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AT A LOSS: CONGRESS, THE SUPREME COURT AND CAUSATION UNDER THE FEDERAL SECURITIES LAWS

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INTRODUCTION

In its eagerly awaited opinion in *Dura Pharmaceuticals, Inc. v. Broudo,*[1] the United States Supreme Court purports to clarify the critical concept of "loss causation" in private securities fraud litigation. Unfortunately, as this article shows, the Court's decision is inconsistent with the federal securities laws, incoherent in its reliance upon an amoebic notion of "economic loss," incomplete in its failure to address pressing causation questions and, ultimately, inconsequential.

Congress' Private Securities Litigation Reform Act of 1995 ("PSLRA")[2] includes a provision titled "Loss Causation" which requires plaintiffs in private securities fraud actions brought under the Section 10(b) of Securities and Exchange Act of 1934 ("the 1934 Act")[3] to prove that the "act or omission of

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1. Dura Pharm., Inc. v. Broudo, 125 S. Ct. 1627 (2005).

2. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (1995). *See, e.g.,* 15 U.S.C. § 78u-4 (2000).

3. Section 10 of the Securities Exchange Act of 1934, 15 U.S.C. § 78j (1994), states:

> It shall be unlawful for any person . . . (b) [t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary

the defendant . . . caused the loss for which the plaintiff seeks to recover damages."[4] This provision created some confusion and conflict among the lower federal courts over whether plaintiffs must plead and prove that defendants' fraud caused a post-transaction decline in the value of the plaintiffs' securities or whether plaintiffs can satisfy the loss causation requirement of the PSLRA by showing that the price was inflated at the time of purchase.[5]

In *Broudo v. Dura Pharmaceuticals, Inc.*,[6] the Ninth Circuit held that the element of "loss causation" in a private securities action could be satisfied by allegations that defendants' misrepresentations or omissions caused the investor to purchase securities at an artificial price.[7] The Court recognized that its understanding of loss causation may be in conflict with that of the Second and Eleventh Circuits.[8] According to Ninth Cir-

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> or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j (1994). Securities and Exchange Commission Rule 10b-5, 17 C.F.R. § 240.10b-5 (2004), provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as fraud or deceit upon any person, in connection with the purchase or sale of any security.

4. 15 U.S.C. § 78u-4(b)(4) (2000).

5. *See* Jay W. Eisenhofer et al, *Securities Fraud, Stock Price Valuation and Loss Causation: Toward a Corporate Finance-Based Theory of Loss Causation,* 59 Bus. Law 1419, 1430 (2004) [hereinafter *Securities Fraud*].

6. 339 F.3d 933, 938 (9th Cir. 2003), *rev'd,* 125 S.Ct. 1627 (2005).

7. *Id.* ("The price at the time of purchase was overstated and sufficient identification of the cause.").

8. *Id.* at 938 n.4. *See, e.g.,* Robbins v. Koger Props., Inc., 116 F.3d 1441, 1448 (11th Cir. 1997) (concluding that loss causation requires a causal link between the fraud and a post-disclosure decline in value); Suez Equity Investors, L.P. v. Toronto-Dominion Bank, 250 F.3d 87, 95 (2d Cir. 2001) (requiring causal link to subsequent decline in value in fraud on the market cases). The circuits appeared to be all over the map in their understanding of the precise causal link required by the PSLRA and the language for articulating that link. In *Semerenko v. Cendant Corp.*, 223 F.3d 165, 168 (3d Cir. 2000), the

cuit, these "other circuits are less favorable to plaintiffs and do require demonstration of a corrective disclosure followed by a stock price drop to be alleged in the complaint."[9]

Third Circuit declared: "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." In *Emergent Capital Inv. Mgmt., LLC v. Stonepath Group Inc.*, 343 F.3d 189, 197-98 (2d Cir. 2003), the Second Circuit held that allegations of a "'pump and dump' scheme" – in which defendants allegedly inflated a security's market price so that they could sell shares before it fell – provided a sufficient connection between the defendants' misstatements and the plaintiffs' loss. "Because the second amended complaint may be read as alleging that NETV was a 'pump and dump' scheme," the Second Circuit held that, "appellant has adequately alleged loss causation for the purposes of its federal securities fraud claims." *Id.* at 198. As the Seventh Circuit observed when it addressed loss causation in *Bastian v. Petren Resources Corp.*, 892 F.2d 680, 685 (7th Cir. 1990), "such conflict as there is appears to be within rather than among circuits." Even at that time, the "cases that express disagreement" in all likelihood remain reconcilable – reflecting *differing facts* rather than *differing doctrines. Id.* at 685-86. In *EP MedSystems, Inc. v. Echocath, Inc.*, 235 F.3d 865, 884 (3d Cir. 2000), the Third Circuit explained:

> Some of the other courts of appeals have also adopted a practical view of loss causation. For example, the Eighth Circuit has stated that "[p]laintiffs are not required to meet a strict test of direct causation under Rule 10b-5; they need only show some causal nexus between [the defendant's] improper conduct and plaintiff's losses." *In re* Control Data Corp. Sec. Litig., 933 F.2d 616, 619 (8th Cir. 1991) (quotation omitted). The Second Circuit similarly held that loss causation "embodied notions of the common law tort concept of proximate causation." AUSA Life Ins. Co. v. Ernst and Young, 206 F.3d 202, 216 (2d Cir. 2000) (quotation omitted), In Ambassador Hotel Co., Ltd. v. Wei-Chuan Investment, 189 F.3d 1017, 1027 (9th Cir. 1999), the Ninth Circuit stated that "the loss causation requirement limits the ability of plaintiffs to recover for losses sustained on the basis of factors unrelated to any misrepresentation or fraud." As the Eleventh Circuit stated in Robbins v. Koger Properties, Inc., 116 F.3d 1441, 1447 (11th Cir. 1997), "the loss causation requirement must be applied on a case-by-case basis."

9. 339 F.3d at 938 n.4. *See also, Securities Fraud, supra* note 5, at 1436-41; David S. Escoffery, *A Winning Approach to Loss Causation Under Rule 10B-5 in Light of the Private Securities Litigation Reform Act of 1995 ("PSLRA")*, 68 FORDHAM L. REV. 1781 (2000) [hereinafter *A Winning Approach*]. In his article surveying the landscape of judicial perspectives to loss causation, David Escoffery discovers a majority view and a minority view. *Id* at 1797. The majority view requires plaintiffs who use post-transaction investment value to measure recoverable loss to establish a connection between that loss and the defendants' fraud. *Id.* Some courts held that proof of loss causation requires a showing that defendants' misrepresentation "touches upon" the rea-

The Supreme Court granted certiorari to resolve this apparent dispute among the federal courts regarding the element of loss causation in a private securities fraud action.[10] In particular, the Court framed the question presented as whether a "securities fraud plaintiff invoking the fraud-on-the-market theory must demonstrate loss causation by pleading and proving a causal connection between the alleged fraud and the investment's subsequent decline in price."[11] In a unanimous decision, the Court reversed the Ninth Circuit and held that mere allegations and proof that defendant's misrepresentation caused an artificially inflated transaction price cannot satisfy the PSLRA's loss causation provision in a fraud-on-the-market case.[12] Rather, plaintiffs must plead and prove that they suffered an "economic loss" proximately caused by the defendants' fraud.[13]

In reaching its result, the Court reasoned that "loss causation" requires a showing that: (1) plaintiffs suffered an actual "economic loss," and (2) defendants' misrepresentation did not merely "touch upon" the reasons for the decline in value

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sons for the investments' decline in value. Huddleston v. Herman & MacLean, 640 F.2d 534, 549 (5th Cir. Mar. 1981), *aff'd in part and rev'd in part on other grounds*, 459 U.S. 375 (1983) ("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."). *See also* Ambassador Hotel Co. v. Wei-Chuan Inv., 189 F.3d 1017, 1027 (9th Cir. 1999) (applying *Huddleston*'s "touches upon" formulation); *see also* Provenz v. Miller, 102 F.3d 1478, 1492 (applying *Huddleston*'s "touches upon" formulation). The phrase "touches upon" is taken from the United States Supreme Court's opinion in *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 12-13 (1971). In that case, however, Justice Douglas used the term "touching" as a metaphor to describe § 10(b)'s statutory requirement that the fraud be "in connection with" the purchase or sale of securities. *Id.* According to the Court, when the plaintiff establishes that he has "suffered an injury as a result of deceptive practices touching [his] sale of securities," he has established that the fraud was in connection with his sale of securities. *Id.* Not surprisingly, therefore, Congress does not employ the "touches upon" language or concept in its PSLRA.

10. Dura Pharm., Inc. v. Broudo, 124 S. Ct. 2904 (2004).

11. Dura Pharm., Inc. v. Broudo, 2003 WL 23146437 (U.S. petition for certiorari filed Dec. 24, 2003) (describing questions presented), *cert. granted*, 124 S. Ct. 2904 (No. 03-932).

12. *Dura*, 125 S. Ct. 1627 (2005).

13. *Id.*

of plaintiffs' investment, but was the proximate cause of the economic loss suffered.[14] The Court justified its conclusion by referring to the PSLRA, lower federal court precedent, common law fraud concepts and the policies underlying the federal securities laws.

In this article, I analyze the concept of loss causation as specifically defined by Congress in the PSLRA, in light of the Supreme Court's *Dura* opinion.[15] Section I demonstrates that the PSLRA's loss causation provision does not require proof of a causal connection between the defendants' fraud and a post-transaction decline in the value of plaintiffs' investments. It requires plaintiffs to establish a causal link only between their recoverable transaction-based, out-of-pocket losses and the defendants' fraud. The Supreme Court's holding to the contrary simply cannot be squared with the PSLRA's unambiguous language, history, documented intent, structure and policies. Investors who prove that the defendants' fraud "caused" a quantifiable disparity between the price at which they actually purchased or sold their securities and the price at which they would have purchased or sold their securities absent the fraud have incurred a direct and discrete transaction-based "loss" recoverable under the federal securities laws. In Section II, the article shows that the Supreme Court not only misconstrued the PSLRA, but also replaced Congress' design with its own ill-defined notion of "economic loss."

In any event, as this article demonstrates in Section III, the Court's holding will likely have little impact upon the future course of securities fraud litigation. The opinion is narrowly tailored to private securities fraud claims brought by purchasers of securities who pursue a fraud-on-the-market theory of reliance. The decision thus leaves unanswered questions of loss and causation in myriad other securities fraud actions. Even in those cases in which *Dura* does apply, the Court's new loss causation standard will prove to be inconsequential be-

14. *Id* at 1634.

15. 15 U.S.C. § 78u-4(b)(4) (1998). The PSLRA governs all private securities litigation brought to enforce the provisions of the Securities and Exchange Act of 1934, 15 U.S.C. § 78a-78ll (1994), most notably Section 10(b), 15 U.S.C. § 78j(b). *See also* Securities and Exchange Commission Rule 10b-5, 17 C.F.R. § 240.10b-5 (2004) (promulgated under the authority of § 10(b)).

cause that standard can be easily satisfied – even in the *Dura* case itself.

I.
THE SUPREME COURT DISREGARDS CONGRESS' UNAMBIGUOUS LANGUAGE, LEGISLATIVE HISTORY, INTENT, STRUCTURE AND POLICIES

A. *The Supreme Court Disregards the PSLRA's Unambiguous Loss Causation Language*

The PSLRA leaves little doubt that in a private securities fraud action under §10(b) of the 1934 Act, plaintiffs must prove that their losses were caused by defendants' misrepresentations or omissions. The Supreme Court cites the PSLRA's loss causation language to support its position that the statute requires a showing of "economic loss."[16] Yet, although the Court emphasizes the phrase "economic loss," that phrase appears nowhere in the statute. Contrary to the Supreme Court's unfounded and undefined concept of "economic loss," the plain language of the PSLRA indicates that loss causation does not require a showing that defendants' conduct caused a post-transaction decline in the value of the plaintiffs' investment.[17]

The statute is precise in its formulation of both loss and causation. It specifically defines the requirement with explicit reference to the "loss for which the plaintiff seeks to recover damages."[18] Plaintiffs need not establish a causal link between defendants' wrongdoing and any losses for which the plaintiffs do not seek to recover damages. The statute, therefore, requires an initial definition of the precise losses for which the plaintiff seeks damages. After – but only after – the losses for

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16. *Dura*, 125 S. Ct. at 1633.

