket losses as follows:

[T]he so-called out-of-pocket measure . . . fixes recovery at the difference between the purchase price and the value of the stock at the date of purchase. This difference is proximately caused by the misrepresentations of the defendant. It measures precisely the extent to which the purchaser has been required to invest a greater amount than otherwise would have been necessary. It furthers the purpose of rule 10b-5 without subjecting the wrongdoer to damages the incidence of which resembles that of natural disasters.

However, the plot thickens upon implementation of this relatively straightforward theoretical construct. To identify the actual value of the stock at the time an artificially high price was paid for it, courts have permitted the use of the stock's value after a corrective disclosure as a substitute for its value on the date of the plaintiff's purchase. This method simply assumes that the price to which the stock falls on the date the fraud is revealed reflects its fraud-free value. As it eliminates some complicated proof issues, this proxy method of measuring plaintiff's damages has been called the "expedient" out-of-pocket measure. Indeed, Congress seems to have latched on to this measure as the

124. 541 F.2d 1335 (9th Cir. 1976).
125. Id. at 1341 (Sneed, J. concurring) (citations omitted).
126. An alternative described by Professors Cornell and Morgan is the use of "equivalent disclosure" pricing. Cornell & Morgan, supra note 36, at 895-96.
127. See, e.g., WILLIAM K. S. WANG & MARC. I. STEINBERG, INSIDER TRADING § 4.8.2.2 (1st ed. 1996) (distinguishing "expedient" out-of-pocket measure from "true" out-of-pocket, which uses value of stock at time of plaintiff's transaction). For early cases using "expedient" measure, see, for example, Esplin v. Hirschi, 402 F.2d 94, 104-05 (10th Cir. 1968) (holding that defrauded buyer is entitled to recover difference between price paid for the security and the value of the security as of the time of the discovery of the fraud); Harris v. Am. Inv. Co., 523 F.2d 220, 226-27 (8th Cir. 1975) (finding that appropriate date for ascertaining damages under 10(b) was the date of public disclosure of fraud); Richardson v. MacArthur, 451 F.2d 35, 43-44 (10th Cir. 1971). See also BLOOMENTHAL & WOLFF, SECURITIES & FEDERAL CORPORATE LAW § 13:46 (2d ed. 2005) (maintaining that under the PSLRA, the general method for calculating loss is the difference between the price paid by the plaintiff and the price after ameliorative information is released to the market, minus any amount of loss that may have been caused by other market factors).
Loss Causation Post-Dura

usual method of damage computation.\(^\text{128}\) The expedient out-of-pocket measure can be effective in the 10(b) case involving a single fraud and a singular disclosure thereof. However, the problem with the expedited out-of-pocket measure is that even in a simple case, the defendant bears the burden of paying for any post-transaction reductions in price that do not result from fraud. Consequently, this has been referred to as the "gross loss" measure of damages.\(^\text{129}\) A minority of early decisions used this approach, either assuming no market effects, rationalizing that any windfall it produces should go to the plaintiff and not the defendant, or preferring the roughness of the justice it provides to the cost of netting out market effects.\(^\text{130}\) In essence, the gross loss measure gives plaintiffs a rescission-like result.\(^\text{131}\)

Instead of the "gross loss" measure, the majority of courts have opted for a "net loss" measure that seeks to remove other price-confounding effects from the total stock drop, namely company- or industry-specific news affecting the stock, or conditions affecting the market generally.\(^\text{132}\) It is in this context that the argument has arisen that unless a defendant's misrepresentation or omission is directly linked to the investment's decline in value, the defendant would be paying for losses it did not cause, which would pose an unconscionable threat of almost unlimited liability under 10(b).\(^\text{133}\) This is an appropriate avenue of inquiry if the case sub judice involves a plaintiff who is seeking to hold a defendant responsible for his investment's entire loss in value up to the date of trial.

But Dura was not clearly of that ilk, and so the Court did not need to enter that fray. Thus, the opinion avoids addressing the measure of a fraud-on-the-market plaintiff's losses and expressly declines to define the parameters of the loss causation element or to adopt any of the existing approaches used in the

\(^\text{128}\) H.R. CONF. REP. NO. 369, 104th Cong., at 42 (1995), as reprinted in 1996 U.S.C.C.A.N. 741 ("Typically, in an action involving a fraudulent misstatement or omission, the investor's damages are presumed to be the difference between the price paid for the security and the price of the security on the day the corrective information gets disseminated to the market.").

\(^\text{129}\) See, e.g., Merritt, supra note 18, at 476.

\(^\text{130}\) Thompson, supra note 37, at 1182; see, e.g., Marbury Mgmt. v. Kohn, 629 F.2d 705, 707 (2d Cir. 1980); Garnatz v. Stifel, Nicolaus & Co., 559 F.2d 1357, 1361-62 (8th Cir. 1977); Esplin v. Hirschi, 402 F.2d 94, 104 (10th Cir. 1968).

\(^\text{131}\) This is consistent with results under other sections of the federal securities laws. See, for example, section 12(b) of the 1933 Act, 15 U.S.C. § 77l(b) (2006).


\(^\text{133}\) Kaufman, supra note 11, at 365. Judge Sneed's now famous concurring opinion in Green v. Occidental Petroleum Corp. cautioned: "[t]o impose upon the defendant the burden of restoring all investment losses by those who held their stock until disclosure burdens the defendant with certain losses which it neither caused nor with respect to which it assumed a responsibility," likening the use of such a broad measure of damages to "subjecting the wrongdoer to damages the incidence of which resembles that of natural disasters." 541 F.2d at 1344 (Sneed, J., concurring).
circuit courts. Instead, the Court quite simply found that the Ninth Circuit's artificial price inflation theory was inconsistent with the requirement that injuries actually result from a fraud, and that the Broudo plaintiffs' complaint had failed to provide the defendants with notice of "what the relevant economic loss might be or of what the causal connection might be between the loss and the misrepresentation."134 Plaintiffs' failure to identify a theory of recoverable damage is discussed more fully in the following subsection.

2. Identification of a "Theory" of Loss

Having opined that artificial price inflation alone does not constitute a loss because of the possibility that damage will never accrue, the Court focused on the bare bones nature of plaintiffs' complaint. The following statement by Justice Breyer is indicative of the nature of some of the questioning of plaintiffs' counsel at oral argument:

But surely they wanted to have a person be able to read a complaint and just understand what it's about. . . . And I don't see how you could understand it unless you have in the complaint what your theory is. . . . Is your theory that the loss took place at the time the person bought the stock because he overpaid $30? Is your theory that the stock went down and, because of that, he lost the money? Is your theory that the stock didn't go down but it would have gone up more? All they're asking is not for evidence, but a simple, clear explanation of the theory, and plead in the alternative if you want. But I mean, what's the problem? Why is that so hard to do?135

Justice Breyer's ensuing opinion later reflects this fundamental concern,136 when he writes:

We concede that ordinary pleading rules are not meant to impose a great burden upon a plaintiff. . . . But it should not prove burdensome for a plaintiff who has suffered an economic loss to provide a defendant with some indication of the loss and the causal connection that the plaintiff has in mind. At the same time, allowing a plaintiff to forgo giving any indication of the economic loss and proximate cause that the plaintiff has in mind would bring about harm of the very sort the statutes seek to avoid.137

