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Wendy Gerwick Couture
University of Idaho

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Around the World of Securities Fraud in Eighty Motions to Dismiss

Remarks of Wendy Gerwick Couture*

I am delighted to join this discussion about securities fraud pleading requirements because the motion to dismiss operates as the litmus test in securities fraud class actions. A motion to dismiss is filed in virtually every securities fraud class action. According to data compiled by NERA Economic Consulting, a motion to dismiss is filed in 96% of securities class actions, with the remaining 4% of cases settling before the motion is filed.¹ For purposes of comparison, according to a recent report to the Judicial Conference Advisory Committee on Rules, even in a post-*Iqbal* world,² 12(b)(6) motions to dismiss are filed in only 6.2% of cases overall.³

In addition to being omnipresent, motions to dismiss are extraordinarily successful in securities fraud class actions. Indeed, approximately 32% of all securities class actions are terminated via a motion to dismiss.⁴ Of those cases that survive dismissal, the vast

* Wendy Gerwick Couture is an Associate Professor of Law at the University of Idaho, where she teaches securities regulation and white-collar crime.

1. RENZO COMOLLI, SUKAINA KLEIN, RONALD I. MILLER & SVETLANA STARYKH, NERA ECON. CONSULTING, RECENT TRENDS IN SECURITIES CLASS ACTION LITIGATION: 2012 FULL-YEAR REVIEW 16–17 (2013) [hereinafter NERA, RECENT TRENDS], available at http://www.nera.com/nera-files/PUB_Year_End_Trends_01.2013.pdf (analyzing securities class actions filed and resolved from 2000 through 2012).

2. *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (“To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to ‘state a claim to relief that is plausible on its face.’” (citation omitted)).

3. JOE S. CECIL, GEORGE W. CORT, MARGARET S. WILLIAMS & JARED J. BATAILLON, FED. JUDICIAL CTR., REPORT TO THE JUDICIAL CONFERENCE ADVISORY COMMITTEE ON CIVIL RULES: MOTIONS TO DISMISS FOR FAILURE TO STATE A CLAIM AFTER *IQBAL* 8–9 (2011) [hereinafter CECIL ET AL.], available at [http://www.fjc.gov/public/pdf.nsf/lookup/motioniqbal.pdf/\\$file/motioniqbal.pdf](http://www.fjc.gov/public/pdf.nsf/lookup/motioniqbal.pdf/$file/motioniqbal.pdf). This report undercounts the total number of motions to dismiss filed in cases overall for two reasons. First, it excludes prisoner and pro se cases, in which motions to dismiss are perhaps more likely. See *id.* at 9 (noting the exclusion of these cases); Patricia Hatamyar Moore, *An Updated Quantitative Study of Iqbal’s Impact on 12(b)(6) Motions*, 46 U. RICH. L. REV. 603, 607, 639–40 (2012) (criticizing the exclusion of these cases from the data set). Second, it only identifies motions filed within ninety days after the case was filed in federal court or removed to federal court. CECIL ET AL., *supra*, at 8 n.13. Nonetheless, motions to dismiss are certainly much more prevalent in securities fraud class actions than in cases generally.

4. CORNERSTONE RESEARCH, SECURITIES CLASS ACTION FILINGS: 2011 YEAR IN REVIEW 18

majority settle before the court rules on another motion, with only 8% of all cases reaching a ruling on a motion for summary judgment.⁵ Therefore, courts' opinions on motions to dismiss are immensely important to the evolution of the substantive and procedural law of securities fraud.⁶

In order to ensure that my remarks reflect current trends in this ever-evolving area, I have analyzed a data set of eighty opinions issued in 2013 on motions to dismiss securities fraud class actions,⁷ and I will share eight observations about those opinions. My comments are, admittedly, influenced by my prior writing in this area.⁸ However, my data set is publicly available on the Social Science Research Network,⁹ and I encourage you to draw further observations therefrom based on your own areas of research.

I. WINNOWING IS REAL BUT RELATIVELY RARE

One argument in favor of the prominent role that motions to dismiss play in securities fraud class actions is their winnowing role,¹⁰ whereby

& fig.16 (2012), available at <http://www.cornerstone.com/getattachment/8001e1dc-3579-44d2-b0b8-f9f97302d9c7/Securities-Class-Action-Filings%E2%80%94942011-Year-in-Review.aspx> (analyzing a sample of filings from 1996 to 2011 that have been resolved and for which Cornerstone Research had sufficient data).