17. The Supreme Court, in its previous securities fraud decisions, has declared that statutory construction must begin and end with the plain language of the statute, where that language is unambiguous. *See, e.g.*, Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 756 (1975) (Powell, J., concurring) (the "starting point in every case involving construction of a statute is the language itself.") *See also* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 197 (1976) ("we turn first to the language of § 10(b) . . ."); Cent. Bank v. First Interstate Bank, 511 U.S. 164, 173 (1994) ("with respect . . . to the scope of conduct prohibited by § 10(b), the text of the statute controls our decision").

18. 15 U.S.C. § 78u-4(b)(4) (2000).

which plaintiff seeks damages are defined with precision, can a determination be made regarding whether plaintiff can establish a causal link between the defendants' challenged conduct and those losses.[19] The Supreme Court disregarded this statutory directive in fashioning its own theory that the plaintiffs in *Dura* could not show they had suffered any "economic loss." In fact, plaintiffs did seek to recover damages for a precise recoverable "loss" recognized by the PSLRA and by virtually every federal court to address the issue.

The difference between the consideration paid by plaintiffs and the consideration that they would have paid had the alleged misrepresentations not been made is unquestionably a "loss" recoverable in a private § 10(b) action. As the Supreme Court has repeatedly declared, investors induced by fraud to purchase a security ordinarily are entitled under § 10(b) to recover their out-of-pocket loss, which is simply "the difference between the fair value of all that the [plaintiff] received and the fair value of what he would have received had there been no fraudulent conduct."[20] Both prior to and since Congress enacted the PSLRA, the federal courts have consistently held that the recoverable loss in securities fraud cases typically will

19. For example, in the *Dura Pharmaceuticals* case, plaintiffs alleged that they purchased Dura Pharmaceuticals securities for as much as $53 per share between April 15, 1997 and February 24, 1998 (the "class period"). 339 F.3d at 935-36. The market price of these securities allegedly plummeted by 47% to $20 3/4 the day after Dura revealed that it expected lower-than-forecast revenues and earnings per share because of lower than expected sales of its Ceclor CD antibiotic. *Id.* at 936. Dura had issued several press releases during the class period representing that the sales of its Ceclor CD were rising and that it also had engaged in satisfactory development and testing of its Albuterol Spiros asthma medication delivery device. Dura's business continued to decline throughout 1998 and, in November, 1998, Dura also discovered that the FDA had determined that the Albuterol Spiros device would not be approved. *Id.* The district court concluded that plaintiffs could not establish loss causation with respect to the Albuterol Spiros device because the February decline in the market price of their securities pre-dated the disclosure of the FDA's non-approval. As the Ninth Circuit recognized, however, the precise loss for which the plaintiffs sought damages was the difference between the price they paid for their Dura securities and the price they would have paid had defendants not made their alleged misrepresentations and omissions. Congress requires plaintiffs to establish that the difference was caused by the defendants' alleged misrepresentations and omissions. Plaintiffs clearly pled that causal connection. *Id.* at 937-39.

20. Randall v. Loftsgaarden, 478 U.S. 647, 661-62 (1986) (quoting Affiliated Ute Citizens v. United States, 406 U.S. 128, 155 (1972)).

be the plaintiffs' "out-of-pocket loss," or the difference between the actual transaction price paid and the transaction price that would have been paid absent the fraud, measured as of the date of the fraudulent transaction.[21] Under the PSLRA, where plaintiffs seek to recover this precise "loss," plaintiffs need only show that this precise loss was caused by defendants' misrepresentations.

B. *The Supreme Court Disregards the Legislative History of the PSLRA's Loss Causation Provision*

The Supreme Court's concepts of "economic loss" and "proximate cause" are contrary to the PSLRA's legislative history, which the Court ignores in pertinent part. The legislative history of the PSLRA's loss causation provision confirms that plaintiffs may satisfy the element of loss causation by proving that the defendants' misstatements or omissions created a disparity between price and value, at the time of the transaction.[22]

1. *The Senate Committee Recognizes that Loss Causation May Be Properly Established in Fraud-on-the-Market Cases from Proof that Defendants Caused an Artificial Transaction Price*

On May17, 1994, the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs first addressed the judicial "presumption of loss causation (as well as reliance) in fraud-on-the-market cases."[23] The subcom-

21. *See, e.g.*, *Affiliated Ute*, 406 U.S. at 155; *Loftsgaarden*, 478 U.S. at 657-61; Ambassador Hotel Co. v. Wei-Chuan Inv., 189 F.3d 1017, 1030 (9th Cir. 1999); Farley v. Henson, 11 F.3d 827, 837 (8th Cir. 1993); Stone v. Kirk, 8 F.3d 1070, 1092 (6th Cir. 1993); Arthur Young & Co. v. Reves, 937 F.2d 1310, 1336 (8th Cir. 1991), *aff'd on other grounds*, 507 U.S. 170 (1993); Astor Chauffeured Limosine Co. v. Runnfeldt Inv. Corp., 910 F.2d 1540, 1551 (7th Cir. 1971); Miller v. Asensio & Co., 364 F.3d 223, 227-28 (4th Cir. 2004); *In re* Imperial Credit Indust. Sec. Litig., 252 F. Supp. 2d 1005, 1014 (C.D. Cal. 2003); *In re* Executive Telecard Ltd. Sec. Litig., 979 F. Supp. 1021, 1025 (S.D.N.Y. 1997). *See also Securities Fraud, supra* note 5, at 1424-25.

22. The Supreme Court also has analyzed the legislative history of the federal securities laws to interpret the elements of § 10(b) liability. *See e.g.*, *Hochfelder*, 425 U.S. at 196.

23. *Abandonment of the private right of action for aiding and abetting securities fraud/staff report on private securities litigation: Hearing before the Subcommittee on Securities of the Committee on Banking, Housing, and Urban Affairs*, 103rd Cong.

mittee initially expressed some uncertainty about whether loss causation could be automatically established in a fraud-on-the-market case from the same evidence used to presume reliance: "Even if the fraud-on-the-market theory is a reasonable means of establishing reliance, it is unclear that the theory should also be used to impute causation."[24] The subcommittee's resolution of that ambiguity, however, is telling.

The subcommittee explains that "there may be cases in which the plaintiff reasonably relied on the *integrity* of the market price, but the market *price* was not affected by the defendant's misrepresentations . . ."[25] The subcommittee thus recognizes the difference between reliance and loss causation in fraud-on-the-market cases. Reliance focuses upon the market price's "integrity;" causation focuses upon whether the purchase price itself was "affected by the defendant's misrepresentation . . ."[26] The subcommittee here acknowledges that in some cases, the plaintiff can employ the fraud-on-the-market theory to create a presumption of both reliance on the integrity of the market price and that the defendant's fraud affected the market price, thereby causing losses.[27] The subcommittee also recognizes situations in which "other information in the market neutralized any impact which the misrepresentation might have had."[28] If, but only if, such other information neutralizes the impact of defendants' misrepresentation on the market price will plaintiffs have to make a showing of causation beyond the showing required for a presumption of reliance.

Significantly, however, the subcommittee also makes clear that even in those particular cases in which the fraud-on-the-market showing of reliance will not also establish loss causation, the element of loss causation can be established by proof

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228 (1994) (printed for the use of the committee on Banking, Housing, and Urban Affairs) [hereinafter *Senate Subcommittee*].

24. *Id.* at 228. The fraud on the market theory creates a presumption that an investor purchases securities in reliance upon the integrity of the market price in an efficient market. *See Basic*, 485 U.S. at 251 (1988). *See also* D. Fischel, *Efficient Capital Markets, the Crash, and the Fraud on the Market Theory*, 74 CORNELL L. REV. 907, 917-22 (1989).

25. *Senate Subcommittee*, *supra* note 23, at 228 (emphasis added).

26. *Id.*

27. *Id.*

28. *Id.*

that the price at which plaintiffs purchased securities was affected by the defendants' misrepresentations: "It may therefore be appropriate to require plaintiff to provide proof in fraud-on-the-market cases that the alleged misrepresentation caused an effect in market price."[29] In such cases, therefore, loss causation can be established by proving that the defendants' misrepresentation in fact caused a disparity between the market price of the securities and their true value. The subcommittee does not in any way indicate that, in fraud-on-the-market cases, plaintiffs must also prove that the defendants' conduct caused any subsequent, post-transaction decline in the value of plaintiffs' investments.

Suppose, for example, that plaintiffs claim to rely on the integrity of the market price in purchasing their securities at $100 per share, and also claim that defendants' misrepresentations and omissions artificially inflated that price. The fraud-on-the-market theory will supply a presumption that plaintiffs relied upon the "integrity" of the market price. As envisioned by the Senate subcommittee, plaintiffs should be able to establish loss causation quite easily in some cases by showing that defendants' conduct caused the market price to be artificially inflated. In other cases, however, defendants may claim that their misrepresentations had no effect on the actual purchase price because the alleged undisclosed truth was already incorporated into that price. As courts prior to 1995 had recognized, the fraud-on-the-market theory also gives rise to the truth-on-the-market theory.[30] The truth-on-the-market theory allows defendants to break the causal link between their misrepresentations and the plaintiffs' purchase price by proving that the alleged nondisclosed or misrepresented facts were credibly disclosed to the market and incorporated into the plaintiffs' purchase price. In other words, "other information in the market neutralized any impact which the misrepresentation might have had . . ."[31]

29. *Id.*

30. *See* Asher v. Baxter Int'l. Inc., 377 F.3d 727, 732 (7th Cir. 2004); Wielgos v. Comm. Edison Co., 892 F.2d 509 (7th Cir. 1984); *In re* Apple Computer Sec. Litig., 886 F.2d 1109, 1114 (9th Cir. 1989) ("Provided they have credibly entered the market through other means, the facts allegedly omitted by the defendant would already be reflected in the stock's price . . .").

31. *See Senate Subcommittee*, *supra* note 23, at 228.

According to the Senate subcommittee, in such a case (but only in such a case) it might be "appropriate to require plaintiffs to provide proof in fraud-on-the-market cases that the alleged misrepresentation caused a quantifiable impact on the market price."[32] For instance, defendants may be able to show that the $100 market price accurately reflected the true value of the securities, in which case plaintiffs would have difficulty proving that the defendants' fraud caused any loss due to artificial inflation. Perhaps, instead, defendants can present evidence suggesting that only some, but not all, of their misrepresentations were incorporated into the market price. In that case, plaintiffs may be able to establish that some but not all of the alleged price inflation was cause by the defendants' conduct.

In any case, however, proof of loss causation requires only a showing that defendants' misrepresentations caused some quantifiable artificiality in the purchase price, calculated as of the purchase date. It does not require any showing that defendants' conduct also proximately caused any subsequent, post-transaction decline in the value of plaintiffs' investments.

2. *Congress Eliminated Any Requirement of Proof that Post-Transaction Declines Were Proximately Caused by the Fraud Even in Fraud-on-the Market Cases.*

The House of Representatives developed an initial draft of the PSLRA, titled the "Common Sense Legal Reform Act of 1995" (the "House Reform Act").[33] The House Reform Act's early loss causation language required the plaintiff to prove that the challenged "misstatement or omission *proximately caused* (through both transaction causation and loss causation) any loss incurred by the plaintiff."[34] This loss causation language was repeated in the revised bill that ultimately was passed by the House in March of 1995.[35] On January 22, 1995, the Senate began debating a bill entitled "The Private Securi-

32. *Id.*

33. H.R. 10, 104th Cong. (1995). *See also* John W. Avery, *Securities Litigation Reform: The Long and Winding Road to the Private Securities Litigation Reform Act of 1995*, 51 Bus. Law. 335, 347 (1996); *A Winning Approach, supra* note 9, at 1810 (2000).

34. *Id.* (emphasis added).

35. H.R. 1058, 104th Cong. (1995).

ties Litigation Reform Act of 1995," which would have required plaintiffs to meet "the burden of proving that the misstatement or omission caused any loss incurred by the plaintiff."[36] That provision, however, would have required plaintiffs to establish loss causation only in cases where they claimed "to have bought or sold the security based on a reasonable belief that the market value of the security reflected all publicly available information . . ."[37] The PSLRA loss causation language which Congress ultimately enacted, however, differs significantly from the initial Senate and House bills.

First, unlike the House Bill and the Supreme Court's untethered ruling, the enacted statute makes no reference whatsoever to the common law concept of proximate cause or to the federal common law concept of transaction causation. The statute refers only to reliance and loss causation.