The opinion actually adverts to a number of possible scenarios, as Justice Breyer alluded to at oral argument. First, Justice Breyer speculates in the opinion that the plaintiff may "sell the shares quickly before the relevant truth

134. Dura, 544 U.S. at 347.
135. Dura Transcript, supra note 40, at *26-27.
136. In detail, Justice Breyer presses the point that the complaint's sole reference to loss is to the artificial price inflation (without pointing to a corrective disclosure or otherwise advertsing to any reduction in the stock's price as it affected plaintiffs), which cannot constitute a loss without more. Dura, 544 U.S. at 343-44. Further, the opinion refers to the "short and plain statement" required by Rule 8 FED. R. CIV. PRO. and the "fair notice" required by Conley v. Gibson, 355 U.S. 41, 47 (1957). Dura, 544 U.S. at 346.
137. Dura, 544 U.S. at 347 (quoting Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 741 (1975)).
Loss Causation Post-*Dura*

begins to leak out."\(^{138}\) Here the plaintiff is not injured, and there is no theory supporting recovery.\(^{139}\) But, he notes, the plaintiff might sell "later after the truth makes its way into the market place, [at which point] an initially inflated purchase price *might* mean a later loss."\(^{140}\) This situation gives rise to two potential theories of relief. One possibility is that the later sale at a lower price actualizes at least some portion of the artificial price inflation (though "the lower price may reflect ... events, which taken separately or together account for some or all of that lower price").\(^{141}\) Alternatively, the *Dura* opinion contemplates a scenario where the later sale is at a higher price, giving rise to a "claim that a share's higher price is lower than it would otherwise have been—a claim we do not consider here."\(^{142}\) Either scenario provides a theory of causation, which is what Justice Breyer found to be fatally lacking in the *Dura* complaint.

In fact, a larger set of theories is actually possible. Assuming the plaintiff paid an artificially inflated price, he or she may ultimately recover if the inflation is removed for *any* reason. Consider the following analogous scenarios in the realm of common law deceit involving the residential real estate market, which illustrate a number of loss theories.

**Scenario 1**

Suppose Bret buys a house in Miami for $500,000 based on Arlene's fraudulent misrepresentation or omission concerning a latent defect in the home. Let us also assume that if the house had been truthfully described, it would only have been worth $450,000 because fixing the defect would cost $50,000. Bret has paid an artificially inflated price for the home—a fraud premium. But to assess his compensable loss, if any, we have to know what happened next. Four different basic scenarios become apparent. First, if Bret sells the home to Cindy for $500,000 fairly soon thereafter with neither of them having learned of the defect, Bret has not been injured.\(^{143}\)

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\(^{138}\) *Id.* at 342. This possibility raises another situation in which plaintiffs might not be able to show losses, namely where a fraud is concealed for such a lengthy time that it does not impact the price when it is revealed. See Adolph A. Berle, *Liability For Stock Market Manipulation*, 31 COLUM. L. REV. 264, 269 (1931) (noting that "a false statement ... some years ago would have little appreciable effect on the price of the stock today").

\(^{139}\) This result is dictated by Section 28 of the 1934 Act, 15 U.S.C. § 78bb (2006) ("[N]o person ... shall recover ... a total amount in excess of his actual damages on account of the act complained of."). At oral argument, plaintiffs' counsel in the case articulated this as the difference between plaintiffs' incurring a loss and their being possessed of a claim for recoverable damages. *Dura* Transcript, *supra* note 40, at *32, *42.

\(^{140}\) *Dura*, 544 U.S. at 342 (emphasis in original).

\(^{141}\) *Id.* at 343.

\(^{142}\) *Id.* Even Professor Coffee allows that the court's placement of this type of loss on equal footing with the price decline scenario suggests that new forms of losses might be recoverable. Coffee, *Phantom Losses, supra* note 18, at 535.

\(^{143}\) This simple hypothetical intentionally ignores the possibility of appreciation during the short time frames described.
Scenario 2

What if instead the defect becomes apparent to Bret during the time he has the house for sale? Naturally, now, he either has to repair the defect at a cost of $50,000, or he can sell the house for $450,000. It is probably uncontroversial to say that he has been damaged in the amount of $50,000. His suit against Arlene based on the common law tort of deceit should yield him the cost of repairing the defect. So far, so good.

Scenario 3

Varying the hypothetical yet again, assume Bret does not find out about the defect, but instead, following a decline in the “frothy” Miami real estate market, he sells the house to Dennis for $425,000 eighteen months after his purchase from Arlene. Regardless of the specific reason for the decline in value, Arlene’s fraud still caused Bret $50,000 in damages. Were it not for Arlene’s misrepresentations or omissions, Bret may still have bought this home, but not at a price of $500,000. It is logical to assume that negotiating from an informed position, he would have agreed to a price that took into account the defect, and therefore that he would have paid only the home’s $450,000 value. When the Miami real estate market declined for reasons unrelated to the fraud, Bret then would have lost only $25,000 in value and not $75,000. The $50,000 artificial price inflation caused by Arlene’s fraud has been removed, and she has damaged Bret to that extent regardless of the ultimate reason for the reduction in sales price of the home. Bret’s suit against Arlene, alleging that he paid an artificially inflated price for the home resulting in damage when he sold at a lower price, should be sustainable.

We could make the same argument if the neighborhood sustained a direct hit from a Category 5 hurricane, reducing the home to little more than

144. See, e.g., Posner v. Davis, 395 N.E. 2d 133 (Ill. App. 1979); Maguire v. Masino, 388 So. 2d 844 (La. App. 1975); Beardmore v. T.D. Burgess & Co., 226 A.2d 329 (Md. App. 1967); Sparagnanapi v. Wright, 110 A.2d 82, 85 (D.C. App. 1954) (ruling that proper measure of plaintiffs’ damages was actual cost of replacing defective boiler fraudulently misrepresented by defendants); Nunn v. Howard, 288 S.W. 678, 679 (Ky. App. 1926) (holding that damages for fraudulent misrepresentation of well on property as providing good and lasting water supply was cost of drilling new well). An aggrieved party to this purchase and sale contract could also sue for rescission of the contract based on a theory of fraudulent misrepresentation. See, e.g., Cohen v. Vivian, 349 P.2d 366, 368 (Colo. 1960) (affirming finding that one victim of residential real estate fraud involving misrepresentation of foundation of lots entitled to damages, other entitled to rescission).

145. Former Federal Reserve Board Chairman Alan Greenspan has called the real estate market “frothy” in some U.S. cities; Robert J. Shiller has identified Miami as a “glamour city” susceptible to a real estate bust. Sara Clemence, Real Estate Vulnerability Index, FORBES.COM, June 3, 2005 http://www.forbes.com/realestate/2005/06/03/cx_sc_0603home.html?chan=14vulnerable; see also Motoko Rich, Housing Goes Frothy to Flat in Denver Area, N.Y. TIMES, July 17, 2005, at A1 (describing the Miami real estate market as among those considered “frothy”).