5. *Id.*

6. See Stephen J. Choi & A. C. Pritchard, *The Supreme Court's Impact on Securities Class Actions: An Empirical Assessment of Tellabs*, 28 J.L. ECON. & ORG. 850, 860 (2012) (“Notably, only a trivial percentage of cases is resolved through summary judgment or trial. These findings confirm that the motion to dismiss is the main event; if the defendants fail to prevail at this point, settlement is likely.”).

7. I compiled this data set of eighty opinions as follows: On November 17, 2013, I performed the following “terms and connectors” search in the DCT (U.S. District Court Cases) database on Westlaw: “securities fraud” & “motion to dismiss” & (“P.S.L.R.A.” “private securities litigation reform act”) & “class action” & da(aft 1/1/2013). There were 153 results. I discarded opinions that (1) did not rule on motions to dismiss; (2) did not rule on putative class actions; or (3) did not rule on claims of securities fraud. In addition, if the data set included multiple opinions on successive motions to dismiss filed in the same case, I included only the last opinion. Finally, after performing the above culling, I chose the first eighty opinions to have been issued in 2013.

8. *E.g.*, David Coale & Wendy Couture, *Loud Rules*, 34 PEPP. L. REV. 715 (2007); Wendy Gerwick Couture, *Mixed Statements: The Safe Harbor's Rocky Shore*, 39 SEC. REG. L.J. 257 (2011); Wendy Gerwick Couture, *Opinions Actionable As Securities Fraud*, 73 LA. L. REV. 381 (2013) [hereinafter Couture, *Opinions Actionable*]; Wendy Gerwick Couture, *The End of the Vexatiousness Rationale*, 41 SEC. REG. L.J. 301 (2013) [hereinafter Couture, *Vexatiousness*]; Wendy Gerwick Couture, *The Falsity-Scienter Inference*, 40 SEC. REG. L.J. 303 (2012) [hereinafter Couture, *Falsity-Scienter*].

9. SSRN Author Page for Couture, Wendy Gerwick, SOC. SCI. RES. NETWORK, <http://ssrn.com/author=1070964> (last visited Feb. 19, 2014) [hereinafter SSRN].

10. See, *e.g.*, Sharon Nelles & Hilary Huber, *Pleading Securities Fraud Claims: The Good, The Bad, and The Ugly*, 45 LOY. U. CHI. L.J. 653, 660 (2014) (asserting that heightened standards for surviving a motion to dismiss serve the expressed purpose of the PSLRA by minimizing

the motion to dismiss, rather than disposing of the case altogether, focuses the court and the litigants on the potentially meritorious issues. This narrowing function is especially useful in securities fraud cases, where complaints are notoriously prolix. Motions to dismiss that are granted in full do not winnow the case; they terminate it. Only motions to dismiss that are denied altogether, or granted in part and denied in part, serve to focus the parties. Therefore, the degree to which winnowing actually occurs depends on how often courts deny motions to dismiss, either in full or in part.

By this measure, winnowing is real but relatively rare. According to data compiled by NERA Economic Consulting, in those cases to reach a ruling on a motion to dismiss, 17% of motions to dismiss are granted in part and denied in part, and 14% are denied.¹¹ In total, therefore, motions to dismiss serve a winnowing function in only 31% of cases to reach a ruling on a motion to dismiss. The motions to dismiss in my data set reflect a similar outcome. Of the eighty motions to dismiss, 20% were granted in part and denied in part, and 6% were denied.¹² In sum, motions to dismiss operated to focus the courts and the parties in only 26% of the cases in my data set.

II. DICTUM ABOUND, AND THAT'S A GOOD THING

Dicta are statements that are not necessary to a court's ruling.¹³ Obiter dicta are tangential discussions about issues that were not briefed by the parties, and judicial dicta are discussions that, albeit not necessary to the court's ruling, at least benefit from the parties' briefing.¹⁴ Dicta is frowned upon, and treated as non-binding, for two reasons: (1) a concern for full consideration; and (2) a concern about limits on judicial power.¹⁵ Obiter dicta implicate both rationales more than judicial dicta.¹⁶

Dictum abounds in rulings on motions to dismiss securities fraud claims. As an example, if a securities fraud complaint fails to plead a strong inference of scienter, the court's additional conclusion that the complaint also fails to plead loss causation would not be necessary to

frivolous law suits).