Second, the loss causation requirement ultimately enacted by Congress is more tailored than both of the previous House and Senate versions and the Supreme Court's standard. Both of the prior versions required the plaintiff to prove that the alleged misstatements or omissions caused "*any* loss incurred by the plaintiff."[38] That phrase was changed in the final statute to require the plaintiff to prove that the alleged misstatements or omissions caused only the precise loss "for which" the plaintiff seeks to recover damages.[39] The enacted statute recognizes that there may be losses to the value of plaintiffs' investments that are not part of plaintiffs' damages claims. Only if the loss for which plaintiffs seek damages can be identified, can the loss causation requirement have any meaning. Contrary to the Supreme Court's novel concept of economic loss, the federal securities laws plainly allow plaintiffs to recover damages for artificial inflation in their purchase

36. S. 240, 104th Cong. § 104 at 18 (1995).

37. *Id.* After negotiations between the House and the Senate, Congress passed the PSLRA, ultimately overriding the President's veto. *See* Cong. Rec. S17, 997 (daily ed. Dec. 5, 1995) (Senate passes the House Conference Report); Cong. Rec. H14, 055 (daily ed. Dec. 6, 1995) (House passes the bill); Cong. Rec. H15, 214-15 (daily ed. Dec. 20, 1995) (President Clinton vetoes the bill); Cong. Rec. S19, 180 (daily ed. Dec. 22, 1995) (Congress enacts bill over President's veto).

38. H.R. 10; S. 240 § 104 (emphasis added).

39. 15 U.S.C. § 78u-4(b)(4) (2000).

price.[40] In such a case, Congress requires plaintiffs to prove only that their statutorily recognized loss was caused by the defendants' misstatements and omissions.

C. *The Supreme Court Disregarded Congressional Intent Supporting the PSLRA's Loss Causation Provision.*

Documented congressional intent supporting the loss causation statutory language also demonstrates that loss causation can be established by proof that the defendants' misstatements and omissions caused losses measured by the disparity between transaction price and true value. The House and the Senate each presented Reports accompanying the PSLRA which set forth the statute's purposes.[41] In *Dura,* the Supreme Court relied upon Congress' intent to curb "abusive practices" leading to the filing of frivolous securities fraud claims to support its reading of the loss causation provision.[42] There is no question that these Reports evidence Congress' overall intent to curb nonmeritorious securities fraud class actions by, among other things, placing on plaintiffs the burden of demonstrating a causal connection between the defendants' fraud and their claimed losses.[43] Nor is there any question that Congress "sought to strike the appropriate balance between protecting the rights of victims of securities fraud and the rights of public companies to avoid costly and meritless litigation."[44] Yet, those objectives are served by the heightened pleading and sanction provisions in the statute, not by the loss causation provisions. In fact, even the Court "concede[d]" that these pleading provisions *do not* govern the loss causation provision.[45]

40. *See* cases cited *supra* note 21.

41. H.R. Conf. Rep. No. 104-369, at 31 (1995); S. Rep. No. 104-98 (1995).

42. 125 S. Ct. at 1634.

43. *See* S. Rep. No. 104-98, at 6-7 (PSLRA's "strong pleading requirement" is designed to reduce the cost of raising capital); H.R. Conf. Rep. No. 104-369, at 31 (PSLRA designed to remedy abuses caused by lawyers filing frivolous lawsuits, plaintiffs using discovery to impose settlement inducing costs on defendants and class action lawyers manipulating clients).

44. S. Rep. No. 104-98, at 10.

45. 125 S. Ct. at 1634.

1. *The Court Disregards Congress' Clear Examples of the Intended Application of Its Loss Causation Provision.*

In reaching its result, the Supreme Court ignored legislative history providing clear insight into the congressional understanding of the appropriate burdens of pleading and proof regarding the element of loss causation. The Senate Report, which was drafted by the Banking, Housing and Urban Affairs Committee and submitted on June19, 1995, explained the PSLRA's loss causation requirement as follows:

> The Committee also requires the plaintiff to show that the misstatement . . . 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 the 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.[46]

The House Report's "Statement of Managers" also defined the PSLRA's loss causation language:

> The Conference Committee also requires the plaintiff to plead and then prove that the misstatement or omission alleged in the complaint actually caused the loss incurred by the plaintiff in new Section 21D(b)(4) of the 1934 Act. For example, the plaintiff would have to prove that the price at which the plaintiff bought the stock was artificially inflated as the result of the misstatement or omission.[47]

Both Reports provide an identical example of one way in which plaintiffs may meet their burden of proving loss causation: by showing that the defendants' misstatements or omissions caused the price at which plaintiffs bought their stock to be artificially inflated. Congress neither elaborated upon nor qualified its explanation of how its new loss causation language should be interpreted. There was no need to do so. The example provided by both the House and the Senate is clear and unmistakable.

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46. S. REP. NO. 104-98, at 15.
47. H.R. CONF. REP. NO. 104-369, at 41.

The example indicates that proof that defendants' misstatements or omissions caused the price at which plaintiffs purchased their securities to be "artificially inflated" alone suffices to establish the element of loss causation. Misrepresentations or omissions that "artificially" inflate the purchase price of a security create a disparity between that transaction price and the true value of the security, measured on the transaction date. The example of proof of loss causation supplied by the Senate and House Reports makes no mention of any requirement that plaintiffs prove that defendants' fraud caused any post-transaction decline in the value of the plaintiffs' securities or investments. Moreover, the Senate Report indicates any additional burden of proving that "factors unrelated to the fraud contributed to the loss" should be placed squarely on the defendant.[48]

2. *The Supreme Court Mischaracterizes the Federal Court and Common Law Causation Authority that Congress Intended to Codify.*

The explanation provided by Congress of the loss causation language is consistent with Congress' stated intent to codify the existing loss causation authority in both federal securities fraud cases and common law fraud cases. According to the Senate Report, Congress intended to codify the "current law" regarding the loss causation requirement.[49] The "current law" which Congress intended to codify includes the federal court securities fraud decisions regarding loss causation, as well as the common law conception of causation in fraud cases. In *Dura,* however, the Supreme Court mischaracterized both federal court loss causation decisions and common law causation authorities.

(a) Congress Codified Federal Court Loss Causation Decisions Requiring a Causal Link between Defendant's Fraud and Plaintiffs' Out-Of-Pocket Losses

Under then "current law," federal courts had "uniformly concluded or assumed that loss causation is an element of a

48. S. REP. NO. 104-98, at 15.
49. *Id.* at 7.

private right of action for damages under Rule10b-5."[50] Despite some rhetorical inconsistency in a few pre-1995 decisions, the cases were actually consistent in their fundamental legal principle: plaintiffs must plead and prove that the losses for which Rule10b-5 allows recovery were caused by the defendants' misstatements or omissions.[51] Before 1995, the federal courts also recognized that the ordinary out-of-pocket measure of recoverable losses under Rule10b-5 was the difference between the transaction price and the true value of the securities purchased, as of the transaction date.[52] Accordingly, the federal courts also were quite consistent in their view that plaintiffs could demonstrate "loss causation" by showing simply that the defendants' misstatements or omissions caused that precise measure of recoverable loss.[53]

In fact, the pre-1995 body of case law which arguably created the heaviest loss causation burden is consistent with Congress' explanation that loss causation can be established by proof that the plaintiffs' purchase price was artificially inflated as the result of the defendants' misstatements or omissions.[54] The seminal loss causation decision of *Huddleston v. Herman & MacLean*[55] is consistent with the example that both the House and the Senate used to explain the PSLRA's loss causation standard. In *Huddleston*, the court made clear that even if plaintiffs could not establish that defendants' misrepresentations caused their investment's subsequent decline in value, those plaintiffs could nonetheless recover their precise losses

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50. *See* Michael J. Kaufman, *Loss Causation: Exposing a Fraud on Securities Law Jurisprudence*, 24 IND. L. REV. 357, 394-95 n. 8 (1991) [hereinafter Kaufman, Loss Causation] (citing cases).

51. *See id.* at 389-96 (showing that the pre-1995 case law was actually somewhat remarkably consistent in its application of the loss causation concept).

52. *Id.* at 384 n. 158 (citing pre-1995 Supreme Court and federal court cases for the proposition that the Supreme Court and the federal courts had uniformly agreed that § 10(b) plaintiffs may recover out-of-pocket damages measured as the difference between transaction price and value as of the transaction date). *See also Securities Fraud*, supra note 5, at 1424 nn. 21-22.

53. Kaufman, *Loss Causation*, *supra* note 50, at 389-96.

54. *See* H.R. CONF. REP. 104-369, at 41; S. REP. NO. 104-98, at 15.

55. *Huddleston*, 640 F.2d at 547-48. Although the term loss causation was actually first used by the court in *Schlick v. Penn-Dixie Cement Corp.*, 507 F.2d 374, 380 (2d Cir. 1974), the *Huddleston* decision was the first to identify the evidentiary burden created by "loss causation."

measured as the difference between their purchase price and the true value of the securities purchased at the time of the transaction. In the application of its standard, the *Huddleston* court clearly indicated that loss causation requires only proof that the defendants' misstatements or omissions caused an artificial disparity between the transaction price and the value of the securities purchased as of the date of the transaction.[56] Even Judge Meskill's influential dissenting opinion in *Marbury Management, Inc. v. Kohn* emphasized that loss causation can be established by showing that the "victim's injury" derived from the investment "decision" which the violation "precipitated."[57]

The strong line of loss causation decisions developed by the Seventh Circuit prior to 1995 also consistently recognized that plaintiffs can recover the amount by which their transaction price was artificially altered as the result of defendants' misstatements or omissions.[58] In *Bastian v. Petren Resources Corp.*,[59] the court, in an opinion written by Judge Posner, affirmed the dismissal of plaintiffs' securities fraud claims because they had failed to allege that defendants' misrepresentations regarding their integrity actually caused their investment losses in an oil and gas partnership.[60] The court's reasoning indicates, however, that if plaintiffs could have pled and proved that the defendants' nondisclosures actually caused a disparity between the price that a reasonable investor would have paid for the oil and gas partnership and the price they actually paid, they could have recovered the amount of that disparity.[61] Indeed, Judge Posner explains that where plaintiffs claim that a broker misrepresents to them that their investment is "risk-free," they can demonstrate loss causation by showing that the broker's misstatement created a quantifiable disparity between the artificial purchase price and the true value of the investments. Loss causation is demonstrated because defendants' misrepresentation ("risk-free") artificially in-

56. *Huddleston,* 640 F.2d at 549; *See also* Kaufman, *Loss Causation, supra* note 49, at 363-64.

57. Marbury Mgmt. Inc. v. Kohn, 629 F.2d 705, 720 (2d Cir. 1980) (Meskill, J. dissenting).

58. *See* Kaufman, *Loss Causation, supra* note 50, at 392-96.

59. Bastian v. Petren Res. Corp., 892 F.2d 680 (7th Cir. 1990), *cert. denied,* 496 U.S. 906 (1990).

60. *Id.* at 684-86.

61. Kaufman, *Loss Causation, supra* note 50, at 394-95.

flates the purchase price, not because that fraud caused the subsequent decline in the value of the investments.[62] Prior to the PSLRA, the Seventh Circuit also warned that any requirement that plaintiffs prove that defendants' fraud caused a post-transaction decline in the value of plaintiffs' investments could effectively "exempt" defendants from liability, "a result that would eviscerate Rule10b-5."[63]

62. *Id.* In fact, the Court emphasized that a representation regarding the riskiness of a transaction would simply be more material to an investor than a representation regarding the integrity of management. Even if the representation regarding management integrity had proven false, that representation would not be so material as to alter the purchase price. In other words, even if the risk of a lack of management integrity had materialized, the plaintiffs still could not have established loss causation. On the other hand, the representation regarding a risk-free investment is material, and alters the price at which reasonable investors purchase securities. That purchase price is altered regardless of whether the misrepresentation actually materializes. Judge Posner was more concerned about the materiality of misrepresented risks than about whether the misrepresented risks ultimately materialized.