146. This is a conservative view. In common law securities fraud cases, the highest courts of two states have found the defendants liable for the entire amount of the investment loss, even where the decline in the investment’s value was caused by something other than the defendant’s fraud. Fotler v. Moseley, 185 Mass. 563, 70 N.E. 1040 (Mass. 1904); Crater v. Binninger, 33 N.J. L. 513 (N.J. Err. & App. 1869).
Loss Causation Post-\textit{Dura}

At that point Bret still has the value of the lot, though even its price has been somewhat depreciated by the hurricane's devastation and consequent depression in region's land values generally. As a result, his half-million dollar "home" is now worth only $100,000. To blame Bret's entire $400,000 loss in value on the hurricane is specious. Again, if Arlene had not misrepresented the home, Bret would only have had $450,000 rather than $500,000 at risk when the hurricane hit. If Bret sues Arlene seeking to recover only $50,000—the fraud premium that she caused and which now has been removed—she has damaged him by that amount and should be liable to him for it. Arlene is not liable for the remainder of the loss in value to the home, which Bret would have sustained anyway.\footnote{148}{Professor Coffee has argued persuasively that the \textit{Dura} opinion opens the door for recovery of this variety of what he calls "phantom losses." Coffee, \textit{Something for Everyone}, supra note 16, at 5.}

\textbf{Scenario 4}

The inverse is also possible. Now assume that rather than a general decline in values, the residential real estate market in Miami experiences a period of sustained increases in sale prices. Bret now is able to sell the home to Emily for $650,000 even after repairing or reducing the price to account for the defect. Without the defect, Bret would have netted $50,000 more on the sale, and therefore Arlene's fraud has still caused him $50,000 in damage.\footnote{149}{This is the increasing price example the Court contemplates at \textit{Dura}, 544 U.S. at 346. Unsurprisingly, there is support for this notion within the Ninth Circuit, where at least one court has expressly held that a securities fraud plaintiff's damages "consist of two components: the value lost due to the casualty and the amount lost because [the investor] overpaid for the stock. This latter component of damages is related directly to the initial misrepresentation. Hence, this amount should be recoverable in an action for securities fraud." \textit{In re Wash. Pub. Power Supply Sys. Sec. Litig.}, 650 F. Supp. 1346, 1353-54 (W.D. Wash. 1986), aff'd, 823 F.2d 1349 (9th Cir. 1987); see also Blackie v. Barrack, 524 F.2d 891, 908 (9th Cir. 1975) (noting that "a stock purchaser does not ordinarily seek to purchase a loss in the form of artificially inflated stock") (quoted in Basic, Inc. v. Levinson, 485 U.S. 224, 244-45 (1988)).}

\textbf{Scenario 5}

Finally, let us consider a different twist on the original hypothetical. Imagine that prior to purchasing from Arlene, Bret was also contemplating the purchase of a comparably priced home from Franklin in San Diego. In the end, he chose Arlene's home in Miami because he really liked her neighborhood, and he reasonably assumed the home did not have the fraudulently undisclosed defect. If Bret had known about the defect, rather than pay a reduced price for Arlene's Miami home, he would have chosen to deal with Franklin. Next, to make matters simple, let us assume that the real estate bubble bursts and prices decline in Miami but not in San Diego. If the home Bret purchased from Arlene for $500,000 can now only be sold for $425,000, here again, applying traditional tort theory, there is little question that he can recover damages from Arlene, with the only question being whether he should be permitted to recover the $50,000 value of the misrepresented defect or the entire $75,000 in lost

\footnotesize{\textit{Cf. Restatement (Second) of Torts} § 548A cmt. b (1977).}

\footnotesize{147. Cf. \textit{Restatement (Second) of Torts} § 548A cmt. b (1977).}

\footnotesize{148. Professor Coffee has argued persuasively that the \textit{Dura} opinion opens the door for recovery of this variety of what he calls "phantom losses." Coffee, \textit{Something for Everyone}, supra note 16, at 5.}

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value of the home. The latter argument is entirely plausible given that Bret would have preferred a completely different purchase (a home in San Diego that did not fall prey to declining real estate values within a short time of his purchase), and thus Arlene's fraud actually caused Bret—somewhat idiosyncratically—the full amount of the lost value when the market declined.

Note that only in Scenario 2 (the simplest case and perhaps the least analogous to most fraud-on-the-market cases) does the unexpected discovery of the defect Arlene concealed result in a sudden drop in value of the home. Yet in all of the others, no matter the cause for the deflation in price, Bret still recovers. This complete look at the application of the common law of deceit to the various possible 10(b) recovery theories supports the author's argument. And, as the Supreme Court pointed out, the federal securities laws with their fundamental remedial purpose should supplement the common law, not provide results that are less protective.

B. Prior Supreme Court Precedent

Nothing in the Supreme Court's 10(b) pronouncements in Basic or Affiliated Ute Citizens requires plaintiffs to prove that defendant's conduct caused the post-transaction decline in value of the security. Indeed, these two cases can be read together to support the opposite proposition. Furthermore, these two cases reflect the Court's willingness to engage in presumptions that operate in the plaintiffs' favor, balancing them with a defendant's right to rebut. This supports the "net loss" view of plaintiffs' damages in securities fraud cases, but certainly does not lead to the inevitable conclusion that if later events wipe out the value of the security, the defendant who committed fraud is not responsible for any portion of plaintiffs' losses.

150. In one Supreme Court opinion pre-dating the 1933 and 1934 Acts, the Court held that when a defrauded purchaser overpays for a security, his loss is "the difference between the real value of the stock at the time of sale and the fictitious value at which the buyer was induced to purchase." Sigafus v. Porter, 179 U.S. 116, 124 (1900) (quoting High v. Berret, 23 A. 1004, 1004 (Pa. 1892)).

151. "Actions under Rule 10b-5 are distinct from common-law deceit and misrepresentation claims and are in part designed to add to the protections provided investors by the common law." Basic, 485 U.S. at 244 n.22 (citations omitted).


153. See Kaufman, supra note 11, at 373-77.

154. Cf. Huddleston v. Herman & MacLean, 640 F.2d 534, 549 (5th Cir. 1981). A footnoted hypothetical perhaps suggests to the contrary, positing that misrepresentations about a ship's capacity may not lead to recovery if the ship sinks for reasons unrelated to capacity. Id. at 549 n.25. But this result is inconsistent with the actual holding in Huddleston. And, more importantly, nothing in Dura signals the Court has adopted the Huddleston "touches upon the reasons for the investments decline in value" rule.

155. This reflects the deterrence objective of the federal securities laws. Randall v. Loftsgaarden, 478 U.S. 647, 664 (1986) (emphasizing that Congress's purpose in the 1934 Act was not only to
Loss Causation Post-Dura

Moreover, in the context of the express statutory securities fraud claims, the Court has indicated that the plaintiffs' burden of proving causation is limited to showing that defendant's fraud created a disparity between the price and the value of the securities at the time of plaintiffs' transaction. In *Piper v. Chris-Craft Industries, Inc.*, 156 Chris-Craft sought damages for its failure to obtain control of Piper. The Supreme Court addressed the claim under Section 9(e) of the '34 Act. Admittedly, the section 9(e) cause of action—a claim for willful price manipulation—focuses more on price than a claim under 10(b). However, Justice Blackmun's concurrence in the case provides guidance on the question of loss causation generally. According to Justice Blackmun, Chris-Craft failed to allege causation because it had not even intimated that the price it paid for Piper shares was influenced by defendant's conduct. Blackmun's concurrence also suggests that if Chris-Craft had sought damages for its overpayment for Piper shares, proof that the defendants' conduct "influenced" the purchase price of the shares would have been adequate to establish causation.157