11. NERA, RECENT TRENDS, *supra* note 1, at 17.

12. Of the eighty motions to dismiss in my data set, five were denied; six were granted in part with prejudice and denied in part; and ten were granted in part without prejudice and denied in part.

13. Coale & Couture, *supra* note 8, at 725.

14. *Id.* at 725, 727.

15. *Id.* at 725–26.

16. *Id.* at 725–27.

the court's holding and would thus be dictum. Yet, district courts routinely grant motions to dismiss on the basis of multiple overlapping reasons. In my data set, of the seventy-five opinions granting motions to dismiss in full or in part, thirty-seven opinions—or 49%—engaged in dicta. Indeed, several of these courts rather sheepishly acknowledged that they were entering into the realm of dicta, commenting that they were doing so “in an abundance of caution”¹⁷ or “for the sake of completeness.”¹⁸

That is not to say that dictum is omnipresent in opinions on motions to dismiss securities fraud claims. In my data set, 51% of the opinions granting motions to dismiss, either in full or in part, did so without engaging in dicta. Many of these courts explicitly noted that they were exercising judicial restraint, often indicating that they “need not” reach additional arguments for dismissal.¹⁹

Although these courts' self-restraint is impressive, I nonetheless contend that district courts should feel free to engage in judicial dicta when ruling on motions to dismiss securities fraud cases. The parties extensively brief each potential ground for dismissal, so these courts are engaging in judicial dicta rather than the more problematic obiter dicta. Additionally, district courts' rulings are not binding on any future courts,²⁰ so their dicta will not inappropriately bind future litigants (although it certainly might be persuasive).

Further, dictum serves an important role in securities fraud litigation. When a motion to dismiss is granted *without prejudice*, dictum serves to guide the plaintiff's drafting of an amended complaint. Typically, a plaintiff has only one opportunity after dismissal without prejudice to cure the complaint's defects before dismissal with prejudice,²¹ so the

17. *In re Royal Caribbean Cruises Ltd. Sec. Litig.*, No. 1:11-22855-CIV, 2013 WL 3295951, at *17 (S.D. Fla. Apr. 19, 2013).

18. *City of Royal Oak Ret. Sys. v. Juniper Networks, Inc.*, No. 5:11-CV-04003-LHK, 2013 WL 2156358, at *9 (N.D. Cal. May 17, 2013).

19. *E.g.*, *In re Omnicare, Inc. Sec. Litig.*, No. 11-cv-173-DLB-CJS, 2013 WL 1248243, at *5 (E.D. Ky. Mar. 27, 2013); *City of Sterling Heights Gen. Emps. Ret. Sys. v. Hospira, Inc.*, No. 11 C 8332, 2013 WL 566805, at *24 n.9 (N.D. Ill. Feb. 13, 2013); *Stratte-McClure v. Morgan Stanley*, No. 09 Civ.2017(DAB), 2013 WL 297954, at *9 (S.D.N.Y. Jan. 18, 2013); *In re Satyam Computer Servs. Ltd. Sec. Litig.*, 915 F. Supp. 2d 450, 485 (S.D.N.Y. 2013).

20. Charles A. Sullivan, *On Vacation*, 43 HOUS. L. REV. 1143, 1179 (2006) (explaining “why a decision of a federal district court is not binding as a matter of precedent on anyone”).

21. *See CECIL ET AL.*, *supra* note 3, at 22 (“We also found that motions were more likely to be granted without leave to amend when they were directed at an amended complaint. . . . This finding is unsurprising: courts take earlier amendments into account in deciding motions to dismiss.”). My data set is consistent with this conclusion: 40% of first dismissals, in full or in part, were without prejudice, while only 13% of second (or subsequent) dismissals, in full or in part, were without prejudice. *See also, e.g.*, *Mallen v. Alphatec Holdings, Inc.*, No. 10-cv-1673-

court's guidance on the myriad potential grounds for dismissal is invaluable to the plaintiff. When a motion to dismiss is granted *with prejudice*, dictum provides alternative grounds for affirmance on appeal, thereby conserving judicial (and litigants') resources.