63. Rankow v. First Chicago Corp., 870 F.2d 356, 367 (7th Cir. 1989). In keeping with its pre-PLSRA understanding of loss causation, the Seventh Circuit has since reaffirmed that loss causation can be established by demonstrating that defendants' conduct caused an artificial disparity between transaction price and value, on the transaction date. In *Caremark Inc. v. Coram Healthcare Corp.*, 113 F.3d 645, 649 (7th Cir. 1997), the court declared that loss causation "ought not to place unrealistic burdens on the plaintiff at the initial pleading stage. It does not require, for instance, that the plaintiff plead that all of its loss can be attributed to the false statement of the defendant." The Seventh Circuit concluded that the plaintiff must allege merely "that it was in fact injured by the misstatement or omission of which it complains." *Id.* Defrauded investors have no burden to plead or to prove that the post-transaction decline in the value of their investments were caused by the fraud. *See Id.* at 649-50 (citing Provenz v. Miller, 102 F.3d 1478, 1492 (9th Cir. 1996)). In *Isquith v. Caremark Int'l, Inc.*, 136 F.3d 531 (7th Cir. 1998), the Seventh Circuit re-emphasized the key distinction between causation for out-of-pocket losses and causation for consequential damages. There, plaintiffs (shareholders of Baxter) alleged that Baxter had forced them to sell their shares at fraudulently deflated prices by lying about the purpose of a spin-off under the terms of which plaintiffs would accept Caremark shares. When the purpose of the spin-off was disclosed, the price of Caremark stock plummeted and the spin-off never occurred. The court concluded that plaintiffs would not recover their post-transaction, consequential damages stemming from the failure of the spin-off to occur without proof of a causal connection between those subsequent damages and the fraud. Significantly, however, the court also made clear that plaintiffs could establish that their recoverable out-of-pocket losses were caused by the fraud merely by proving that the fraud caused a recover losses "discrepancy between the actual market value

(b) The PSLRA's Precise Loss Causation Provision is Consistent with Fairly Characterized Causation Requirements in Common Law Fraud Cases

Section 10(b) and Rule 10b-5 are "distinct from common-law deceit and misrepresentation."[64] They were "in part designed to add to the protections provided investors by the common law."[65] Nonetheless, the Supreme Court in *Dura* and elsewhere has employed "common-law doctrines of fraud and deceit" as a model for interpreting the elements of liability under these provisions.[66]

To the extent that common law fraud causation authorities guide the judicial construction of the PSLRA's loss causation language, these authorities make clear that plaintiffs are not required to prove that defendants' conduct caused a post-transaction decline in value as a prerequisite to recovering losses measured by the difference between the transaction price and the true value at the time of the transaction.[67] In *Dura* the Supreme Court supported its result by selectively editing and mischaracterizing these common law authorities.

First, the Supreme Court equates the unassailable tort requirement that the plaintiff establish injury or damage with the Court's very different conception of "economic loss."[68]

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of a stock and what the value would have been had there been no misrepresentation." *Id.* at 535.

64. *Basic,* 485 U.S. at 244 n.22 (1988) (citing *Blue Chip Stamps,* 421 U.S. at 744-45.

65. *Basic,* 485 U.S. at 244 n.22 (citing Herman & MacLean v. Huddleston, 459 U.S. 375, 388-89 (1983)).

66. *See Dura,* 125 S. Ct. at 1628. *See also Basic,* 485 U.S. at 253 (White, J., concurring in part and dissenting in part). *See also* Chiarella v. United States, 445 U.S. 222 (1980).

67. See Kaufman, *Loss Causation, supra* note 50, at 380-82 (showing that any reliance upon the RESTATEMENT (SECOND) OF TORTS, § 548A cmt. B (1977) or on W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS § 110, at 787 (5th ed. 1984) for the position that common law causation requires something more than proof that the defendants' conduct caused the disparity between price and value would be based on a gross misreading of those authorities). *See also Caremark,* 113 F.3d at 649 (any requirement that plaintiff prove that the fraud caused the post-transaction decline in the value of plaintiffs' investments "would be far more stringent than the common law tort requirement . . .").

68. *Dura,* 125 S. Ct. at 1632.

None of the authorities cited employs the Court's phrase or conception of "economic loss."

Second, the Court's reliance on common law causation authorities is also misleading. Both the second Restatement of Torts and Prosser and Keeton declare that, "[i]f false statements are made in connection with the sale of corporate stock, losses due to a subsequent decline in the market . . . or other factors [that] in no way relate to the representation[s] will not afford any basis for recovery."[69] Nonetheless, as a careful reading of those authorities reveals, this principle applies only where the plaintiff seeks to recover not only "direct damages" from a fraudulent transaction, but "in addition thereto" seeks to recover "such other damages as special or consequential damages as the plaintiff can prove."[70] If, but only if, plaintiff seeks to recover "consequential" damages (i.e., post-transaction losses flowing as a subsequent consequence of the fraud) must the plaintiff establish that these subsequent, consequential damages are related to the misrepresentations. On the other hand, "[w]here, as is commonly the case," the defendant's misrepresentation "induces a transaction that involves the transfer of something of value," the common law courts allow plaintiffs to recover their "direct damages" without any showing that the misrepresentation also causes additional consequential damages.[71]

Direct damages, of course, are losses measured by the difference between the value of what the plaintiff was fraudulently induced to transfer to the defendant and the value of what the plaintiff would have transferred to the defendant in the absence of the fraud – all measured as of the transaction date.[72] The Restatement, Prosser and Keeton, and the common law cases cited therein show that *consequential* damages may be unavailable in some fraud cases. They do not fairly support the Court's proposition that in order to recover "commonly" awarded "direct damages" in fraud cases, plaintiffs must prove that the defendants' conduct also caused their

69. 69. RESTATEMENT OF TORTS (SECOND) § 548A cmt. B (1977); KEETON ET AL., *supra* note 67, at 767 (5th ed. 1984).

70. *See* KEETON ET AL., *supra* note 67, § 110, at 766.

71. *See Id.*

72. *See Id.*

"consequential" damages.[73] Notwithstanding the Supreme Court's selective editing, the weight of common law authority is consistent with the view that defrauded plaintiffs may recover their "direct damages" measured as the difference between transaction price and true value, and must prove simply that the defendants' fraud caused that difference.[74]

D. *The Supreme Court Misconstrues Congress' Careful Design of the PSLRA and the Federal Securities Laws*

The Supreme Court's conceptions of "economic loss" and proximate cause are also inconsistent with the structure of the PSLRA and the federal securities laws.[75]

1. *Loss Causation Is Not Part of the PSLRA's Heightened Pleading Standards.*

The Court suggests that its view of loss causation finds support in the PSLRA's pleading standards. Indeed, the PSLRA enacts significant, heightened pleading requirements

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73. *See* Kaufman, *Loss Causation, supra* note 50, at 380-81 (citing Waddell v. White, 56 Ariz. 420, 108 P.2d 565 (1940); Hotaling v. A. B. Leech & Co., 247 N.Y. 84, 159 N.E. 870 (1928)).

74. *See* Kaufman, *Loss Causation, supra* note 50, at 381. Federal and state court judges who read those authorities with care have recognized the common law's clear distinction between the causation required to link fraud to transaction-based out-of-pocket losses and the causation required to link fraud to subsequent, post-transaction consequential losses in the value of an investment. *See, e.g.,* Caremark Inc. v. Coram Healthcare Corp., 113 F.3d 645 (7th Cir. 1997) (rely upon common law causation principles to conclude that plaintiffs need only establish a causal link between their out-of-pocket losses and the fraud); Reisman v. KPMG Peat Marwick LLP, 781 N.E. 2d 821, 832-34 (Mass. App. 2003) (carefully reviewing common law authorities and concluding that the showing that plaintiffs' consequential damages were caused by the fraud is not required where plaintiffs seek to recover their recovering out-of-pocket damages, measured as the difference between their "artificially inflated" purchase price and the true value of the securities on the transaction date).

75. *See* Reno v. Koray, 515 U.S. 50, 57 (1995) ("It is a fundamental principle of statutory construction that the meaning of a word cannot be determined in isolation, but must be drawn from the context in which it is used"), Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 174-80 (1994) (interpreting the lack of aiding and abetting language in § 10(b) by reference to the existence of such language in other statutory provisions).

for private securities fraud claims.[76] Yet, the loss causation provision is not among them. The statute requires plaintiffs to allege with particularity defendants' misrepresentations and omissions, together with a statement of reasons why they are misleading.[77] In addition, the statute requires plaintiffs to plead with particularity facts which give rise to a "strong inference" that defendants made their misstatements or omissions with the requisite state of mind.[78] These heightened pleading standards do not mention causation at all.

Moreover, the PSLRA provides a mechanism for testing the sufficiency of plaintiffs' claims *before* the issue of loss causation even becomes relevant. The statute invites defendants to test the pleadings by making a motion to dismiss and indicates that discovery typically will be stayed until the court resolves that motion.[79] The pleading standards appear in subsections (b)(1) and (b)(2) of the statute.[80] Those pleading provisions are followed by subsection (b)(3), which explicitly presents the mechanism for testing only whether the pleading standards set forth in (b)(1) and (b)(2) have been met.[81] The loss causation subsection appears after Congress has addressed the statute's pleading regime. Notably, the loss causation language, in stark contrast to the PSLRA's preceding subsections, does not include any reference to pleadings. The loss causation subsection only refers to the burden of proof at trial.[82] Nowhere does Congress create any requirement of pleading that the defendants' wrongdoing caused a post-transaction decline in the value of the plaintiffs' investments.

76. *See, e.g.*, 15 U.S.C. § 78u-4(b) (2000).

77. 15 U.S.C. § 78u-4(b)(1) (2000).

78. 15 U.S.C. § 78u-4(b)(2) (2000).

79. 15 U.S.C. § 78u-4(b)(3) (2000). As the Third Circuit emphasized, "The causation issue becomes most critical at the proof stage." EP MedSystems, Inc. v. Echocath, Inc., 235 F.3d 865, 884 (3d Cir. 2000). "Whether the plaintiff has proven causation is usually reserved for the trier of fact." *Id.* at 884-85 (citing *Huddleston*, 640 F.2d at 549-50 as reversing for failure to submit causation to the jury).

80. 15 U.S.C. § 78u-4(b)(1)-(2) (2000).

81. 15 U.S.C. § 78u-4(b)(3) (2000).

82. 15 U.S.C. § 78u-4(b)(4) (2000). Indeed, any factual defense to the absence of a causal link between defendants' fraud and the artificiality of the transaction price in a fraud-on-the-market case is not available at the pleading stage. *See* Ather v. Baxter Int'l., Inc., 377 F.3d 727, 735 (7th Cir. 2004).

2. *The PSLRA's Loss Causation Provision for 1934 Act Claims Is Designed To Be Fundamentally Different From Other Loss Causation Provisions in the Federal Securities Laws*

The Supreme Court has construed the elements of liability under § 10(b) of the 1934 Act by relying on the contrasting language of the securities fraud remedies in the 1933 Act to establish that Congress must have intended to establish different standards for the two Acts.[83] In *Dura*, however, the Court performed no such comparison of the 1933 and 1934 Acts. Such an analysis would have undercut the Court's result.

The unambiguous contrast between the PSLRA's loss causation provision and other loss causation provisions in the federal securities laws further demonstrates that private § 10(b) plaintiffs need not prove that defendants' wrongdoing caused a subsequent decline in an investment's value. None of the express antifraud remedies in the 1933 Act requires plaintiffs to prove that defendants' fraud caused a post-transaction decline in the value of their investments. In particular, when Congress did explicitly address the subject of causation in its express private remedies, it clearly placed on defendants the burden of proving the absence of a causal link between their wrongdoing and the plaintiffs' losses.[84] Section 11 of the 1933 Act expressly permits acquirors of securities offered pursuant to a registration statement containing material misstatements or omissions to seek damages against the issuer, its officers, directors and professionals.[85] Section 11(e) contains an explicit damages formula that allows plaintiffs to recover the difference between the offering price and the post-transaction "value" of the securities.[86] The statute further expressly provides that the post-transaction "value" is generally measured either as of the date the lawsuit is filed or as of the date the securities are sold by the plaintiffs before suit.[87] This damages

83. *See, e.g., Hochfelder*, 425 U.S. at 206-07 (concluding that § 10(b) requires "scienter" by contrasting the plain language of that section with the different language in the 1933 Act liability provisions).

84. *See* Kaufman, *Loss Causation*, *supra* note 50, at 366, citing 15 U.S.C. § 77k (2000).

85. 15 U.S.C. § 77k (2000).

86. 15 U.S.C. § 77k(e) (2000). The calculation begins with the "amount paid" by plaintiffs for the security or the offering price, whichever is lesser.

87. *Id.*

formula is not based on the out-of-pocket rule.[88] Damages are not calculated as the difference between the "amount paid" and the true value of the securities purchased as of the purchase date. Instead, the statute defines recoverable damages as the decline in value between the public offering price and the subsequent *post*-transaction value of the investment.[89] The measure of damages under § 11(e) allows plaintiffs to recover the full post-transaction decline in the value of their investments, thus placing upon defendants the risk of post-transaction price declines, including declines that are not at all attributable to defendants' fraud.[90]

In light of the fact that the measure of recoverable loss under § 11 is defined as the post-transaction decline in value of the plaintiffs' investments, the loss causation proviso in § 11(e) makes perfect sense.[91] This section affords defendants an affirmative defense to the recovery of damages to the extent that they can satisfy their burden of proving that "any portion or all of such damages represents other than the depreciation in value of such security resulting from such part of the registration statement, with respect to which his liability is asserted . . ."[92] Because the measure of recoverable loss under § 11 itself is based upon the post-transaction "depreciation in value" in the plaintiffs' investments, Congress logically allows defendants the chance to demonstrate that all or part of that recoverable post-transaction decline in value was caused by something other than their misrepresentations.