C. Support from Corporate Finance Theory

According to basic corporate finance principles, the price of a publicly traded stock reflects the market's projection of the issuer's future cash flows, discounted to present value at the issuer's cost of capital.158 And, any time an issuer makes an announcement bearing on past or present financial performance, the market views this information as indicative of the issuer's future cash flows. Hence, any disclosure that causes the market to believe future performance will fail to meet expectations—whether related to the fraud or not—will have the effect of deflating the stock's price.159 If it turns out that the stock price, that is the initial expectations upon which investors relied, was inflated due to fraud, finance theory would support the conclusion that investors would be victimized regardless of when the disclosure of the fraud occurs.160

Not only is the timing of the disclosure of the fraud irrelevant to establishing a fraud-caused injury, but how the fraud is disclosed is immaterial as well.161 A number of commentators have cautioned against sanctioning a company's "walking down" its numbers in anticipation that a fraud will be revealed, or rewarding those companies that either can obscure their fraud with

157. Id. at 53.
159. Id.
161. Id. at 1444 (concluding that "the disclosure that drives down the stock price need not be a disclosure that fraud has taken place").
its complexity or can hide their fraud the longest, by permitting them to escape liability for having thwarted plaintiffs on the element of loss causation.\(^{162}\)

Corporate finance theory does not necessarily support the Ninth Circuit’s bare “some causal nexus” pleading in an artificial price inflation case. Instead, it requires a discernible impact on the stock’s price as a result of the fraud, should the plaintiff seek to recover post-transaction losses.\(^{163}\) If, however, only the premium paid due to the fraud were sought, then plaintiffs’ complaint should simply have to link the prior misguided cash flow expectations to the fraud to show that they were damaged by having purchased at an artificially high price:

Where a defendant makes a materially misleading statement to the investing public in a deliberate attempt to artificially inflate the stock price of a company, and the plaintiff, in reliance on the market price of those securities as manipulated by the defendant, purchases the company’s stock at such artificially inflated prices, the plaintiff should be deemed to have suffered a loss caused by the defendant to the extent of the inflation so long as the earlier disclosures were fraudulent.\(^{164}\)

Unfortunately, finance theory—primarily in the form of the “event study”\(^{165}\)—lately has been used to create an environment in which defense counsel insists that the only way to prove the fraud-free price of a stock is to parse its post-transaction share value. Then, once the plaintiffs are boxed into that realm, defense counsel obfuscates the question and may ultimately succeed in defeating loss causation by arguing that the defendants were not the cause of some or all of the post-transaction events affecting the share’s price.\(^{166}\) As this Article further demonstrates, the proper focus in an artificial price inflation case should be on establishing the fraud premium as a matter of damages, requiring as a showing of loss causation only that the defendants caused the artificial inflation.

V. DECISIONS APPLYING DURA AND IMPLICATIONS FOR CIRCUITS

To examine the effect of Dura, this next section reviews the various

\(^{162}\) See, e.g., Merritt, supra note 18, at 530-31.

\(^{163}\) Eisenhofer et al., supra note 36. This is consistent with the Huddleston court’s “touches upon” rule.

\(^{164}\) Id. at 1442-43.

\(^{165}\) “An event study is a statistical regression analysis that examines the effect of an event on a dependent variable, such as a corporation’s stock price.” Id. at 1425. Event studies are now so widely used in proving and controverting 10(b) damages that it may have become a \textit{sine qua non} of their existence. See, e.g., \textit{In re Executive Telecard, Ltd. Sec. Litig.}, 979 F. Supp. 1021 (S.D.N.Y. 1997) (finding plaintiffs’ expert’s damage report was flawed in part due to lack of event study parsing specific factors affecting share price). For other cases demonstrating importance of event studies in trial court proceedings, see, for example, \textit{In re Worldcom, Inc.}, Sec. Litig., 219 F.R.D. 267 (S.D.N.Y. 2003); \textit{In re N. Telecom Sec. Litig.}, 115 F. Supp. 2d 446 (S.D.N.Y. 2000); \textit{In re Oracle Sec. Litig.}, 829 F. Supp. 1176 (N.D. Cal. 1993).

Loss Causation Post-Dura

approaches to loss causation through the salient opinions in each of the federal circuit courts that has considered the issue in a 10(b) case. It also reviews the continued efficacy of these approaches and comments on the few precedents that have surfaced post-Dura.

A. Analysis of Extant Circuit Court Approaches

1. “Strict” Loss Causation (Second, Third, Fourth, and Eleventh Circuits)

Before Dura, a number of circuits had articulated the so-called “strict” position\(^{167}\) that to plead and/or prove loss causation, a plaintiff must be able to show that the facts omitted or misrepresented were the same facts that caused the investment’s decline in value. None of these courts has issued a loss causation opinion since Dura was decided.

The strongest of these strict loss causation cases is the Eleventh Circuit’s Robbins v. Koger Properties, Inc.\(^{168}\) Though the holding in the case applies not to an issuer defendant, but instead to a defendant accounting firm, and procedurally the opinion follows a post-trial motion seeking to set aside a jury verdict, the holding in Robbins—if it is still good law—most squarely rejects the view of Dura espoused in this Article. In Robbins, the plaintiffs sought to recover only the amount of the price inflation they suffered, using the amount of the stock’s price drop after a cut in dividends was announced as a proxy for the amount of the artificial price inflation they allegedly paid. To tie the stock drop to the damages they sought to recover, plaintiffs argued that the dividend cut was the inevitable result of the defendants’ misrepresented cash flow problems. Reminiscent of the district court’s opinion in Dura, the Eleventh Circuit focused on the minutes of the directors’ meeting at which the issuer decided to cut dividends and the self-serving statements of the issuer when it announced the dividend cut:

The dividend cut was announced officially in a press release on October 1, 1990. The press release stated that “[t]here has been no decline in the cash flow of Koger Properties.”

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The minutes of the September 1990 board meeting as well as KPI’s financial situation point to the conclusion that KPI cut its dividend in October 1990 because it was concerned that future financing would not be available to sustain its sales of properties—not because it discovered that past accounting errors had overstated its cash flow. No testimony supporting a contrary conclusion was offered.\(^{169}\)

Despite this last statement, the court acknowledged, “Plaintiffs’ expert testified that if the market had learned of the overstated cash flow figures while

\(^{167}\) See Escoffery, supra note 30.

\(^{168}\) 116 F.3d 1441 (11th Cir. 1997).