Finally, as discussed above, motions to dismiss are often the only opportunity for courts to rule on the substantive and procedural law of securities fraud. Therefore, district courts' dictum contributes to the depth and vibrancy of the judicial discussion about securities law. Debate among the district courts about emerging issues of securities law informs the courts of appeals, in much the same way that the "process of percolation allows a period of exploratory consideration and experimentation by lower courts before the Supreme Court ends the process with a nationally binding rule."²² For example, the district courts are currently engaged in thoughtful debates about whether courts can take judicial notice of 10b5-1 plans to negate an inference of scienter at the motion to dismiss stage,²³ whether Item 303 of Regulation S-K creates a duty to disclose that is actionable as securities fraud,²⁴ and whether, in light of *Janus Capital Group, Inc. v. First Derivative Traders*,²⁵ the group pleading doctrine can still be used to

BEN(MDD), 2013 WL 1294640, at *14 (S.D. Cal. Mar. 28, 2013) ("[W]here the [party] has previously been granted leave to amend and has subsequently failed to add the requisite particularity to its claims, '[t]he district court's discretion to deny leave to amend is particularly broad.'" (citing *Zucco Partners, LLC v. Digimarc Corp.*, 552 F.3d 981, 1007 (9th Cir. 2009) (internal quotation and citation omitted))); *Plumbers Local #200 Pension Fund v. Wash. Post Co.*, 930 F. Supp. 2d 222, 233 n.5 (D.D.C. 2013) ("Given that this is Plaintiff's second unsuccessful attempt to survive a motion to dismiss, the court finds that dismissal with prejudice is appropriate.").

22. *California v. Carney*, 471 U.S. 386, 400 n.11 (1985) (Stevens, J., dissenting) (quoting Samuel Estreicher & John E. Sexton, *A Managerial Theory of the Supreme Court's Responsibilities: An Empirical Study*, 59 N.Y.U. L. REV. 681, 716 (1984)).

23. See *Pipefitters Local No. 636 Defined Benefit Plan v. Tekelec*, No. 5:11-CV-4-D, 2013 WL 1192004, at *15 n.7 (E.D.N.C. Mar. 22, 2013) ("Courts are divided about whether to consider Rule 10b5-1 [trading] plans at the motion to dismiss stage. . . . Here, the court need not weigh in on the dispute."). Compare *In re Gentiva Sec. Litig.*, No. 10-cv-5064 (ADS)(WDW), 2013 WL 5291297, at *20 (E.D.N.Y. Sept. 19, 2013) (considering a 10b5-1 plan and concluding that it is one factor negating scienter), with *In re Bridgepoint Educ., Inc. Sec. Litig.*, No. 3:12-CV-1737JM (WMC), 2013 WL 5206216, at *27 (S.D. Cal. Sept. 13, 2013) ("Defendants may not use trading plans at the pleading stage to defeat an inference of scienter.").

24. Compare *Stratte-McClure*, 2013 WL 297954, at *5 (interpreting Second Circuit precedent under section 11 as suggesting that the failure to disclose pursuant to Item 303 can be actionable as securities fraud), with *Shah v. GenVec, Inc.*, No. DKC 12-0341, 2013 WL 5348133, at *15 n.16 (D. Md. Sept. 20, 2013) (agreeing with Third Circuit authority that Item 303 cannot form the basis for a securities fraud claim).

25. *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2302 (2011) ("For purposes of Rule 10b-5, the maker of a statement is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it.").

link an individual defendant to an allegedly false corporate statement.²⁶ For all of these reasons, I contend the district courts should continue to engage in judicial dicta when ruling on motions to dismiss securities fraud cases.²⁷

III. SCIENTER IS (STILL) KING

Failure to plead a strong inference of scienter, as required by the Private Securities Litigation Reform Act (“PSLRA”),²⁸ is by far and away the most frequently successful ground for dismissal. In a recent study, Stephen J. Choi and A.C. Pritchard documented that scienter was a successful ground for dismissal, at least in part, in 53% of motions to dismiss securities fraud claims.²⁹ Similarly, in my data set, scienter was the dominant ground for dismissal, with 65% of the opinions granting dismissal, at least in part, on this basis.