When Congress enacted the PSLRA, it also amended § 12 of the 1933 Act to contain a loss causation affirmative defense virtually identical to that contained in § 11(e).[93] The differences between the PSLRA's loss causation provision in

88. *Id.*

89. *See, e.g.,* Level 3 Communications, Inc. v. Fed. Ins. Co., 272 F.3d 910-12 (7th Cir. 2001) (distinguishing the measure of recovery on a § 11 case from the tort measure of out-of-pocket losses).

90. *See, e.g., In re* Initial Pub. Offering Sec. Litig., 241 F. Supp. 2d 281, 349-50 (S.D.N.Y. 2003); Akerman v. Oryx Communications, Inc., 609 F. Supp. 363 (S.D.N.Y. 1984).

91. The Section 11(e) proviso has been called a "proximate cause limit." *See* 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) [hereinafter Merritt, *A Consistent Model*].

92. 15 U.S.C. § 77k(e) (2000).

93. 15 U.S.C. § 77l(a) (2000).

amended § 12(b) of the 1933 Act and the PSLRA's loss causation provision in the 1934 Act are striking. Section 12 of the 1933 Act, like Section 11, has a damages provision that calculates recoverable loss by reference to the post-transaction decline in the value of plaintiffs' investments.[94] Section 12(a)(2) of the 1933 Act expressly allows purchasers of securities to bring a private right of action against sellers of securities who employ material misstatements or omissions.[95] The statute also expressly provides that successful plaintiffs may "recover the consideration paid for such a security with interest thereon less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security."[96]

Like § 11(e), this explicit damages provision is not based on the out-of-pocket rule. To the contrary, this language creates a "broad rescissionary measure of damages."[97] Section 12's rescissory damages provision permits defrauded buyers to recover the full post-transaction and post-disclosure decline in the value of their investment between the purchase date and the subsequent tender of their securities.[98] The defendant returns to the defrauded investor the purchase price and the defrauded investor returns either the deflated securities themselves or the value of those deflated securities, measured after the fraud is disclosed. As the United States Supreme Court recognized, in this clear § 12 damages language, "Congress has shifted the risk of an intervening decline in the value of the security to defendants, whether or not that decline was actually caused by the fraud."[99]

In light of the fact that the measure of recoverable loss under § 12 is based on the post-transaction and post-disclosure decline in the value of plaintiffs' investments, Congress' new §12 loss causation defense also makes perfect sense. Section 12(b) now mirrors § 11(e) in providing that defendants may limit those recoverable rescissory losses to the extent that they can meet their burden of proving that "any portion or all of

94. *Compare* 15 U.S.C. § 77k(e) (2000), *with* 15 U.S.C. § 77l(a)(2) (200)
95. 15 U.S.C. § 77l(a)(2) (2000).
96. 15 U.S.C. § 77l(a) (2000).
97. *See* Merritt, *A Consistent Model*, *supra* note 91, at 491.
98. *See, e.g.*, *In re* Mego Fin. Corp. Sec. Litig., 213 F.3d 454, 461 (9th Cir. 2000).
99. Randall v. Loftsgaarden, 478 U.S. 647, 659 (1986).

the amount recoverable . . . represents other than the depreciation in value of the subject security resulting from such part of the [misrepresentation], with respect to which the liability . . . is asserted."[100]

Because the measure of recoverable loss under § 12 is the post-transaction decline in the value of plaintiffs' investments, Congress affords defendants an opportunity to demonstrate that some or all of that post-transaction decline in value was caused by something other than their falsehoods. Section 11 and amended Section 12 are thus consistent in their structure. Both sections have damages provisions that define loss as post-transaction decline in value. Both sections have provisions that grant to defendants the affirmative defense of proving that some or all of the post-transaction decline was caused by something other than their own wrongdoing.

Contrary to the Supreme Court's reasoning, the language and structure of the PSLRA's loss causation provision for § 10(b) private actions under the 1934 Act is markedly different from that contained in the 1933 Act provisions. The PSLRA's loss causation language is built on a foundation of recoverable loss for § 10(b) claims that is unlike the § 11 and § 12 1933 Act remedies. The measure of recoverable loss under § 10(b) of the 1934 Act is not ordinarily based on the post-transaction decline in the value of plaintiffs' investments. Rather, the measure of damages consistently applied for such claims has been based on the out-of-pocket rule. That rule fixes damages as of the transaction date. Accordingly, when Congress enacted the PSLRA's loss causation provision for such 1934 Act securities fraud claims, it recognized that under the "current law" of § 10(b) damages, plaintiffs' recoverable losses typically were based upon the disparity between the price and the value of the securities as of the transaction date. It would have made little sense for Congress to have then created a loss causation provision requiring plaintiffs to prove a causal link between the defendants' misrepresentations and the post-transaction decline in the value of plaintiffs' investments. Such a provision would have required plaintiffs to

100. 15 U.S.C. § 77l(b) (2000). *See also* S. REP. No. 104-98, at 23 (1995) ("The amendment to Section 12(2) is modeled after Section 11 of the Securities Act, which provides for a similar affirmative defense").

prove that defendants caused a measure of loss for which plaintiffs do not ordinarily seek damages.

Instead, Congress quite logically enacted a loss causation provision in the PSLRA for § 10(b) claims which is dramatically different from the loss causation provision for 1933 Act claims. The PSLRA's loss causation provision for § 10(b) claims, in stark contrast to that of the 1933 Act, properly makes no mention of causal links between the defendants' conduct and any post-transaction "depreciation in the value" of the plaintiffs' investments.[101] To the contrary, the loss causation provision governing § 10(b) claims requires plaintiffs to prove only a causal link between the defendants' conduct and "the loss for which the plaintiff seeks to recover damages."[102] Because Congress recognized that under "current law,"[103] that loss is the disparity between the transaction price and the value of the securities, the loss causation provision does not contain any language requiring analysis of causal links between defendants' conduct and any post-transaction depreciation in the value of plaintiffs' investments.

It would be erroneous to suggest that because Congress placed the burden of proving the absence of loss causation on defendants in its amendments to § 12 of the 1933 Act, it must also have intended to do the same with its identically titled provision in the PSLRA's 1934 Act amendments. It is true that the PSLRA's new 1933 Act and 1934 Act causation provisions are both entitled "loss causation," and that words in a statute generally should be given consistent meaning.[104] In this instance, however, Congress undeniably chose very different words to describe its loss causation requirements.[105] In the 1933 Act amendments, Congress clearly created an affirmative defense which placed on defendants the burden of proving

101. *Compare* 15 U.S.C. § 77k(b) (2000), *with* 15 U.S.C. § 77l(e) (2000).

102. 15 U.S.C. § 78u-4(b)(4) (2000).

103. S. REP. NO. 104-98, at 7.

104. *See, e.g.*, Gustafson v. Alloyd Co., 513 U.S. 561, 568 (1995) (interpreting the term "prospectus" as used throughout the Securities Act of 1933 to have a consistent meaning.).

105. *See Central Bank*, 511 U.S. at 173-178 (presuming that if Congress had intended to impose aiding and abetting liability, it would have used the words aid and abet in the statutory text – as it had done in other provisions. The fact that it did not, demonstrates its intent to preclude that component of liability.).

that the "depreciation in the value" of plaintiffs' investments was not caused by defendants' misstatements or omissions.[106] Congress had an occasion to create that same construct in its PSLRA amendments to the 1934 Act private remedy provisions, and certainly knew how to create language based on the model of loss causation provided by § 11 of the 1933 Act when it wanted to do so. That is precisely what it did in its contemporaneous PSLRA amendments to § 12 of that Act.[107] Nonetheless, Congress explicitly declined to do so. It created a very different construct and very different language in its PSLRA amendments to the 1934 Act remedies. In those amendments, Congress plainly does *not* place the burden of proving the absence of causation on defendants. The Supreme Court's attempt to rewrite the PSLRA to add a loss causation requirement is thus contrary to settled principles of statutory construction.

Similarly, in the PSLRA's 1934 Act amendments, Congress plainly does not place the burden of proof on plaintiffs to prove that defendants' conduct caused a post-transaction "depreciation in the value" of their investments. It did so in its original 1933 Act provisions and in its PSLRA amendments to § 12 of that Act. It could have done so in its PSLRA amendments to the 1934 Act remedies but it did not. The Supreme Court's construction of the PSLRA, which requires plaintiffs to prove that defendants' conduct caused such a post-transaction depreciation in the value of their investments, therefore is contrary to Congress' plain language and careful design.[108]

3. *The Supreme Court Also Disregards the PSLRA's Damage Cap*

Although it fashions elements of "economic loss" and proximate cause for actions under the PSLRA, the Supreme Court remarkably never addresses the statute's unique damages provisions. Those provisions cannot be reconciled with the Court's reasoning.

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106. 15 U.S.C. §§ 77k(e), 771 (2000).

107. 15 U.S.C. § 77k(e) (2000); S. Rep. No. 104-98, at 23.

108. *See, e.g.*, Leathermen v. Tarrant County Narcotics Intelligence & Coordination Unit, 507 U.S. 163, 168 (1993) (unanimously employing the principle of construction of "[*e*]*xpressio unius est exclusion alterius*" – the statement of one thing indicates an intent to exclude the other).

Section 21D(e) of the PSLRA provides a limitation on the "award of damages" to private plaintiffs bringing claims under the 1934 Act. The award of damages generally "shall not exceed the difference between the purchase or sale price paid or received . . . by the plaintiff . . . 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."[109] The cap was designed to apply only to publicly traded securities and not to private securities offerings or private securities transactions.[110] In addition, the PSLRA's damages cap only applies where plaintiffs in fact seek losses measured by the post-corrective disclosure market price decline of their investments. As one court recognized, "Section 78u-4(e) essentially caps a plaintiff's damages to those recoverable under the rescissory measure."[111] The rescissory measure of damages contemplates a return of the injured party to the position occupied before the fraudulent transaction.[112] In a se-

109. 15 U.S.C. § 78u-4(e)(1) (1994 & Supp. II 1996).

110. In their article regarding the PSLRA's damages cap, Dickey and Mayer also identify an ambiguity regarding the treatment of in-and-out traders who buy and sell during the class period, when the share price is allegedly distorted by the defendants' alleged misrepresentations and omissions. Jonathan C. Dickey & Marcia K. Mayer, *Effect on Rule 10b-5 Damages of the Private Securities Litigation Reform Act: A Forward-Looking Assessment*, 51 Bus. Law. 1203, 1213 (1996) [hereinafter Dickey & Mayer]. The exception of paragraph (2) of section 21D(e) applies only to shares sold (or short sales repurchased) during the 90-day *post*-curative disclosure period. Suppose an in-and-out investor closes its position *before* curative disclosure. Such investors cannot be governed by the statutory damages cap. The post-disclosure mean trading price is hardly a legitimate cap on damages for positions closed before disclosure. *Id.* at 1203-12. *See also* Robert B. Thompson, *"Simplicity and Certainty" in the Measure of Recovery Under Rule 10b-5*, 51 Bus. Law. 1177, 1194-97, 1199-1200 (1996). Professor Thompson is also troubled by the ambiguity in the scope of the cap's coverage. The cap is limited to cases in which the plaintiff attempts to establish "damages" by reference to the "market price" of a security. Professor Thompson argues that the cap should not apply to claims seeking rescission or unjust enrichment as those measures of recovery are not accurately characterizable as "damages." Moreover, he questions whether references to the "market" price are limited to cases in which the plaintiff seeks recovery for losses from stock transactions in an efficient market.

111. *In re* Mego Fin. Corp. Sec. Litig., 213 F.3d at 461.