\(^{169}\) Id. at 1445, 1448 (emphasis added).
KPI was operating "the stock would have totally collapsed," but the court instead used this contrary conclusion to support the court's view that:

any price inflation due to Deloitte's misrepresentations was still present after October 1990 and, therefore, the value plaintiffs lost was not caused by Deloitte's misrepresentations. ... It was not until 1991 that KPI corrected its past operating revenue figures and not until 1992 that KPI charged an adjustment for the previous overcapitalizations. 170

As such, the Eleventh Circuit thus permitted itself, and dispositively so, to be persuaded by the issuer's reason for the stock drop that followed its announcement. This is one of the defects in a rule that allows damages only where a corrective disclosure is pleaded (in Robbins this was the company's own admission two years later that it had misstated its revenue). It allows the issuer who has perpetrated a fraud to "walk" the stock price down with other bad news—which may or may not permit others to suspect the truth and reduce their expectations for the stock—all the while continuing to conceal the fraud until such point that the market yawns when the truth is ultimately admitted. In the Eleventh Circuit, defendants who have committed fraud have effectively cornered the plaintiff into a rule that requires a corrective disclosure, whereupon they avoid liability by simply failing to issue one. Naturally, this result has been criticized. 171

Other courts have adopted strict loss causation rules in cases where it is less clear exactly what plaintiffs were seeking to recover in terms of "losses." For example, just before Dura was decided, the Second Circuit ostensibly settled on a strict loss causation position—also in a non-issuer fraud-on-the-market case. That Circuit's approach to loss causation has gone from one extreme to the other, 172 perhaps reflecting the wide variety and large number of 10(b) cases it has considered over the years. 173 The most recent iteration of its view on loss causation is set out in Lentell v. Merrill Lynch & Co., Inc., 174 which was decided while Dura was pending. There, the court attempts to reconcile its own multiple views. In so doing, the court stiffens its "foreseeability" rule into a test for loss causation pleading that requires a plaintiff to show that the loss in value of the investment was the "materialization of the concealed risk." 175 As such, it is consistent with the strict test set out in Robbins. But Lentell is not a straight

170. Id. at 1448.
171. See Eisenhofer et al., supra note 36, at 1435-36.
172. Compare Lentell v. Merrill Lynch & Co., 396 F.3d 161 (2d Cir. 2005), with Marbury Mgmt. v. Kohn, 629 F.2d 705, 716 (2d Cir. 1980) (permitting proof of transaction causation to suffice to also show loss causation, in case involving a trainee stock salesman's misrepresentation that he was a licensed broker).
173. The Second Circuit's very fractured views on loss causation are well documented. See Ann Morales Olazabal, Analyst and Broker-Dealer Liability Under 10(b) for Biased Stock Recommendations, 1 N.Y.U. J. L. & BUS. 1, 63-71 (2004) (discussing the Second Circuit's splintered views on loss causation in the 10(b) context).
174. 396 F.3d 161 (2d Cir. 2005).
175. Id. at 173-74 (emphasis added).
Loss Causation Post-Dura

issuer fraud-on-the-market case. Instead, it is an analyst bias case in which plaintiffs asserted that misrepresentations by defendant analysts and their employer brokerage firms induced plaintiffs' purchases of stock at artificially inflated prices. Defendants, for their part, maintained that the collapse of the internet stock sector was the cause of their losses. The district court\(^\text{176}\) agreed, finding an intervening cause.\(^\text{177}\) The Second Circuit went along, in essence refusing to hold the brokerage firm and its research analyst superstar responsible for the bursting of the Internet bubble. Even Professor Coffee has opined that the approach to loss causation set out in Lentell may not have survived Dura.\(^\text{178}\)

Though the Third Circuit's Semerenko v. Cendant Corporation\(^\text{179}\) is one of the leading cases espousing a "strict" view of loss causation, its core ruling supports the notion that in a simple stock drop case where a corrective disclosure leads to a decrease in the investment's value, loss causation is easily pled in the traditional way. The plaintiffs in Semerenko asserted that defendants' fraud artificially inflated the stock's price\(^\text{180}\) and a corrective disclosure subsequently deflated it.\(^\text{181}\) Finding these allegations to be adequate to show loss causation, the Third Circuit reversed the district court's dismissal of the complaint.

In addressing the loss causation issue, the court first recognized that its earlier opinions\(^\text{182}\) actually had espoused a rule that would permit a plaintiff to establish loss causation "simply by showing that he or she purchased a security at a market price that was artificially inflated due to a fraudulent misrepresentation."\(^\text{183}\) But, the court in Semerenko interpreted these cases to assume "that the artificial inflation was actually 'lost' due to the alleged fraud."\(^\text{184}\) In articulating a rule that is perhaps broader than was necessary to decide the case then before it, the Third Circuit reasoned in much the same way

\(^{176}\) Now-deceased Senior District Judge Milton Pollack of the Southern District of New York actually gave four reasons for dismissing the case, only one of which was loss causation. See In re Merrill Lynch & Co. Research Reports Sec. Litig., 273 F. Supp. 2d 351 (S.D.N.Y. 2003).

\(^{177}\) This is contrary to what Robbins v. Koger Properties and the Third Circuit's Semerenko v. Cendant would permit in a case against an issuer.

\(^{178}\) See Coffee, Phantom Losses, supra note 18. Professor Coffee opines that Dura's dictum permits recovery of what he calls phantom losses—a plaintiff who sells stock at a gain claims that absent the fraud the stock could have sold for an even higher price. As such, it sets forth a "less demanding" standard than that required by the Second Circuit in Lentell.


\(^{180}\) Semerenko, 223 F.3d at 186 ("[T]he price of ABI common stock was 'buoyed' by the defendants' alleged misrepresentations.").

\(^{181}\) Id. at 185 ("[T]he Class suffered a loss when the truth was made known and the price of ABI common stock returned to its true value.").


\(^{183}\) Semerenko, 223 F.3d at 184.

\(^{184}\) Id. at 185.
the Court in *Dura* did, noting that "[i]n the absence of a correction in the market price, the cost of the alleged misrepresentation is still incorporated into the value of the security and may be recovered at any time simply by reselling at the inflated price."\(^{185}\) However, the Third Circuit then went on to adopt the following rule for proof of loss causation, echoing *Robbins*: "because a [10(b)] plaintiff . . . must prove that he or she suffered an actual economic loss, we are persuaded that an investor must also establish that the alleged misrepresentations proximately caused the decline in the security's value . . . ."\(^{186}\)

This statement of what is mandated by loss causation raises two issues. First, it is something of a *non sequitur*. To require a plaintiff to prove that he or she has actually been damaged (that is, has sustained some form of economic loss) and to require that the plaintiff's damage consist of a misrepresentation-caused decrease in value of the investment are syllogistically unrelated. While the premise is somewhat axiomatic, the conclusion is without support in either the court's reasoning or in the facts of the case. Second, the Third Circuit's statement went far beyond what the Supreme Court decided in *Dura* when faced with similar arguments about the lack of an allegation that the artificial price inflation had been removed. Presumably, this nuance would not escape the Third Circuit were it now to consider a pure fraud premium case along the lines of either of hypothetical Scenarios 3 or 4.

Notably, the court in *Semerenko* went on to consider defense arguments that other events and circumstances also might have caused either the price inflation or the decrease in value of the stock. Wary of permitting such blanket intervening cause arguments as "would eviscerate 10b-5,"\(^{187}\) the court warned: "so long as the alleged misrepresentations were a substantial cause of the inflation in the price of a security and in its subsequent decline in value, other contributing forces will not bar recovery."\(^{188}\)

The Fourth Circuit has also taken a strict view of loss causation. However, its opinion in *Gasner v. Board of Supervisors*\(^ {189}\) does not arise in an artificial price inflation, fraud-on-the-market case. Instead, the suit followed a $3 million bond issue to raise funds for the construction of a county anaerobic composting facility that ultimately failed. Bondholders sued, alleging misrepresentations as to the facility's technological viability. Affirming summary judgment, the court found significant specific cautionary language in the prospectus warning the sophisticated investor plaintiffs of the risk of failure of the facility, rendering

\(^{185}\) *Id.* (citation omitted).

