

May 3, 2005

## Supreme Court Clarifies Plaintiff's Burden to Establish Loss Causation in Securities Litigation

On April 19, 2005, the United States Supreme Court issued its decision in *Dura Pharmaceuticals v. Brouda* (“*Dura*”). The Court’s decision resolved a Circuit split regarding whether a plaintiff in a fraud-on-the-market securities case must plead and prove a causal nexus between an alleged fraud and a subsequent decline in stock value in order to establish the required “loss causation” element of their case. In a unanimous decision authored by Justice Breyer, the Court reversed a controversial decision of the Ninth Circuit Court of Appeals, and held that a plaintiff must plead and prove a specific causal connection between an alleged misrepresentation and a subsequent decline in stock price. Under the Court’s decision, plaintiffs can no longer meet their “loss causation” burden by merely alleging that they paid an inflated price for the company’s stock due to an alleged omission or misrepresentation.

“Loss causation” has always been a required element of a securities fraud claim. This element addresses the causal link (if any) between the alleged misconduct and the financial harm ultimately suffered by a plaintiff. Prior to the Supreme Court’s decision, the various Federal Circuits had taken different approaches on how to define loss causation, with several Circuits effectively eliminating the requirement by holding that plaintiffs were only required to plead that they would not have made the investment if they had known the “true facts.” These Circuits treated these allegations, which alleged simply that the plaintiff purchased stock at an inflated price, as sufficient to meet all requirements of causation, including loss causation. Critically, these Circuits ignored other intervening factors, such as general market conditions (for example, the overall collapse of the Internet “bubble”), and the lapse of time, in concluding that plaintiffs had plead this element of their securities fraud claims.

In *Dura*, the plaintiffs alleged that defendants made misleading statements during a ten month period about, among other things, clinical trials necessary to obtain FDA clearance for Dura’s Albuterol Spiros delivery device for asthma medication. Among other grounds, the defendants moved to dismiss the complaint on ground that plaintiffs failed to plead a sufficient causal connection between the

alleged misrepresentations and the subsequent drop in stock value. The district court dismissed the complaint, determining that Plaintiff’s complaint did not contain any allegations that the FDA’s non-approval of the Albuterol device had any relationship to the subsequent decline in Dura’s stock price.

The Ninth Circuit reversed, concluding that the plaintiffs were not required to establish a causal connection between the Dura’s alleged omissions and the subsequent decline in the stock price. Instead, the Ninth Circuit concluded that the plaintiffs could satisfy the loss causation element by merely pleading that the price at the time of purchase was inflated because of defendants’ conduct. According to the Ninth Circuit, the injury occurred when the plaintiffs purchased the stock at an inflated price; thus, the plaintiffs were not required to allege a subsequent disclosure and related decline in the market price of the stock.

The Supreme Court reversed the Ninth Circuit, clarifying the requirements for loss causation, as well as the benchmark for when a plaintiff in a securities fraud case begins to sustain damages. The Court dismissed the idea that price inflation is the equivalent of an economic loss: “[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 instance possesses equivalent value.” Recognizing the role intervening factors can play in a stock price decline, the court added, “the logical link between the inflated purchase price and any later economic loss is not invariably strong, since other factors may affect the price.” While the inflated purchase price suggests that the misrepresentation “touches upon” a later economic loss, the Court pointed out that “to touch upon a loss is not to *cause* a loss.”

The Supreme Court’s decision is a significant victory for all issuers and other potential defendants in securities cases. Nonetheless, while the Court’s decision clarifies that a plaintiff’s “inflated price” theory cannot survive loss causation analysis, the opinion still leaves a number of questions unanswered, such as the quantification of damages in “mixed cases” (*i.e.* cases in which stock price decline is

attributable to an alleged misrepresentation and other intervening factors), the pleading requirements applicable to causation, and the impact of subsequent corrective disclosures. For example, the Court notes that several factors, other than misrepresentations, can cause a stock price decline, but fails to provide guidance on how plaintiffs can successfully plead and prove loss causation, and quantify damages, in cases where some or all of these factors are present. In addition, the opinion is unclear as to whether the stock price decline needs to be the result of a corrective disclosure that reveals the “truth” to the market, as opposed to some other related factor that is alleged to have impacted the market. Finally, the Court expressly left open the question of whether plaintiffs need to plead loss causation with particularity as required by Fed. R. Civ. P. 9(b) or the Private Securities Litigation Reform Act.

For a copy of the Opinion, [click here](#).

*We have summarized the important issues of this ruling to keep this memo brief but at the same time to call this development to your attention. This memo has been written by several Seyfarth Shaw attorneys who regularly defend securities complex class action matters throughout the country. For further information regarding this opinion, or to discuss any of these issues in more detail, please contact a member of Seyfarth Shaw's Securities and Financial Litigation Practice Group.*

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