112. *Id.* at 460, citing Green v. Occidental Petroleum Corp., 541 F.2d 1335, 1342 (9th Cir. 1976).

curities market setting, the injured party either tenders the stock or resells the stock in the market. The defendant effectively "returns the purchase price" to the victim "by compensating the injured party for any difference between the price that the injured party paid for the security and its trading price following disclosure of the fraud."[113] Rescissory damages are based on the difference between the transaction price and the value of the securities after the fraud has been disclosed.[114]

The PSLRA's damages cap limits damages, but only in cases where plaintiffs seek such a rescissory measure of recovery based on the value of the securities after disclosure of the fraud. Congress enacted the 90-day bounce back cap specifically because it believed that "calculating damages based on the date the corrective information is disclosed may substantially overestimate plaintiff's actual damages."[115] Congress developed two ways to prevent the overestimation of damages in such cases. The damages cap insures that the post-disclosure market price will not be overly depressed because of the shock of the disclosure. Moreover, if, but only if, the "loss for which" plaintiffs seek to recover damages is the rescissory difference between transaction price and post-disclosure value, the requirement of loss causation precludes recovery for post-transaction decline in value not attributable to the fraud. On the other hand, where the plaintiffs seek out-of-pocket losses rather than rescissory damages, such losses do not include post-transaction or post-disclosure declines in the value of plaintiff's investments. Rather, the out-of-pocket losses for which plaintiff seeks damages are measured as of the date of the transaction. Congress clearly did not intend to require plaintiffs to prove that defendants caused their rescissory damages as a pre-condition to their recovery of any out-of-pocket damages.

Even in those cases in which the PSLRA's damages provision applies, that provision is merely a limitation on the award of damages otherwise available to plaintiffs rather than an ele-

113. *Id.*

114. *Id.*

115. S. REP. NO. 104-98, at 20 (citing Baruch Lev & Meiring de Villers, *Stock Price Crashes and 10b-5 Damages: A Legal, Economic and Policy Analysis*, 47 STAN. L. REV. 7, 9-11 (1994)).

ment of the plaintiffs' burden of proof.[116] The very title of the PSLRA's damages provision is "limitation on damages," suggesting that the provision – at most – requires a reduction in the amount of damages which would otherwise be awarded to the plaintiffs.

The reduction, of course, is unnecessary when the award of damages would otherwise be less than that resulting from the damages provision. Suppose, for example, that the plaintiffs prove that they purchased their securities at a market price of $100 per share, and that in the 12month period after disclosure to the market of the fraud and before the lawsuit is filed, the market price declined to $10 per share. If, but only if, the loss for which plaintiffs seek to recover damages by reference to the subsequent market price is the full $90 post-disclosure decline in the market price of their securities, will the damages cap work to limit the award of damages to plaintiffs. In such an instance, the cap would reduce plaintiffs' damages to the difference between their purchase price and the average closing price of their securities over the 90 days after disclosure. If that 90-day look-back price is less than $10 per share, plaintiffs could recover the full $90 in damages. If, instead, the 90-day average closing price is greater than $10 per share, the award of damages must be reduced.

Even when the reduction in damages applies, that reduction does not alter plaintiffs' burden of proving the causal link between the defendants' fraud and the losses for which they seek damages. Only after plaintiffs have established the essential elements of their securities fraud claim does the reduction in the award of damages become relevant. Indeed, the section reads as a directive to the court rather than an element of the cause of action. After plaintiffs have proved their damages, the court may not "award" to the plaintiffs an amount of damages that exceeds the statutory limit. Where the facts regard-

116. In *Dura*, the Supreme Court's grant of certiorari suggests a distinction between loss causation in fraud on the market cases and loss causation in other fraud cases. 125 S. Ct. 1627 (2005). Congress, however, did not erect separate *loss causation* requirements – one for fraud on the market cases and one for all other cases. It would be contrary to congressional language and intent to create two distinct requirements. The only arguable reference in congressional language to fraud on the market cases is in the PSLRA's *damages cap's* application only to those cases in which plaintiffs seek to establish damages by reference to the market price.

ing the market dates and the market prices necessary to calculate the cap are undisputed, the cap can be applied by the court on its own. Where these facts are disputed, the cap acts as an affirmative defense on which defendants have the burden of proof. A statutory limitation on damages is an affirmative matter avoiding the full effect of plaintiffs' claim for damages, and therefore defendants have the burden of proving the elements of that affirmative defense.[117]

Finally, in those cases in which plaintiffs seek to recover damages "by reference to the market price of the security" after disclosure, the cap serves only to approximate the traditional out-of-pocket measure of damages in securities fraud cases. That measure of loss, which had been uniformly accepted by the federal courts prior to the PSLRA,[118] calculates the difference between transaction price and security value on the date of the transaction itself. That calculation invariably includes an actual number and a hypothetical number. The actual number is the consideration paid or received by the investor. That number rarely presents any evidentiary problems. The other component in an out-of-pocket calculation, however, is more difficult.

The plaintiff must ultimately prove that the defendants' misstatements or omissions created a disparity between the actual amount of the consideration paid or received and the hypothetical amount that would have been paid or received had the truth been known. Prior to the PSLRA, that hypothetical figure was typically provided through an expert opinion.[119] Experts for both plaintiffs and defendants usually attempted to offer an opinion regarding the true value of the security on the transaction date, given the truth of the misstated or undis-

117. The limitation of damages based on the applicability of a statutory cap is an affirmative defense. *See, e.g.*, Ingraham v. United States, 808 F.2d 1075, 1078 (5th Cir. 1987); Lucas v. United States, 807 F.2d 414, 417 (5th Cir. 1986); Simon v. United States, 891 F.2d 1154, 1156-57 (5th Cir. 1990); Kleinknecht v. Gettysburg College, 989 F.2d 1360, 1373 (3d Cir. 1993). *But see* Taylor v. United States, 821 F.2d 1428, 1433 (9th Cir. 1987), *cert. denied*, 485 U.S. 992 (1988). *See also Taylor*, 485 U.S. at 993 (White, J., dissenting from denial of certiorari).

118. See Kaufman, *Loss Causation*, *supra* note 50, at 384, n.158 and cases cited therein.

119. *See, e.g.*, *In re* Oracle Sec. Litig., 829 F. Supp 1176, 1181 (N.D. Cal. 1993); *Securities Fraud*, *supra* note 5, at 1426.

closed information.[120] Experts devised several methods of arriving at that "value" figure, including event studies.[121] An event study "looks to how the price of the stock changed after the fraud was disclosed,"[122] but only as "evidence of the amount by which it was inflated prior to disclosure."[123] The goal of an event study usually is to determine what the plaintiff would have paid for a given security had the alleged misrepresentations or omissions not been made. The study, of course, often begins with the event of corrective disclosure.[124] The expert determines the precise reaction of the market price following disclosure of the previously concealed information. The study also attempts to eliminate any market reaction caused by events other than the disclosure of the information.

Yet, a truly sound expert analysis always takes one more critical step.[125] The expert then attempts to determine how the market price would have reacted to the disclosure had that disclosure been made at the time of the transaction. An event study that merely determines post-disclosure decline in market price cannot calculate the actual *loss* caused by the fraud, because the loss occurred at the time of the transaction. Thus, the expert's event study must determine if the concealed infor-

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120. Dickey & Mayer, *supra* note 110, at 1203. *See also Securities Fraud, supra* note 5, at 1426-28.

121. Dickey & Mayer, *supra* note 110, at 1203-14; *Securities Fraud, supra* note 5, at 1427-28. *See also In re* Imperial Credit Indust., Inc., 252 F. Supp. 2d 1005, 1014-15 (C.D. Cal. 2003); *In re* WorldCom, Inc. Sec. Litig., 219 F.R.D. 267, 299 n. 42 (S.D.N.Y. 2003). "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." *In re* Imperial Credit Indust., Inc., 252 F. Supp. 2d at 1014 (citing RMED Int'l, Inc. v. Sloan's Supermarkets, Inc., 2000 WL 310352, at *6 (S.D.N.Y. 2000)). The event study method is "an accepted method for the evaluation of materiality damages to a class of stockholders in a defendant corporation." *In re* Gaming Lottery Sec. Litig., 2000 U.S. Dist. LEXIS 1558, at *1 (S.D.N.Y. 2000) (citations omitted).

122. United States v. Grabske, 260 F. Supp. 2d 866, 867 (N.D. Cal. 2002).

123. *Id.* at 867-868. *See also In re* Imperial Credit Sec. Litig., 252 F. Supp. 2d at 1014-15; *In re* Seagate Tech. II Sec. Litig., 843 F. Supp. 1341, 1348 (N.D. Cal. 1994); *In re* Oracle Sec. Litig., 829 F. Supp. at 1181. *See also,* Jon Koslow, Note, *Estimating Aggregate Damages in Class-Action Litigation under Rule 10b-5 for Purposes of Settlement,* 59 FORDHAM L. REV. 811, 822 (1991).

124. *But see Securities Fraud, supra* note 5, at 1445 ("Courts should reject the economically simplistic and pseudo-scientific approach of requiring an admission followed directly by a stock price doctrine. There is no basis for such a mechanistic approach in either law or economics").

125. *Id.* at 1442, 1444-45.

mation would have made a difference at the time of the transaction.

Congress' look-back provision merely provides a crude rule of thumb to replace expert analysis of the price that plaintiffs would have paid for their securities had the truth been disclosed at the time of their purchases.[126] The "cap" uses the 90-day mean trading price as a measure of value where plaintiff's experts would otherwise attempt to deflate or inflate that value to serve their client's interests. The statute simply presumes that the price that plaintiffs would have paid for their securities had the truth been disclosed on the transaction date is no greater than the 90-day average price of the security

126. In their article regarding the PSLRA's damages provision, Dickey and Mayer therefore predict that the provision will have "at most, a modest impact in the great majority of future cases." Dickey and Mayer looked at 196 federal court cases that were settled between 1991 and 1994. For each stock in the sample, the bounce back ratio was calculated. In 40.3 percent of the cases, if Section 21D(e) had been used, the plaintiff's average damages would have been reduced. The median value of the bounce back would have been a 10.9 percent reduction. In 2.6 percent of the sample, the bounce back was over 100 percent and the plaintiff's claim to damages would have been eliminated entirely. Dickey & Mayer, *supra* note 110, at 1214-16, 1219. The authors' reasoning proceeds from a comparison of expert valuation techniques used under the pre-PSLRA and those likely to be used under the PSLRA. *Id.* at 1203-14. Experts utilized two different approaches to determine the "value line" against which a company's actual stock price is compared. They are the "constant ribbon" method and the "constant true value" method. The "constant ribbon" method presumes that all plaintiffs who purchased and retained shares during the class period were damaged by the amount the stock declined following a curative disclosure. For example, if the stock declined by $5 a share following a curative disclosure, then the constant ribbon theory presumes that the stock price was inflated throughout the class period by $5. Often the price reaction is measured relative to a market or industry index. The "constant true value method," by contrast, presumes that the price following the curative disclosure was the true value throughout the class period. The excess of stock price over true value is inflation per share. A common variant of this approach is the comparable index method. This method presumes the true value, while equal to stock price immediately after the class period, varies during that period in proportion to a market or industry index. For shares purchased during the class period and retained to the curative disclosure, the damage equals inflation per share. Most plaintiffs' damages analyses employ the "constant true value" methodology which also permits "in and out" investors to recover damages as long as the difference between the price line and the lower value line decreases between the date of purchase and the date of sale. *Id.* at 1204-05.

after disclosure of that truth. As the Senate Banking, Housing and Urban Affairs Committee reported, the statute's damages limitation formula is designed only to reduce some of the uncertainty in the actual calculation of securities fraud damages.[127]

The look-back provision thus is entirely consistent with a definition of loss causation that requires proof that the defendants' fraud caused a disparity between purchase price and value created by that fraud. Defendants' fraud has caused plaintiffs' recoverable losses because plaintiffs have paid more money for their securities than they would have paid in the absence of that fraud. The 90-day look-back damages provision suggests that the amount of money that plaintiffs would have paid for their securities in the absence of fraud approximates the market price of the securities over the 90 days after the fraud is disclosed. Contrary to the Court's logic, however, Congress makes clear that the post-disclosure value is not the "economic loss" for which plaintiffs seek damages; it is merely a statutory presumption regarding the degree of artificial price inflation that occurred on the transaction date – the date when the loss for which plaintiffs are seeking damages really occurred. This so-called 90-day look-back provision is only a cap on damages; it is not a causation provision. The language here does not explicitly or implicitly create any requirement of a causal connection between the alleged misrepresentation or omission and any decline in value after corrective disclosure.

E. *The Supreme Court's Policy Concerns Are Unfounded*

The unmistakable language, history, purpose, and design of Congress' loss causation provision indicates that the element can be demonstrated by proof of a causal link between the defendants' misrepresentations and a quantifiable disparity between an artificial transaction price and the true value of securities. Even if that congressional loss causation provision resulted in significant policy difficulties, the Supreme Court itself has made clear that the provision must be enforced as written and intended.[128]

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127. S. Rep. No. 104-98, at 20, *reprinted in* 1995 U.S.C.C.A.N. 679, 699.