\(^{186}\) *Id.*

\(^{187}\) *Id.* at 186 (citing Rankow v. First Chicago Corp., 870 F.2d 356, 367 (7th Cir. 1989); W. PAGE KEETON ET AL., PROSSER & KEETON ON THE LAW OF TORTS § 44 (5th ed. 1984)).

\(^{188}\) *Semerenko*, 223 F.3d at 186-87 (citing *Robbins*, 116 F.3d at 1447 n.5).

\(^{189}\) 103 F.3d 351 (4th Cir. 1996).
the alleged misstatements and omissions immaterial as a matter of law under the “bespeaks caution” doctrine. The court then found that summary judgment was “supportable on another ground,” namely loss causation, citing (pre-Lentell) Second Circuit authority for the proposition that “a direct or proximate relationship between the loss and the misrepresentation must be shown.” Thus, the court in Gasner required a showing that the misrepresentation caused the decrease in value of the investment:

The fact that the technology was allegedly experimental and unproven had little to do with the company’s collapse. It was not faulty technology which caused the failure of the venture but rather economic factors. Appellants have not pointed to evidence in the record which would support their allegation that the proximate cause of their loss was the failure of the technology to work. We conclude on this record that appellants have failed to produce evidence below to show that the alleged misrepresentations or omission proximately caused their damages.

It is unclear whether plaintiffs sought to recover the entire value of their investment or only the amount by which the defendants’ alleged misrepresentations may have artificially inflated the price of the bonds, and no other Fourth Circuit case addresses loss causation. Therefore it is uncertain how that Circuit might respond to a pure artificial price inflation claim.

2. An Ad Hoc Approach: The Seventh Circuit

Bastian v. Petren Resources Corporation, heralded as the Seventh Circuit’s definitive statement on loss causation, is noted by the Dura Court as one of the several circuit court positions inconsistent with the Ninth Circuit’s ruling in Dura. Frequently cited in fraud-on-the-market cases, Bastian involved plaintiffs who sued under 10(b) when the value of their oil and gas limited partnership investments fell to nothing. Their complaint alleged that defendants’ misrepresentations and omissions in the offering memorandum induced their purchase, and that they would not have invested had they known the truth. The Bastian plaintiffs admitted they “had no idea why their investments lost their value.” In affirming the district court’s dismissal of the complaint, the court assumed that plaintiffs would have invested in some other gas and oil partnership; therefore their attempt to recover the entire amount of their investment was in vain:

[T]he profitability of drilling for oil (and gas, which generally is produced with it) in the continental United States plummeted. . . . [Plaintiffs] wanted to invest in oil and gas limited partnerships; they only wanted to be sure that the general partners were honest and competent people. Yet to be honest and competent is not to be gifted with prevision. If the alternative oil and gas limited partnerships to which

190. Id. at 358.
191. Id. at 360.
192. Id.
194. Id. at 680.
these plaintiffs would have turned had the defendants leveled with them were also
doomed, despite competent and honest management, to become worthless, the
plaintiffs were not hurt by the fraud; it affected the place but not the time or amount
of their loss.\footnote{195}

The court further noted: "The plaintiffs in the present case were not told
that oil and gas partnerships are risk-free. They knew they were assuming a risk
that oil prices might drop unexpectedly. They are unwilling to try to prove that
anything beyond the materializing of that risk caused their loss."\footnote{196} The court
was quick to point out that recovery for the entire amount of their losses would
not be precluded in other settings involving, for example, a misrepresentation
about the investment that, had it been truthfully described, might have
prompted the plaintiffs to invest their money elsewhere.\footnote{197} This reasoning lies
squarely in support of recovery in hypothetical Scenario 5.

The suit in \textit{Bastian} involved neither an artificial price inflation allegation
nor a fraud-on-the-market setting. Therefore, its application in that context is
perhaps suspect. Indeed, how the Seventh Circuit might approach a pure price
inflation case remains quite uncertain. On the one hand, the court in \textit{Isquith v.
Caremark International, Inc.}\footnote{198} distinguished transaction causation from loss
causation, defining the latter as "a loss produced by a discrepancy between the
actual market value of a stock and what that value would have been had there
been no misrepresentation."\footnote{199} But more to the point, the court stated that the
kinds of losses with which 10(b) is concerned are those that involve "a loss of
investment value as a consequence of the concealment or distortion of the
truth." This \textit{dicta}, if applied broadly and indiscriminately, would preclude a
pure fraud premium suit of the type described herein.

Somewhat unsurprisingly, \textit{dicta} in another Seventh Circuit opinion of the
same vintage is not in accord. In \textit{Goldberg v. Household Bank FSB},\footnote{200} the court
affirmed dismissal of the case, wryly concluding that the plaintiff "came up
short on the facts rather than the theory."\footnote{201} Indeed, Judge Easterbrook’s
opinion intimates that damage theories other than the most traditional are

\footnote{195. \textit{Id.} at 684. Interestingly, in aid of its decision the court makes an analogy to a medical
malpractice case in which the plaintiff alleges that his decedent died following a physician’s inept care,
but gives no cause of death and does not aver that it was the result of the physician’s maltreatment. \textit{Id.} at
684. This analogy may be somewhat apt in a securities fraud case involving individual reliance and in
which the plaintiff is seeking recovery of the entire value of his investment, but it is strained at best in a
fraud-on-the-market suit involving an attempt to recover only the fraudulently inflated portion of the
purchase price.}

\footnote{196. \textit{Id.} at 686.}

\footnote{197. \textit{Id.} at 685-86 (citing Bruschi v. Brown, 876 F.2d 1526 (11th Cir. 1989)); see also Marbury
Mgmt. v. Cohn, 629 F.2d 705, 716 (2d Cir. 1980) (finding liability in similar circumstances despite
apparent conflation of transaction and loss causation).}

\footnote{198. 136 F.3d 531 (7th Cir. 1998).}

\footnote{199. \textit{Id.} at 535.}

\footnote{200. 890 F.2d 965 (7th Cir. 1989).}

\footnote{201. \textit{Id.} at 967.}
feasible under 10(b). This acknowledgment supports the notion that plaintiffs who have paid artificially inflated prices can suffer and therefore make a claim for losses caused by defendants' securities fraud if they establish that their ultimate sales price would have been higher without the defendant's fraud:

[Plaintiff] sought $3.75 per share, the amount the stock declined on the date the truth came out. The defendants replied that he could not recover anything, because the price after the revelation was no worse than what he paid. Yet a firm that lies about some assets cannot defeat liability by showing that other parts of its business did better than expected, counterbalancing the loss. When markets are liquid and respond quickly to news, the drop when the truth appears is a good measure of the value of the information, making it the appropriate measure of damages.

Here, the court's reaction to somewhat extreme facts both illustrates and validates the expedient out-of-pocket measure. But it also reflects a willingness, similar to that of the Dura Court's, to entertain alternative theories of loss under 10(b).

3. "Some Causal Nexus" (Eighth and Ninth Circuits)

Recall that before Dura, the Eighth and Ninth Circuits took a very liberal approach to pleading loss causation, permitting cases to proceed beyond the dismissal stage on mere positing of "some causal nexus" between the alleged fraud and the plaintiff's damage. One of the biggest criticisms of this approach in artificial price inflation cases is that it could result in some plaintiffs reaping a windfall for uncorroborated or nonexistent damages. In its simplest form, the argument goes that so-called "in and out" traders could sell their inflated stock before any loss in value occurred and then double-dip by also collecting damages in the form of the fraud premium in a subsequent class action.