The following chart compares the findings of Choi and Pritchard with the results of my data set:

26. See *In re Satyam Computer Servs. Ltd. Sec. Litig.*, 915 F. Supp. 2d 450, 477 n.16 (S.D.N.Y. 2013) (holding that the group pleading doctrine survives *Janus Capital*); see also *City of Austin Police Ret. Sys. v. Kinross Gold Corp.*, No. 12 Civ.1203(PAE), 2013 WL 1174017, at *36 n.1 (S.D.N.Y. June 6, 2013) (opinion denying reconsideration) (noting conflicting authority in the Southern District of New York about whether the group pleading doctrine survives *Janus Capital*); *In re Am. Apparel*, No. CV 10–6352MMM(JCGx), 2013 WL 174119, at *24–25 (C.D. Cal. Jan. 16, 2013) (reviewing conflicting authority on whether the group pleading doctrine survives *Janus Capital*).

27. Other scholars have argued that dictum is valuable when used by other courts in other contexts. E.g., Mohsen Manesh, *Damning Dictum: The Default Duty Debate in Delaware*, 39 J. CORP. L. (forthcoming 2014), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2222136 (arguing that the use of dictum is an “established Delaware judicial practice that has been vital to the state’s success in attracting corporate, and now LLC, charters”); Judith M. Stinson, *Why Dicta Becomes Holding and Why It Matters*, 76 BROOK. L. REV. 219, 242–43 (2010) (recognizing that, because of its “unique position in our legal system,” the Supreme Court has reasons to express itself via dicta). Placing my argument within this larger debate, perhaps it is time to recognize that the appropriateness of dicta should depend on the role that a particular court plays in certain types of litigation and should not be generalized to all courts in all circumstances.

28. 15 U.S.C. § 78u-4(b)(2)(A) (2012) (“[I]n any private action arising under this chapter in which the plaintiff may recover money damages only on proof that the defendant acted with a particular state of mind, the complaint shall, with respect to each act or omission alleged to violate this chapter, state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.”).

29. Choi & Pritchard, *supra* note 6, at 862 tbl.3. This percentage reflects the sum of the following two columns in Table 3 of Choi and Pritchard’s study: “Both denied and granted dismissal based on this ground” and “Dismissal granted (at least partially) based on this ground.” *Id.*

Percentage of Motions to Dismiss Granted, At Least in Part, On This Basis
(Includes Motions to Dismiss That Were Also Partially Denied On This Basis)

Basis for (At Least Partial) Dismissal	Choi & Pritchard³⁰	My Data Set³¹
Scienter	53% (rank = 1)	52/80 = 65% (rank = 1)
Misstatement (Falsity)	33% (rank = 2)	43/80 = 54% (rank = 2)
Forward-Looking Safe Harbor	15% (rank = 3)	16/80 = 20% (rank = 4)
Loss Causation	13% (rank = 4)	14/80 = 18% (rank = 6)
Materiality	13% (rank = 4)	15/80 = 19% (rank = 5)
Attribution to Defendant (Maker)	7% (rank = 6)	5/80 = 6% (rank = 7)
Puffery	4% (rank = 7)	22/80 = 28% (rank = 3)

As you can see, the relative success rate of dismissal grounds in my data set is fairly consistent with the findings of Choi and Pritchard, with the exception of the heightened role of the puffery doctrine in my data set. This discrepancy may be explained by courts' incoherent approach to puffery, which I discuss below in Part VII.

One take-away from this data is that the future for innovation and reform in the area of securities fraud litigation lies in the pleading of scienter. With respect to innovation, if plaintiffs can find new ways to satisfy the scienter pleading standard, they have the potential to decrease their dismissal rates substantially. One possibility, the falsity-scienter inference, is discussed below in Part IV. With respect to

30. *Id.* This percentage reflects the sum of the following two columns in Table 3 of Choi and Pritchard's study: "Both denied and granted dismissal based on this ground" and "Dismissal granted (at least partially) based on this ground." *Id.* Therefore, this percentage includes some motions to dismiss that were denied in part on this basis, as long as the motions to dismiss were also granted in part on this basis.

31. Seventy-five out of the eighty opinions in my data set granted the motion to dismiss, at least in part, for a partial dismissal rate of 94%. SSRN, *supra* note 9. As discussed above in Part II, many of the opinions in my data set cited multiple bases for dismissal, explaining why the sum of percentages in the column exceeds 94%.

reform, if you believe—as I do—that the fear of unduly vexatious securities fraud litigation³² has caused the pendulum to swing too far in favor of defendants,³³ an effective reform would be to lower the scienter pleading standard. For example, Congress could enact the lower “reasonable or permissible inference” pleading standard, which the Supreme Court rejected in *Tellabs, Inc. v. Makor Issues & Rights, Ltd.* in favor of the higher “cogent and at least as compelling as any opposing inference” pleading standard.³⁴