128. *See e.g.*, *Central Bank*, 511 U.S. at 174-78 (indicating that policy considerations are powerless to alter the plain meaning of congressional language).

In any event, an accurate interpretation of the PSLRA's loss causation provision would not have disserved any of the legitimate policy objectives underlying the federal securities laws. Requiring plaintiffs to prove that defendants' misrepresentations caused only the precise out-of-pocket losses for which they seek damages would not have lead to frivolous lawsuits or to an increase in the cost of capital. As Congress understood, the primary mechanism for screening such frivolous lawsuits is the heightened pleading standards created by the PSLRA.[129] The loss causation provision is not among those heightened standards. If it were, plaintiffs could certainly satisfy those standards by alleging how defendants' misrepresentations caused their quantifiable and recoverable out-of-pocket losses.

Moreover, the Court's suggestion that the PSLRA's loss causation language should be disregarded because "a person induced to invest by a misrepresentation should not be permitted to recover for a decline in value unrelated to the misrepresentation," is misplaced.[130] That argument depends upon a mistaken definition of recoverable "economic" loss as "a decline in value" which "necessarily occurs at a time after the purchase."[131] The loss recoverable in a § 10(b) claim includes out-of-pocket losses at the time of purchase. By requiring a precise causal connection between the defendants' fraud and the artificiality of the transaction price, Congress prevents the recovery of subsequent price declines unrelated to the fraud. Congress also created the damages cap in order to insure that investors who elect to seek damages for losses stemming from the post-disclosure decline in the value of their investments would not be overcompensated for unrelated market declines. No such overcompensation for post-transaction market de-

129. *See* John W. Avery, *Securities Litigation Reform: The Long and Winding Road to the Private Securities Litigation Reform Act of 1995*, 51 BUS. LAW. 335, 362 (1996) (demonstrating that the loss causation provision only has application to cases already adjudged to be meritorious).

130. Brief for the United States as Amicus Curiae Supporting Petitioners at 7, *Dura* (No. 03-932) [hereinafter U.S. Brief]; *Dura*, 125 S. Ct. at 1632-33.

131. U.S. Brief, *supra* note 129, at 7-8. In its brief before the Supreme Court, the government argued that if loss were established on the purchase date, a plaintiff who purchased and then resold at the inflated price would recover a windfall. *Id.* at 8.

cline is possible, however, where plaintiffs seek only their transaction-based out-of-pocket losses.

In fact, construction of the Supreme Court's rule of causation that requires a showing that the disclosure of the fraud caused a subsequent price decline actually would frustrate the objectives of the securities laws: "A requirement that there be a strict linkage between disclosure of the fraud and a stock price drop would allow a sophisticated entity that recognized its fraud was unsupportable to release information in such a way that the fraud was revealed through innocuous appearing announcements and only when the fraudulent information had been fully corrected announce that a fraud had occurred."[132] If plaintiffs must establish that the defendants' fraud caused a post-disclosure price correction, then "a savvy entity could escape liability" for its fraud that clearly "harmed investors."[133]

Finally, as Congress recognized,[134] requiring plaintiffs to prove that defendants' fraud created an artificial disparity between transaction price and true value will not render loss causation indistinguishable from reliance and too easy to prove in fraud-on-the-market cases.[135] In *Basic, Inc. v. Levinson*,[136] the Supreme Court reaffirmed that "reliance" is an independent element of a private securities fraud claim. The Court, however, allowed the lower federal courts to presume reliance from the fact that an investor purchased or sold securities in an open and developed securities market based on the "integrity" of the market price.[137] While it allowed federal courts to recognize the fraud-on-the-market theory in securities litigation, the Court in *Basic* emphasized that the presumption of

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132. *Securities Fraud*, *supra* note 5, at 1420.

133. *Id.*

134. *See Senate Subcommittee*, *supra* note 23, at 228.

135. The government, in its amicus brief in *Dura*, also contends that if loss were established at the time of the transaction, "loss causation would be present in every fraud in the market case in which the presumption of reliance was unrebutted; and there would be no practical difference between loss causation and transaction causation." U.S. Brief, *supra* note 130, at 8.

136. Basic, Inc. v. Levinson, 485 U.S. 224 (1988).

137. As the Supreme Court put it, the "fraud on the market theory is based on the hypothesis that, in an open and developed securities market, the price of a company's stock is determined by the available material information regarding the company and its business. . . Misleading statements will therefore defraud purchasers even if the purchasers do not directly rely on the misstatements." *Id.* at 241-49.

reliance created by that theory was rebuttable.[138] In *Dura*, the Court endorses this presumption of reliance in fraud-on-the-market cases, but also stresses the fact that the presumption is "nonconclusive."[139] The presumption of reliance may be rebutted by establishing that the plaintiffs relied upon factors other than the integrity of the market price in deciding whether to enter their transactions.[140]

The Supreme Court has indicated, and Congress has recognized, that this element of reliance – even in a fraud-on-the-market case – is distinct from the element of loss causation.[141] The Court in *Basic* declared that plaintiffs must also demonstrate the "requisite causal connection between a defendant's misrepresentation and the plaintiffs' injury."[142] The causal connection required is that the defendants' misstatements or omissions created a quantifiable disparity between the transaction price and the true value of the securities on the date of the transaction.[143] That particular "causal connection can be broken" by defendants by showing that the "market price would not have been affected by their misrepresentations."[144] Reliance requires proof that defendants' misrepresentations or omissions influenced plaintiffs' decision whether to invest at all. As developed by the Supreme Court in *Basic*, and as ultimately codified by Congress in the PSLRA, loss causation is proof that these misrepresentations or omissions created a measurable difference between the *price* which plaintiffs actually paid for their securities and the price that they would have paid in the absence of those misrepresentations or omissions. In *Dura*, the Court accepts the definition of reliance fashioned in *Basic* and codified by Congress, but then ignores that definition in manufacturing its own theory of causation and "economic loss."

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138. *Id.* at 248.

139. *Dura*, 125 S. Ct. at 1631.

140. *Basic*, 485 U.S. at 248.

141. *See Dura*, 125 S. Ct. at 1631. *See also Basic*, 485 U.S. at 243; *Senate Subcommittee*, *supra* note 23, at 228.

142. *Basic*, 485 U.S. at 243.

143. *Id.* at 248-49 n.27.

144. *Id.* at 248.

II.
THE SUPREME COURT'S CONCEPT OF ECONOMIC LOSS IS INCOHERENT

The foundation for the Court's opinion in *Dura* is its novel notion of "economic loss." The Court reasons that mere allegations that the plaintiffs purchased securities at an artificially inflated price do not satisfy the Court's requirement of allegations of "economic loss." The Court thereby suggests that "economic loss" may not necessarily occur at the instant of purchase because the plaintiff can recoup the entire purchase price by reselling the securities at that same price. Whatever "economic loss" may mean, apparently it cannot be established merely by an artificially inflated purchase price. Through its application of its "economic loss" concept to the allegations in *Dura,* the Court suggests that economic loss may mean that the price paid for the purchase of securities was higher than the price subsequently received for the sale of those same securities.

The Court's concept, however, is meaningless because the Court rejects the possibility that economic loss could occur by purchasing securities at an artificially inflated price in the *Dura* case, but then accepts that very possibility in other cases. A negative disparity between purchase price and sale price apparently constitute relevant economic loss, as the Court uses that term.[145] Yet, the Court also suggests that economic loss could occur even without any resale of the securities, and even if the resale price is *higher* than the purchase price.[146]

The Court's notion of economic loss also is incoherent because the Court fails to acknowledge that an investor who purchases securities at an artificially inflated price and resells those securities at that price has suffered a loss simply through his or her initial purchase of those securities at the inflated price. That loss is an "economic" loss by any principled definition. If defendants' misrepresentations have caused that artificial price-inflation, then the investor can establish loss causation.

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145. The investor who purchases a security at a price higher than the resale price, of course, may or may not suffer an economic loss in the real world. The Court never considers the short term or long term objective of any investor, or the overall economic position of the investor's portfolio.

146. 125 S. Ct. at 1631-32.

In *Securities Fraud, Stock Price Valuation, and Loss Causation: Toward a Corporate Finance–Based Theory of Loss Causation,*[147] the authors insightfully show how, under well-settled principles of corporate finance, investors suffer economic losses caused by fraud when they purchase their securities at an artificial price inflated by that fraud. Under "basic principles of corporate finance theory," the market price (the transaction price) of a security reflects the market's estimation of the company's future cash flow, discounted to the present at the company's cost of capital.[148] Where a company falsely represents its present or past financial performance, the "market will use this information as an indicator of the company's future cash flows."[149] If the purchasers of securities have purchased at a price that reflects expectations of future cash flow that have been artificially inflated by defendants' fraud, the purchasers have suffered a recognizable loss.[150] That economic loss is recognizable because the investors have purchased securities at a price which falsely inflated their expectations of the company's future cash flow.[151] That loss exists even if there has been no subsequent corrective disclosure of the fraud followed by a decline in the stock price.[152]

Established principles of corporate finance theory also demonstrate that such an investor loss could occur even if the stock price never declines below the purchase price. If the market price rises based on favorable post-transaction news that increases discounted expectations of future cash flow, the artificiality in the plaintiffs' purchase price may never result in a post-transaction decline in value below that purchase price. Yet the investor nonetheless has purchased at a price that is artificially high – it is based on discounted false expectations of future cash flow. The difference between the artificial purchase price (discounted false expectations of future cash flow) and the non-artificial price (discounted non-false expectations of future cash flow) is out-of-pocket loss, which can be measured as of the transaction date. If, as is ordinarily the case, the plaintiff may recover those out-of-pocket losses, then

147. *Securities Fraud, supra* note 5, at 1444-45.
148. *Id.* at 1442.
149. *Id.*
150. *Id.* at 1442-43.
151. *Id.* at 1442.
152. *See id.*

loss causation shall be established without any showing of a connection between the fraud and a post-corrective disclosure price decline.[153]

The authors of *Securities Fraud* ultimately would require "some linkage between the market's original cash-flow expectations and subsequent disclosures related to the fraud."[154] But that linkage can be easily established. By definition, the issue of loss causation does not arise unless it is established that defendants have made material misrepresentations in connection with plaintiffs' decision to invest. Those misrepresentations are material precisely because they alter the market's expectations of a company's future cash flow. Once the misrepresentations are uncovered – through the gradual spread of information to the market, through corrective disclosures, or even through litigation – the linkage between the market's original, artificial cash flow projections and the disclosures can be established.

III.
THE SUPREME COURT'S OPINION IS INCONSEQUENTIAL

A. *The Court's Holding Is Narrowly Tailored to Private Actions by Securities Purchasers Pursuing the Fraud-on-the-Market Theory*

The Supreme Court's opinion is premised on its view that the plaintiffs' complaint alleged "nothing significantly more than the following" regarding economic losses attributable to the defendants' misrepresentations: "*'In reliance on the integrity of the market, [the plaintiffs] . . . paid artificially inflated prices for Dura securities' and the plaintiffs suffered 'damage[s]' thereby.*"[155] The Court's holding is also based on its understanding of the elements of §10(b) liability in "cases involving publicly traded securities and purchases or sales in public securities markets . . ."[156] The Court described such cases as "fraud-on-the-market cases" in which the element of "reliance" can be "nonconclusively" presumed from the fact that plaintiffs purchased

153. *See, e.g., id.* at 1444-45.
154. *Id.* at 1445.
155. *Dura,* 125 S. Ct. at 1630, (citing plaintiffs' amended complaint, App. at 139a) (emphasis added by the Court).
156. *Id.* at 1631.

their shares at a price that "reflects a material misrepresentation."[157]

The Court's decision thus is explicitly limited to claims brought by purchasers of securities who pursue private securities fraud claims under the PSLRA based on the fraud-on-the-market theory. Accordingly, the decision does not address SEC actions, which are not at all governed by the PSLRA. Nor does the opinion reach private actions for securities fraud where the plaintiffs are not attempting to take advantage of the nonconclusive presumption of reliance on the fraud-on-the-market theory. Examples include cases involving securities not traded on a public market, cases involving claims of actual reliance on a fraudulent misrepresentation, cases involving a presumption of reliance from a material omission, and even cases involving a presumption of reliance from the "fraud – created the market" theory. Finally, and somewhat paradoxically, the Court's decision does not take into account any claims brought by defrauded sellers of securities who sell their securities at artificially deflated prices.