But the pre-existing framework for damage analysis in the Eighth and Ninth Circuits prevented any double recovery. Taking the Supreme Court's lead in Affiliated Ute and Randall, these circuits start with the out-of-pocket measure of damages, which implicitly acknowledges that the 10(b) plaintiff's injury occurs at the moment she purchases a stock at an artificially inflated price. In fact, Judge Sneed's influential concurrence in Green v. Occidental

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202. These are the "phantom losses" of which Professor Coffee speaks. Coffee, Phantom Losses, supra note 18.
203. Goldberg, 890 F.2d at 966-67.
204. See, e.g., Coffee, Phantom Losses, supra note 18, at 533 (framing the Dura case, before the Supreme Court's ruling, as follows: "At issue is whether a loss that never actually occurred in the real world—but arguably would have if other events had not intervened or if full corrective disclosure had been made—can support a Rule 10b-5 cause of action against a public corporation"); Reply Brief, Dura Pharm. Inc. v. Broudo, 2003 U.S. Briefs 932, 2004 U.S. S. Ct. Briefs LEXIS 832, at *3.
205. This possibility apparently concerned the Supreme Court greatly in the Dura case. See supra notes 84-89 and accompanying text.
Petroleum argues that the most conservative view of plaintiffs' damages fixes them as "the difference between the purchase price and the value of the investment at the date of purchase"—rather than the date of the discovery of the fraud, which would be a rescissionary measure that improperly burdens defendants with the entire post-fraud loss in value. As Judge Sneed points out, the out-of-pocket damage calculation "measures precisely the extent to which the purchaser has been required to invest a greater amount than otherwise would have been necessary.

To guard against the so-called "in and out" problem, under the Ninth Circuit's damage rubric, plaintiffs are then required to prove not only that they incurred the artificial price inflation injury but also that they suffered compensable damages because they had not passed the price inflation on to other unsuspecting investors by selling before the price inflation was removed. To accomplish this at summary judgment or trial, these circuits strictly limited plaintiffs to their "actual damages"—based on section 28 of the '34 Act—eliminating the concern that uninjured plaintiffs would recover: "If the stock is resold at an inflated price, the purchaser-seller's damages...must be diminished by the inflation he recovers from his purchaser."

Of course, the Dura Court found this procedure to be lacking. In effect, Dura tells the Ninth Circuit that it may not suspend until a later stage in the proceedings the issue of whether recoverable damages have been incurred. Instead, fraud-on-the-market plaintiffs who allege they are injured by artificial price inflation caused by defendants' misrepresentations will have to also allege some theory of damages at the complaint stage—whether it be recovery of the artificial price inflation paid (which has now been removed, and the plaintiffs are thereby damaged), recovery of the reduced profit the plaintiff would have made on sale were it not for the fraud, as suggested by Justice Breyer's questioning at oral argument, or otherwise.

208. 541 F.2d 1335 (9th Cir. 1976).
209. Id. at 1344 (Sneed, J. concurring).
210. Id.
211. Blackie v. Barrack, 524 F.2d 891, 908-09 (9th Cir. 1975); see also Wool v. Tandem Computers, Inc., 818 F.2d 1433, 1437 & n.4 (9th Cir. 1987) (describing the causation and damage calculation as a "two-step process...used when dealing with in-and-out traders"). Other courts outside the Eighth and Ninth Circuits followed this practice as well. See, e.g., In re Cendant Corp. Sec. Litig., 109 F. Supp. 2d 235, 254 (D.N.J. 2000); In re LTV Sec. Litig., 88 F.R.D. 134, 148-49 (N.D. Tex. 1980).
212. Dura Transcript, supra note 40, at *26-27. Recall that Judge Easterbrook of the Seventh Circuit also suggested these types of damages might be available in dicta in a pre-millennium case. Goldberg v. Household Bank Fin., 890 F.2d 965 (7th Cir. 1989). This notion was echoed by the Eighth Circuit more recently in Gebhardt v. ConAgra Foods, Inc., 335 F.3d 824, 831-32 (8th Cir. 2003) (noting that investors can also suffer an injury "[i]f a stock does not appreciate as it would have absent the fraudulent conduct," so that their profit is smaller than it would have been).
Loss Causation Post-Dura

B. Cases Since Dura

Numerous district court cases have now applied Dura in a variety of different ways, based on the different pleadings and fact settings before them.213 But only one circuit court has made a new, Dura-based loss causation pronouncement.214 In D.E. & J. Ltd. Partnership v. Conaway,215 the formerly-silent-on-loss-causation Sixth Circuit discussed Dura at length, interpreting it strictly to require a plaintiff class show that the loss in value of their investment was "the market's acknowledgement of prior misrepresentations."216 Like the complaint in Dura, the D.E. & J. complaint alleged "Plaintiffs and the Class have suffered damages in that, in reliance on the integrity of the market, they paid artificially inflated prices for Kmart publicly traded securities."217 Elsewhere, the complaint stated "the price of Kmart stock dropped from $1.74 per share to $0.70 per share on January 22, 2002, following the company's

213. Compare recent opinions denying defense motions to dismiss, e.g., Brumbaugh v. Wave Sys., Inc., 2006 U.S. Dist. LEXIS 725, at *34-36 (D. Mass. Jan. 11, 2006) (interpreting Dura as not requiring a corrective disclosure), and In re Royal Dutch/Shell Transport Sec. Litig., 2005 U.S. Dist. LEXIS 32190, at *7-27 (D.N.J. Dec. 12, 2005) (disagreeing with defense position that plaintiffs must sell the securities after a decline in value to "actualize" the loss under Dura), with cases granting them, e.g., Jefferson Ins. Co. v. Rouhana (In re Winstar Commc'ns), U.S. Dist. LEXIS 7618, at *45-46 (S.D.N.Y. Feb. 24, 2006) (interpreting Dura to require a corrective disclosure of some type: "[i]t is the exposure of the falsity of the fraudulent representation that is the critical component of loss causation), and In re First Union Corp. Sec. Litig., 2006 U.S. Dist. LEXIS 5083, at *14-16, *18-19 (W.D.N.C. Jan. 20, 2006) (citing Dura for the proposition that "securities fraud plaintiffs must allege that misrepresentation not only induced them to purchase the security at an inflated price, but also caused security's subsequent decline in value")

At least one district court has ruled in plaintiffs' favor on loss causation at the summary judgment stage since the Dura decision. See In re The Loewen Group Sec. Litig., 395 F. Supp. 2d 211, 218 (E.D. Pa. 2005) (ruling that plaintiffs "pleaded loss causation adequately by alleging that they purchased TLGI stock at an inflated price and lost money when the price fell")

214. Other than for purposes of establishing the elements of a 10(b) claim, only two other circuit courts have had occasion since Dura to cite it. The Fifth Circuit mentioned Dura in a criminal securities fraud matter arising out of the collapse of Dynegy Corp. See United States v. Olis, 429 F.3d 540 (5th Cir. 2005). In a section addressing the Federal Sentencing Guidelines' loss calculations, the court in Olis analogizes to the notion of loss causation in civil securities fraud cases, citing Dura for the proposition that the principle of loss causation is well established. Further citing Fifth Circuit precedent and the "general" measure of damages in securities fraud cases, the court finds that, for purposes of assessing a criminal defendant's culpability score, there is no loss attributable to a misrepresentation unless and until the truth is subsequently revealed and the price of the stock accordingly declines. Where the value of a security declines for other reasons, however, such decline, or component of the decline, is not a "loss" attributable to the misrepresentation.

