



## OUTSIDE COUNSEL

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### *Loss Causation in the Ninth Circuit*

This summer, a U.S. district court reversed a \$277.5 million jury verdict based on a perceived failure of the plaintiff to prove loss causation and the U.S. Court of Appeals for the Ninth Circuit wrote two decisions addressing the issue of loss causation on motions to dismiss: one affirming dismissal and the other reversing.

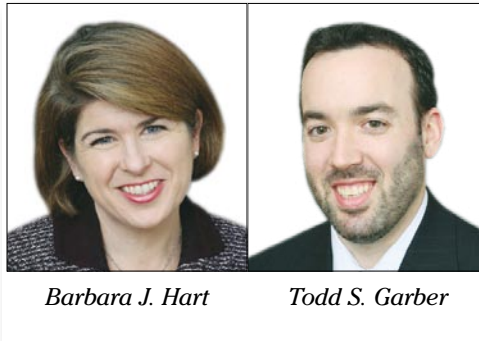
The question presented is whether these decisions articulate a single coherent standard and whether it is more stringent for pleading and proving loss than that articulated under the leading loss causation precedent in the Ninth Circuit in *In re Daou Sys. Inc.*, 411 F.3d 1006, 1026-27 (9th Cir. 2005). In that decision, the court held post-*Dura*, that a plaintiff adequately pleads loss causation by alleging that disclosure of the defendant's true financial condition resulted in a steep drop in its stock price.

In fact, the decisions are readily harmonized and emphasize the low pleading standard and the fact-specific nature of pleading and proving loss causation.

#### Background

The elements of a §10(b) claim are: (1) a material misrepresentation or omissions; (2) scienter, i.e., a culpable state of mind comprising knowledge or severe recklessness; (3) reliance; and (4) "loss causation," i.e., a causal connection between the material misrepresentation and the economic loss. *Dura Phar. Inc. v. Broudo*, 544 U.S. 336, 341 (2005).

In *Dura*, the U.S. Supreme Court decided a narrow issue relating to the pleading of loss causation in actions brought pursu-



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ant to §10(b) of the Securities Exchange Act of 1934 and Rule 10(b)5 promulgated thereunder. Reversing the Ninth Circuit, the Supreme Court held that investors must plead and then prove that a material misrepresentation or omission proximately caused the economic loss alleged so as to provide defendants with fair notice of plaintiffs' claimed losses. *Dura*, 544 U.S. at 346. The Supreme Court went on to state that the loss causation requirement is "not meant to impose a great burden upon a plaintiff" and simply requires a plaintiff to provide a short and plain statement setting forth the relevant loss and "what the causal connection might be between" plaintiff's loss and defendants' misconduct. *Dura*, 544 U.S. at 347.

Following *Dura*, courts in the Ninth Circuit have held that all plaintiffs need do is "provide a defendant with *some indication* of the loss and the causal connection that the plaintiff has in mind." *Plumbers & Pipefitters Local 57 Pension Fund v. Cisco Systems Inc.*, 411 F.Supp.2d 1172, 1175 (N.D. Cal. 2005) (quoting *Dura*, 544 U.S. at 347 (emphasis in original)). While *Dura* did not specify how the causal link could be satisfied, the Ninth Circuit and courts in the Ninth Circuit have held that allegations that a stock declined following a disclosure of the alleged misconduct is sufficient to allege the necessary causal connection. See, e.g., *In re Daou Systems Inc.*, 411 F.3d at 1026-27 (allegations that series of partial disclosures revealed company's "true finan-

cial health" satisfy *Dura*); *Cisco Systems*, 411 F.Supp.2d at 1177-78 (stock declines following partial disclosures sufficient to plead loss causation under *Dura*); *In re Immune Response Sec. Litig.*, 375 F.Supp.2d 983, 1025 (S.D. Cal. 2005) (allegation that "the disclosures caused the drop in stock price" satisfies *Dura*).