B. *Meeting the Court's Standards in the Limited Cases in which those Standards Apply Will Not Be Difficult*

In fraud-on-the-market cases, the elements of private securities fraud liability include "economic loss" and "loss causation" – a "causal connection between the material misrepresentation and the loss."[158] The Court made clear that, "[n]ormally, in cases such as this one (*i.e.*, fraud-on-the-market cases), an inflated purchase price will not itself constitute or proximately cause the relevant economic loss."[159] First, at the "instant" the transaction takes place, the "inflated purchase" price alone cannot constitute "economic loss" because the plaintiff acquires a security of "equivalent value" as measured by that transaction price.[160] Second, the "logical link" between the inflated transaction price and "later economic loss" is not necessarily strong enough to relieve plaintiffs of the bur-

157. *Id.*

158. *Id.* (citing 15 U.S.C. § 78u-4(b)(4) (2000); Thomas Lee Hazen, The Law of Securities Regulation §§ 12.11[1], [3] (5th ed. 2002)).

159. *Id.* at 1631.

160. *Id.* at 1631.

den of pleading and proving such a "link."[161] The Court reasons that the "misrepresentation will not have led to any loss" if: (1) the purchaser sells the shares "quickly before the truth begins to leak out," or (2) the purchaser sells "after the truth makes its way into the market place" but the low price "reflects" events other than the misrepresentation that account for "some or all of that lower price."[162]

Nonetheless, the Court makes clear that an inflated purchase price "will *sometimes* play a role in bringing about a future loss."[163] Although plaintiffs must plead and prove more than that defendants' misrepresentation merely "touches upon" that future loss, they can prevail by establishing that the misrepresentation "proximately" "caused" that loss.[164] The Court's holding rejects the Ninth Circuit's view that loss causation can be established merely by proof that the defendants' misrepresentation caused artificial inflation in the plaintiffs' transaction price, and the Fifth Circuit's view that loss causation can be established by proof that the defendants' misrepresentation merely touches upon the reasons for the decline in the value of plaintiffs' investment.[165] Nevertheless, the Court also rejects the harsh position advanced by Dura in the case and adopted by some federal courts that loss causation requires a showing that defendants made a corrective disclosure of the fraud followed by a causally related price drop. Rather, the Court indicates that allegations and proof that the artificiality in the purchase price was reduced by any kind of dissemination into the market of the concealed information are sufficient to satisfy its tests.

The Court ultimately indicats that the plaintiffs' burden of pleading and proving that they suffered economic loss proximately caused by the defendants' misrepresentations is not an onerous one. The Court first "concede[s]" that neither the "securities statutes" nor the federal rules of civil procedure impose any "special further requirement in respect to the pleading of proximate causation or economic loss"[166] Rather, the

161. *Id.*

162. *Id.* at 1631-32.

163. *Id.* at 1632 (emphasis in original).

164. *Id.* citing 15 U.S.C. § 78u-4(b)(4) (2000) ("To 'touch upon' a loss is not to *cause* a loss, and it is the latter that the law requires").

165. 125 S. Ct. at 1633.

166. *Id.* at 1634.

"simple fact" in Federal Rule of Civil Procedure 8(a) governs the pleading of causation and loss in private securities litigation: plaintiffs must allege a "short and plain statement" of causation and loss that provides defendants with "fair notice of what the plaintiff's claim is and the grounds upon which it rests."[167] According to the Court, the *Dura* complaint failed that "simple test" because it "implies" that the plaintiffs' loss consisted only of an artificially inflated purchase price.[168] The complaint contains nothing that suggests that plaintiffs suffered a "relevant economic loss" caused by the defendants' misrepresentation. The Court, however, makes clear that the complaint would have satisfied the test of pleading loss and causation if it had "provide[d] defendants with notice of what the relevant economic loss might be or of what the casual connections might be between that loss and the misrepresentation . . ."[169] The Court itself recognized that it "should not prove burdensome" for a plaintiff to provide defendants with "some indication of the loss and the causal connection that the plaintiff has in mind."[170]

In fraud-on-the-market cases brought by defrauded purchasers of securities, the Court's concept of economic loss clearly can be established by allegations and proof that the plaintiff purchased securities at a higher price than the plaintiff subsequently resold those securities.[171] A plaintiff who purchases at $100.00 and resells at a market price $50.00 apparently has suffered an economic loss of $50.00 The Court would also recognize an economic loss where the plaintiff purchases securities of $100.00, the securities plummet in market price to $50.00, but the plaintiff retains these securities.

The next step in the Court's construct is to establish that the "economic loss" (here, the difference between purchase price and subsequent market price) was "proximately caused" by the defendants' misrepresentation. The Court suggests that it may be relatively easy to prove that the disclosure of the misrepresented facts caused a market price decline where the dis-

167. *Id.* (citing Fed.R.Civ.P. 8(a); Conley v. Gibsen, 355 U.S. 41, 47 (1957)).

168. *Id.*

169. *Id.*

170. *Id.*(citing Swierkiewicz v. Sonema N.A., 34 U.S. 506, 513-15 (2002)).

171. *See infra* Section II.

closure occurs soon after the purchase, but relatively hard to prove that casual connection where the disclosure occurs further out in time.[172] The time-lag makes it more difficult for the plaintiff to discount or eliminate factors other than the fraud which might have caused the price decline. Yet the Court does not require proof of proximate cause at the pleading stage, only sufficient information to place the adversary on fair notice of the plaintiffs' causation theory. Allegations that the misrepresented and omitted facts were disclosed to the market and that the disclosure had an effect on market price are likely to be sufficient to meet the Court's standards.

Indeed, the Court's opinion indicates that victims of securities fraud can prevail by pleading and proving the following:

(1) Plaintiffs have "suffered actual economic loss" because:
   (a) they purchased securities at a price that is higher than the post-transaction market price at which they resold their securities; or
   (b) they purchased securities at a price that is higher than the post-transaction market price of the securities;[173]
   and
(2) Defendants' misrepresentations or omissions proximately caused plaintiffs' actual economic loss because:
   (a) the lower post-transaction market price at which plaintiffs resold their securities reflects the true facts misrepresented or omitted by defendants;
   (b) the lower post-transaction market price of plaintiffs' securities reflects the true facts misrepresented or omitted by defendants.

The Court's reasoning indicates that plaintiffs can unquestionably meet its standard by pleading and proving that the market price of their securities "fell significantly after the

172. *Dura,* 125 S. Ct. at 1631-32.

173. The Court expressly declines to reach the issue of whether economic loss can be established where the market price of a security increases after the fraudulent transaction, but not as much as it otherwise would have increased absent the fraud. *Id.* at 1633-34.

truth [became] known."[174] Indeed, the plaintiffs in the *Dura* case itself would have little difficulty prevailing under the Court's standard. In their pleadings before the Supreme Court, the plaintiffs represented that they where fully prepared to demonstrate that the market price of Dura's stock declined 21% in response to the disclosure of the defendants' misrepresentations regarding its Alburto Spiros product.[175] In its Supreme Court briefs, Dura even conceded that adverse disclosure regarding Alburto Spiro had resulted in a 21% decline in Dura stock price.[176] At oral argument, plaintiffs' counsel also made clear that it would be able to plead and prove that investors suffered actual economic loss when the price dropped 21% after the truth regarding Alburto Spiros became known.[177] Nor does the Court at all require plaintiffs to plead and prove that the market-price drop was caused by a corrective disclosure. To the contrary, the Court recognized that the market-price can "reflect" the truth in many ways.[178]

C. *The Court Expressly Declined to Reach Other Loss Causation Issues*

After reaching its narrow result regarding the adequacy of the singular allegation of loss causation in the *Dura* matter, the Court explicitly refused to address any "other proximate cause or loss-related questions."[179] The Court did not specify what those questions might be. Yet, the opinion also explicitly declined to consider "a claim that a share's higher price is lower than it otherwise could have been . . ."[180] That issue troubled the Court enough that it was the subject of a significant

174. *Id.* at 1634.

175. *See* Response in Opposition to Petition for Writ of Certiorari Reply at 3, 5, *Dura* (No.03-932).

176. *See* Reply Brief to Petition for Writ of Certiorari Reply at 8, *Dura* (No. 03-932).

177. Transcript of Oral Argument at 41-43, *Dura* (No. 03-932).

178. At oral Argument, the government conceded that the plaintiffs may succeed by demonstrating that the inflation in the purchase price has been reduced regardless of whether truth is revealed in direct or "subtle ways." *Id.* at 18-19.

179. 125 S. Ct. at 1633-34.

180. *Id.* at 1632.

amount of questioning during oral argument.[181] Nonetheless, the Court chose not to reach the question in it its opinion.

Had the Court reached the question, it would have had to refine its concept of "economic loss." The Court seems to recognize, as it must, that an investor who purchases securities at an artificially inflated price, and then resells those securities at a price higher than the purchase price (but "lower than it otherwise would have been"), has a viable claim for securities fraud. Yet, clearly that investor has not suffered an "economic loss," as the Court seems to employ that notion in its opinion. The investor has in fact gained money from the investment itself – sold at a price higher than the purchase price. If that investor suffers a recognizable "loss" under the PSLRA, then the Court's concept of "economic" loss cannot mean simply that the plaintiffs' "purchase price was higher than the sale price." If the Court's concept of economic loss means something other than "purchase price was higher than sale price," then the Court provides no hint as to what that would be.

The soundest interpretation of the Court's concept of "economic loss" is that it permits a showing that the investor suffered a loss by purchasing securities at an artificially inflated price without mitigating that loss by reselling those securities at that same inflated price. Only that definition of "economic loss" gives any meaning to the Court's opinion. By that refined standard, the plaintiffs who purchase securities at an artificially inflated price of $100.00 per share, cannot show "economic loss" if they resell those shares the instant after the transaction at $100.00 per share.[182] Those plaintiffs have fully mitigated their losses. However, a plaintiff who purchases at $100, but resells at $125 at some point after the misrepresentations are disclosed, may suffer an "economic loss" in the Court's sense if the sale price would have been higher in the absence of the fraud. Loss occurs when the dissemination of the misrepresented or nondisclosed facts causes a movement in the market price of the securities.

If loss occurs when the market price of the plaintiffs' investment is altered by the dissemination of the misrepresented or nondisclosed facts, then proof of loss and causation are intertwined. When the disclosure of the fraud is an event that

181. *See* Transcript of Oral Argument at 42, 55, *Dura* (No. 03-932).
182. *Dura,* 125 S. Ct at 1631.

creates appreciable price movement, the fraud has proximately caused the loss in the value of the plaintiff's investment. By the Court's logic, that price movement is the so-called "economic loss." Where the dissemination of the previously-concealed information constitutes an "event" that – apart from all of the other external factors that weigh upon market price – causes a price-movement, the fraud has proximately caused the "economic loss." Loss causation is pleading and proof that the dissemination of facts misrepresented or omitted by the plaintiff caused the market price of the plaintiffs' investment to move in a direction adverse to the plaintiffs' investment interest. As the Court suggests in its refusal to foreclose the possibility that economic loss could be proximately caused in a situation where the market value of plaintiff's investment was lower than it otherwise would have been, plaintiffs may prevail even by showing that they did not profit as much from their investment as they would have in the absence of the fraud.

IV.
CONCLUSION

The Supreme Court has recognized that the federal securities laws are designed to prevent and to remedy investor losses caused by "artificial manipulation" that creates a disparity between "market price" and "just price."[183] In its carefully constructed PSLRA, Congress also has recognized that investors bringing private actions under § 10(b) could recover their out-of-pocket damages, measured by the disparity between their artificial purchase prices and the true value of their securities, on the transaction date. Where the plaintiffs properly seek to recover losses measured by that disparity, Congress explicitly requires them to prove the causal connection between the defendants' fraud and that precise loss.

All of the federal courts have agreed that where plaintiffs seek out-of-pocket losses, the PSLRA requires plaintiffs to prove that defendants' misstatements or omissions caused those transaction-based losses. Because those losses are clearly recoverable under the PSLRA and §10(b), the Supreme

183. Basic, Inc. v. Levinson, 485 U.S. 224, 246 (1988) (quoting H.R. REP. No. 95-1383, 11 (1978)).

Court's injection of concepts like "economic loss" and proximate cause into securities fraud claims raises the spectre of result-oriented reasoning. Through the PSLRA's plain language, legislative history, recorded purposes, statutory structure and policies, Congress clearly permits defrauded plaintiffs to prove that defendants' fraud caused losses for which they seek damages. The PSLRA does not require plaintiffs to prove that defendants' fraud caused losses for which they do not seek damages. The Court's construction of the PSLRA is inconsistent with Congress' unmistakable design and purpose, incoherent in its use of the vague and unfounded concept of economic loss, and ultimately (hopefully) inconsequential.