IV. THE FALSITY-SCIENTER INFERENCE CONTINUES TO PERCOLATE

I have previously argued for the recognition of a “falsity-scienter” inference, whereby the well-pleaded falsity of a statement is sufficient to create a strong inference of scienter when (1) the truth is necessarily within the speaker’s core knowledge; and (2) the statement is sufficiently false to have necessarily caught the speaker’s attention.³⁵ As an admittedly silly example, if a plaintiff pleaded with particularity that I had stated, “My hair is light blond,” and that this statement was false because my hair is dark brown, these allegations would give rise to a strong inference that I spoke at least recklessly when misstating my hair color. My hair color was necessarily within my core knowledge (as opposed, perhaps, to my blood type), and the falsity was extreme enough to have necessarily caught my attention (as opposed, perhaps, to misstating my hair color as black).

Many courts likewise recognize the intuitiveness of the falsity-scienter inference,³⁶ but, rather than defining the inference’s contours as I have proposed, they apply it on an ad hoc basis. For example, in *In re American Apparel, Inc. Shareholder Litigation*, the court held that American Apparel’s alleged immigration violations supported a strong inference of scienter where the violations were extensive, the

32. See *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 739 (1975) (“[L]itigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general.”).

33. See Couture, *Vexatiousness*, *supra* note 8, at 311 (“The vexatiousness rationale is no longer viable. As explained above, the bases for the Supreme Court’s adoption of this policy heuristic are now largely defunct, and there is not an intervening basis for the rationale.”).

34. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 324 (2007).

35. Couture, *Falsity-Scienter*, *supra* note 8, at 303.

36. Other courts, however, reject the falsity-scienter inference out of hand. *E.g.*, *City of Roseville Emps. Ret. Sys. v. Sterling Fin. Corp.*, No. CV-09-0368-EFS, 2013 WL 3990798, at *40 (E.D. Wash. Aug. 5, 2013) (“In essence, Plaintiff asks the Court to accept that Defendants’ fraudulent conduct caused GAAP violations, which in turn provide support for the inference that the conduct was fraudulent; but this is circular reasoning.”); *In re Satyam Comp. Servs. Ltd. Sec. Litig.*, 915 F. Supp. 2d 450, 479 (S.D.N.Y. 2013) (“[T]he magnitude of a fraud, standing alone, cannot support a strong inference of scienter.”).

company's workforce was central to its brand image, and the company repeatedly emphasized the importance of its workforce when publicizing the company.³⁷ Applying the elements of the falsity-scienter inference, the company's compliance with immigration laws was central to the company's identity and thus necessarily within the company's core knowledge, and the company's representations about its compliance were sufficiently different from the alleged actual state of affairs to have necessarily caught the speaker's attention.

As another example, in *In re Anadarko Petroleum Class Action Litigation*, the individual defendant's allegedly false statement about whether Anadarko had specifically authorized deviations from the original well design supported an inference of scienter: "Daniels's statement was unequivocal—'[w]e were not involved in that at all on this well'—which supports that he was at least reckless for speaking without knowledge of Anadarko's involvement on the Macondo well."³⁸ Again applying the elements of the falsity-scienter inference, because the defendant felt confident enough to speak in specific detail about the company's involvement with a particular well, the company's involvement was necessarily within the speaker's core knowledge; and the alleged 180-degree difference between the truth and the statement was sufficient to have caught the speaker's attention.

Similarly, in *City of Sterling Heights General Employees' Retirement System v. Hospira, Inc.*, the court held that, "if the statements as to the condition of Hospira's facilities were in fact false or misleading," it would be "difficult to imagine a non-culpable explanation as to how Defendants, given their monitoring of Hospira's plants," could have made the statements without scienter.³⁹ Under the falsity-scienter inference, the condition of Hospira's facilities was necessarily within the core knowledge of the defendants because of their monitoring of those facilities, and the statements were sufficiently different from the alleged actual condition as to have necessarily caught the defendants' attention.

Finally, in *Cement & Concrete Workers District Council Pension Fund v. Hewlett Packard Co.*, the court noted that, if the individual defendant's failure to disclose his allegedly inappropriate relationship were material, the court would probably find the scienter requirement to

37. *In re Am. Apparel, Inc. S'holder Litig.*, No. CV 10-06352 MMM (JCGx), 2013 WL 174119, at *22 (C.D. Cal. Jan. 16, 2013).