Id. at 546. This statement is consistent with a strict view of loss causation in a traditional or "simple" securities fraud case. Notably, Dynegy's stock price dropped after the defendant's fraud was revealed.

The Third Circuit, likewise, refers to Dura in In re Merck & Co., Sec. Litig., 432 F.3d 261, 274-75 (3d Cir. 2005). The court points out that section 11 plaintiffs need not prove loss causation, and comments in dicta—and without reference to Dura—that 10(b) plaintiffs "have to plead loss causation—i.e., that the misrepresentation caused the stock price drop," but later cites Dura for the proposition that loss causation and materiality are separate elements of a 10(b) claim. Neither of these opinions applies Dura to its facts.

216. Id. at 1000-01 (citing Lentell v. Merrill Lynch & Co., 396 F.3d 161, 175 n.4 (2d Cir. 2005)).
217. Id. at 1000.
disclosure that it had filed for reorganization under Chapter 11. The Court found this latter allegation to be merely an "observation" that the stock's value had decreased and not an allegation that defendants "caused the loss." Therefore, according to the Sixth Circuit, this complaint was no different than that in *Dura*, and the Supreme Court's opinion therefore was directly on point in precluding recovery. Hence the *D.E. & J.* case interprets *Dura* as adopting the Eleventh Circuit's strict loss causation view that a corrective disclosure is required.

On appeal, the class in *D.E. & J.* also argued that a five-cent drop in Kmart's stock price followed the company's restatement of its financials, but this statement apparently was not set out in the complaint. In *dicta* the Sixth Circuit surmises that if plaintiffs had pled facts relative to the five-cent price drop, they would have adequately alleged a theory of economic loss caused by the defendants, presumably only as to that five cents per share. Even without reference to *Dura*, such a corrective disclosure allegation would have allowed the *D.E. & J.* plaintiffs easily to surmount the strict loss causation approach by simply pleading loss causation in the aforementioned traditional way. Instead, it appears that, like the class in *Dura*, they sought to both have their cake and eat it too. Before discovery they did not want to take a position that would preclude (1) an argument for establishing the amount of the artificial price inflation at a higher number; (2) an argument for recovery of the entire loss in value of the investment since their date of purchase; or (3) any suggestion that defendants had failed to come forward with evidence disproving they caused any portion of such a larger loss.

The Ninth Circuit has since discussed *Dura* on several occasions. First, it revised two of its outstanding opinions. In *In re Daou System*, plaintiffs alleged a stock drop caused by revelation of the defendant's true financial picture, which had been concealed by fraudulent revenue recognition practices. The Ninth Circuit found this sufficient to satisfy *Dura*. Given that it follows the traditional pattern of pleading a stock drop following a corrective disclosure, the result is not surprising and would pass muster even under the

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218. *Id.*
219. *Id.*
220. This is unsurprising; it is consistent with prior Fifth Circuit decisions that rely on *Huddleston* for their understanding of loss causation. See, e.g., Campbell v. Shearson/Am. Express Inc., 1987 U.S. App. LEXIS 12102, at *5 (6th Cir. Sept. 9, 1987) (unpublished disposition) (quoting *Huddleston*'s "touches upon" language in non-10(b) setting); Murray v. Hosp. Corp. of Am., 682 F. Supp. 343, 346 (M.D. Tenn. 1988), aff'd, 873 F.2d 972 (6th Cir. 1989) (quoting same language in 10(b) case).
222. *Id.* at 1001.
223. MIGUEL DE CERVANTES SAAVEDRA, DON QUIXOTE., Part ii, ch. xliii (1605) ("You cannot eat your cake and have your cake . . . .").
224. 411 F.3d 1006 (9th Cir. 2005).
225. *Id.* at 1026-27.
Loss Causation Post-Dura

strictest approaches to loss causation employed in other circuits before *Dura*.

The Ninth Circuit also revised its opinion in *Livid v. Salomon Smith Barney, Inc.*, pointing out that the Supreme Court’s ruling in *Dura* was not controlling in the circumstances of the case, which was not a fraud-on-the-market class action suit:

Livid has sufficiently pled both elements of causation because it has alleged both that they would not have purchased the PCI stock but for the misrepresentation and that the Defendants’ misrepresentation was directly related to the actual economic loss it suffered. . . . Defendants’ misrepresentation concealed PCI’s financial situation. As a result of its dire financial situation, PCI eventually went bankrupt, which caused Livid to lose the entire value of its investment in PCI.226

More notably, the Ninth Circuit also has had a few occasions to address loss causation in fraud-on-the-market cases since *Dura*, predictably interpreting its holding with cautious language. For example, in *Knollenburg v. Harmonic, Inc.*227 plaintiffs alleged misrepresentations and their purchase of stock during the class period, but they failed to allege that they sold at a loss. In this most extreme case, the Ninth Circuit dutifully adhered to *Dura*, ruling that plaintiffs failed to adequately allege loss causation.228 Similarly, the court affirmed summary judgment against the plaintiff class in *Mortensen v. Snavely*,229 noting that “plaintiffs needed to prove both that the shares were overvalued on the date of purchase and that the misrepresented value which induced their purchase also caused a loss when they sold their shares”—but in this case, they had failed to do so.230

At a minimum these two cases leave open the possibility that a complaint asserting, as the complaint in *D.E. & J.* did, that 1) fraud caused an artificially inflated price; and 2) this inflation was removed without a “corrective disclosure” for unclear or unrelated reasons, could in fact suffice under *Dura* if the plaintiffs sought to recover only the amount of the artificial price inflation rather than some other larger amount, such as the total reduction in value of the investment since their purchase. This position has yet to be tested and takes only the next logical step beyond what the Court said in *Dura*.

VI. CONCLUSION

*Dura* may be just as important for what it did not accomplish as for what little it said about loss causation. It did not impose a higher pleading standard on loss causation than mandated by Rule 8. And while it recognized the possibility of a corrective disclosure, the opinion cannot properly be read to

226. 416 F.3d 940, 943-44 (9th Cir. 2005).
228. Id. at *29.
230. Id. at *3-4 (emphasis added).
require such as a prerequisite to recovery in fraud-on-the-market suits. Moving to the core of the Court's holding, post-Dura, no longer can plaintiffs throw questionable damage arguments against the wall to see what might eventually stick with a jury. Instead, plaintiffs will have to adhere to a marginally stricter loss causation approach requiring them to describe their damages at an earlier stage of the litigation.

In the wake of Dura, and specifically to recognize the PSLRA's goal of reducing the cost of strike suits, plaintiffs will now be required to articulate their theory of loss—be it recovery of the artificial price inflation, the amount by which defendants' fraud diminished their investment's appreciation, or in the proper case, the entire amount of the investment—at the complaint stage. Thereafter, plaintiffs are required—as they always have been—to prove the traditional elements of causation and loss. About loss causation or damages in 10(b) cases, Dura says no more.