The Ninth Circuit's recent decision affirming dismissal of a securities class action in *Metzler Investment GMBH v. Corinthian Colleges Inc.*, \_\_\_F.3d\_\_\_, 2008 WL 2853402 (9th Cir. July 25, 2008) (*Corinthian Colleges*) followed by the district of Arizona's judgment notwithstanding the jury verdict in *In re Apollo Group Inc. Sec. Litig.*, 2008 WL 3072731 (D. Ariz. Aug 4, 2008) (*Apollo*) appeared to have signaled a raising of the bar for pleading and proving loss causation in the Ninth Circuit and a departure from the Ninth Circuit's post-*Dura* precedent.

However, before the holdings of *Corinthian Colleges* and *Apollo* could ever be debated, much less fully understood, the Ninth Circuit issued yet another decision on loss causation in *In re Gilead Sciences Sec. Litig.*, \_\_\_F.3d\_\_\_, 2008 WL 3271039 (9th Cir. Aug. 11, 2008) (*Gilead*) reversing the district court's dismissal on loss causation, while holding that as "long as the complaint alleges facts that, if taken as true, plausibly establish loss causation," dismissal is inappropriate. *Id.* at \*8.

While it is too early to say how these decisions will be interpreted by other courts within the Ninth Circuit and across the country, the recent decisions do not appear to be the departure from *Dura* they first appeared to be, but rather a reaffirmance of the low threshold for pleading loss causation and its fact specific nature.<sup>1</sup> We briefly discuss each decision below.

#### Recent Cases

In *Corinthian Colleges*, the Ninth Circuit affirmed the dismissal of a securities fraud class action, holding that plaintiffs had failed to, among other things, sufficiently

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plead loss causation. *Corinthian Colleges*, 2008 WL 2853402. In *Corinthian Colleges* the complaint alleged that Corinthian Colleges manipulated student enrollment figures to make it seem as if more students were enrolled than actually were, and, as a result, improperly received federal funding which it reported as income.

According to the complaint, a Financial Times story disclosing a Department of Education investigation of enrollment irregularities at one of Corinthian Colleges' campuses and the company's subsequent earnings announcement adjusting the company's revenue forecast together were public admissions of wrongdoing that were directly responsible for the company's stock decline on those dates.

The Ninth Circuit disagreed, holding that the alleged improprieties divulged in the Financial Times did not reveal companywide fraudulent practices, and that Corinthian Colleges' adjustment of its revenue forecast led to a decline in share price not because it was a "revelation of Corinthian's systematic manipulation of student enrollment," but because "the company failed to hit prior earnings estimates." The Ninth Circuit held that the complaint did not allege that the announcements disclosed "the fraudulent activity that [plaintiff] contend[ed] forced down the stock that caused its losses." Consequently, the court held that plaintiff had failed to plead loss causation.

Little more than a week after *Corinthian Colleges*, Judge James A. Teilborg issued a judgment notwithstanding the jury verdict in *Apollo* overturning a \$277.5 million verdict based on plaintiffs' perceived failure to prove loss causation.

### 'Apollo'

The *Apollo* case involved alleged misrepresentations and omissions relating to a Department of Education report that discussed Apollo's potential violations of department rules. Shareholders claimed that Apollo covered up the Department of Education report that criticized Apollo's recruitment policies.

The report concluded that enrollment counselors were paid solely on their success in securing enrollments, which violated federal regulations. When news of the report became public, Apollo's share price did not move. It was not until one week later, when securities analysts issued what the district court termed the "Flynn reports," which expressed concern about Apollo's exposure to regulatory issues, that Apollo's share price fell. Judge Teilborg held that "even accepting the premise that

analysis of existing facts may sometimes be necessary to reveal a fraud to the market, the Flynn reports were not necessary to reveal the fraud in this case because they did not provide any new, fraud revealing analysis." *Apollo*, at \*3.

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### 'Gilead Sciences'

Then, a little more than two weeks after deciding *Corinthian Colleges*, and after Judge Teilborg's decision in *Apollo*, the Ninth Circuit decided *In re Gilead Sciences Sec. Litig.*, 2008 WL 3271039.

In *Gilead*, the Ninth Circuit reversed a district court dismissal which concluded that plaintiffs' had failed to plead loss causation. The complaint alleged a scheme that hinged on the ability of Gilead to improperly increase sales for one of its leading drugs by selling it in violation of FDA regulations regarding off-label marketing. As a result of Gilead's aggressive marketing through off-label promotion, the FDA issued two warning letters to the company. After the second warning letter, the FDA required the company to publicly correct its marketing statements. The company disclosed the second FDA letter on Aug. 8, 2003 at which time the company's share price did not decline. This absence of a decline formed the basis for the defendants' challenge to loss causation.