38. *In re Anadarko Petroleum Corp. Class Action Litig.*, No. 4:12-cv-0900, 2013 WL 3753972, at *25–26 (S.D. Tex. July 15, 2013).

39. *City of Sterling Heights Gen. Emp. Ret. Sys. v. Hospira, Inc.*, No. 11 C 8332, 2013 WL 566805, at *26 (N.D. Ill. Feb. 13, 2013).

be satisfied because he “obviously knew of his own conduct.”⁴⁰ Under the falsity-scienter inference, the status of the individual defendant’s personal relationships was necessarily within the defendant’s core knowledge, and the failure to disclose that relationship in the face of a duty to do so would not be inadvertent.

In sum, I am heartened that courts are beginning to recognize the intuitiveness of the falsity-scienter inference, but I encourage courts to do so with more rigor, optimally by adopting the two-part test that I have proposed.

V. THE CORE OPERATIONS INFERENCE IS HOT

One important subset of the falsity-scienter inference is the controversial core operations inference, which assumes that “senior management, by virtue of their positions, were or should have been aware of facts so material to the company’s core operations.”⁴¹ Indeed, the viability and scope of the core operations inference is one of the hottest issues in current securities fraud litigation, with 21% of the opinions in my data set analyzing it.

As I have argued previously, the core operations inference is merely an “application of the falsity-scienter inference to the specific factual scenario involving a corporate officer and a false statement about the company’s operations.”⁴² In short:

When a member of the senior management speaks about the company’s core operations, the first element of the falsity-scienter inference test is met because the truth of the statement about the company’s core operations is necessarily within the senior officer’s core knowledge. When the statement about core operations is so false as to necessarily catch the officer’s attention, the second element of the falsity-scienter inference test is met.⁴³

The core operations inference should, therefore, be analyzed within the broader context of the falsity-scienter inference. As such, the analysis of whether operations qualify as “core” should center on whether the subject operations would necessarily be known to the identified officer.⁴⁴ Consistent with my argument, the courts in my data set

40. *Cement & Concrete Workers Dist. Council Pension Fund v. Hewlett Packard Co.*, No. 12-cv-04115-JST, 2013 WL 4082011, at *9 (N.D. Cal. Aug. 9, 2013).

41. Michael J. Kaufman & John M. Wunderlich, *Messy Mental Markers: Inferring Scienter from Core Operations in Securities Fraud Litigation*, 73 OHIO ST. L.J. 507, 524 (2012).

42. Couture, *Falsity-Scienter*, *supra* note 8, at 308–09.

43. *Id.* at 309.

44. *Id.*

focused on whether the subject operations were “core”⁴⁵ such that it would be “‘absurd’ to suggest management was without knowledge of the matter.”⁴⁶

VI. SUBJECTIVE FALSITY MATTERS

The circuits are split on how to establish the falsity of an opinion for purposes of liability under the securities acts. Some courts, including the Second and Ninth Circuits, hold that an opinion is only false if it is both objectively unreasonable (objective falsity) and disbelieved (subjective falsity).⁴⁷ Other courts, including the Sixth Circuit, merely require objective falsity.⁴⁸ I have previously argued that both objective and subjective falsity should be required because the “dual-falsity requirement recognizes that an opinion, in addition to conveying something objective, conveys something subjective—the speaker’s mental processes.”⁴⁹

The resolution of this unsettled issue can be outcome-determinative, not only in section 11 cases, but also in securities fraud cases.⁵⁰ Both