Three months later, when the company subsequently reported its financial results revealing reduced sales of its blockbuster drug, Gilead's stock price plunged 12 percent. The district court concluded that it could not make "the unreasonable inference that a public revelation caused a price drop three months later." 2008 WL 3271039, at \*8.

In reversing the district court, the Ninth Circuit concluded that "the complaint sufficiently allege[d] a casual relationship between (1) the increase in sales resulting from the off-label marketing, (2) the Warning Letter's effect on [the drug] orders, and (3) the Warning Letter's effect on Gilead's stock price." Id.

The Ninth Circuit concluded that the link between the publication of the warning let-

ter in July and the disclosure of poor sales in late October was sufficient. The Ninth Circuit concluded that the more than three-month temporal gap between the time the misrepresentation was revealed and the subsequent decline in stock price did not render plaintiff's theory of loss causation implausible. Id., at \*9.

### Conclusion

As illustrated above, the resolution of loss causation requires a fact-intensive inquiry unique to each fraud. Under the rationale applied in the recent decisions, plaintiffs appear to still be able to easily plead loss causation needing only to allege a plausible connection between the alleged disclosures and the drop in stock price, and such connection can have a significant temporal gap. All *Corinthian Colleges* and *Apollo* have done is serve to highlight the importance of pleading and proving that the alleged disclosures actually provided a "new, fraud revealing analyses," and as proved by *Gilead*, did not raise the bar on pleading and proving loss causation in the Ninth Circuit.

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1. While the Ninth Circuit in both *Corinthian College* and *Gilead* ducked the question of whether the pleading requirements of federal rule of civil procedure 8(a) or 9(b) applies to pleading loss causation, the issue does not appear to be in dispute in either the Ninth Circuit or across the country where the majority of courts that have addressed loss causation since the Supreme Court's decision in *Dura*, including the *Dura* district court on remand, have concluded that, consistent with Rule 8 of the Federal Rules of Civil Procedure, a plaintiff must provide only a 'short and plain' statement adequate to give defendants some indication of the loss and the causal connection that the plaintiff has in mind. See *In re Dura Pharmaceuticals Inc. Sec. Litig.*, 452 F.Supp.2d 1005, 1021 (S.D. Cal. 2006) (citing *Dura*, 544 U.S. at 346, 125 S.Ct. 1627); *In re Coca-Cola Enterprises Inc. Sec. Litig.*, 510 F. Supp. 2d 1187 (N.D. Ga., Feb. 07, 2007); *In re Immucor Inc. Sec. Litig.*, 2006 WL 3000133, at \*19 (N.D. Ga. Oct. 4, 2006); *In re Teco Energy Inc. Sec. Litig.*, 2006 WL 2884960, at \*5 (M.D. Fla. Oct. 10, 2006) ("Loss causation is not subject to the PSLRA's heightened pleading requirement and must only be plead in accordance with Fed.R.Civ.P. 8(a)(2), which requires a 'short and plain statement of the claim showing that the pleader is entitled to relief."); *Brumbaugh v. Wave Systems Corp.*, 416 F. Supp. 2d 239, 256 (D. Mass. 2006) ("[I]n light of *Dura*'s acknowledgment that Fed.R.Civ.P. 8(a)(2) applies to the pleading of economic loss and proximate causation, this court must conclude that plaintiffs have furnished defendants 'with some indication of [their] loss and the causal connection that [they have] in mind."); *Ong v. Sears, Roebuck & Co.*, 459 F.Supp.2d 729, 742-43 (N.D. Ill. 2006) ("As an initial matter, this court concludes that, to the extent defendants suggest that *Dura* imposed stricter fact-pleading requirements for the economic loss and causation elements of an action under §10(b), Defendants are mistaken."); *In re CMS Energy Sec. Litig.*, 403 F.Supp.2d 625, 629 (E.D. Mich. 2005) ("The Supreme Court's opinion in *Dura* clearly explains that it does not modify the pleading requirements of Fed.R.Civ.P. 8(a)(2)...").