45. *E.g.*, *In re* OSG Sec. Litig., No. 12 Civ. 7948(SAS), 2013 WL 4885890, at *12 (S.D.N.Y. Sept. 10, 2013) (“The Company’s core operation is shipping, not tax policy.”); *City of Taylor Gen. Emp. Ret. Sys. v. Magna Int’l Inc.*, No. 12 Civ. 3553(NRB), 2013 WL 4505256, at *26 (S.D.N.Y. Aug. 23, 2013) (“[A]ny allegation that four interior/exterior facilities constituted a core operation of Magna—a global company with approximately 286 manufacturing facilities worldwide—is . . . fanciful on its face.”); *In re* Anadarko Petroleum Corp. Class Action Litig., No. 4:12-cv-0900, 2013 WL 3753972, at *16 (S.D. Tex. July 15, 2013) (“[R]egardless of the importance of deepwater drilling or the Gulf of Mexico to Anadarko, it cannot be presumed that Anadarko’s top executives knew the most granular details regarding operations within those business segments.”); *Wallace v. IntraLinks*, No. 11 CV 8861(TPG), 2013 WL 1907685, at *9 (S.D.N.Y. May 8, 2013) (“The fact that the FDIC was IntraLinks’ largest customer and a substantial part of the Enterprise division, which was a key focus of IntraLinks’ revenue reports, provides a basis for the core operations doctrine.”); *Plumbers Local # 200 Pension Fund v. Wash. Post Co.*, 930 F. Supp. 2d 222, 231 (D.D.C. 2013) (rejecting the argument that a subsidiary two levels below the parent was a core business of the parent).

46. *Gammell v. Hewlett-Packard Co.*, No. SACV 11-1404 AG (RNBx), 2013 WL 1947525, at *18 (C.D. Cal. May 8, 2013) (quoting *S. Ferry, LP No. 2 v. Killinger*, 542 F.3d 776, 786 (9th Cir. 2008)).

47. *Fait v. Regions Fin. Corp.*, 655 F.3d 105, 110 (2d Cir. 2011) (“[L]iability lies only to the extent that the statement was both objectively false and disbelieved by the defendant at the time it was expressed.”); *Rubke v. Capitol Bancorp Ltd.*, 551 F.3d 1156, 1162 (9th Cir. 2009) (“Because these fairness determinations are alleged to be misleading opinions, not statements of fact, they can give rise to a claim under section 11 only if the complaint alleges with particularity that the statements were both objectively and subjectively false or misleading.”).

48. *See* *Ind. State Dist. Council of Laborers v. Omnicare, Inc.*, 719 F.3d 498, 505 (6th Cir. 2013) (discussing requirements to establish liability for a false statement).

49. *Couture, Opinions Actionable*, *supra* note 8, at 404.

50. *See e.g.*, *City of Omaha, Neb. Civilian Emp. Ret. Sys. v. CBS Corp.*, 679 F.3d 64, 68 (2d Cir. 2012) (“Moreover, even if the second amended complaint did plausibly plead that defendants were aware of facts that *should* have led them to begin interim impairment testing earlier, such

the subjective falsity requirement and the securities fraud element of scienter depend on the speaker's state of mind, but the standards are not identical. Rather, the subjective falsity requirement of disbelief is a higher bar than the scienter standard of recklessness.⁵¹ As such, a complaint that adequately pleads scienter might nonetheless fail to plead subjective falsity. Indeed, several of the courts in my data set granted motions to dismiss securities fraud claims for failure to plead subjective falsity.⁵²

Even though the characterization of a statement as an opinion carries with it the potentially outcome-altering subjective falsity requirement, courts continue to make this characterization on an ad hoc basis, without defining the distinction between statements of fact and statements of opinion. For example, in my data set, courts characterized the following statements as opinions without fully explaining why:

- (a) An officer's statement that video subscriber loss was attributable to the retransmission dispute;⁵³
- (b) Auditor reports of Generally Accepted Accounting Principles compliance;⁵⁴
- (c) Statements about the adequacy of loan loss reserves;⁵⁵
- (d) A bank's statements that it had acted conservatively with respect to risk and that it had adhered to conservative lending standards;⁵⁶

pleading alone would not suffice to state a securities fraud claim after *Fait*. Plaintiffs' second amended complaint is devoid even of conclusory allegations that defendants did not believe in their statements of opinion regarding CBS's goodwill at the time they made them.”).

51. Couture, *Opinions Actionable*, *supra* note 8, at 397 (“Because the subjective falsity requirement is more stringent than the ordinary scienter requirement, the merger of these two analyses when the alleged misrepresentation is a statement of opinion has the effect of raising the applicable scienter level. In other words, when the alleged misrepresentation is a statement of opinion, the applicable scienter level is raised from *recklessness* to *actual disbelief* or *actual knowledge of falsity*.”). *But see* McIntire v. China MediaExpress Holdings, Inc., 927 F. Supp. 2d 105, 133 (S.D.N.Y. 2013) (stating that the difference between subjective falsity and scienter is a “distinction without a difference”).

52. *E.g.*, Livingston v. Cablevision Sys. Corp., No. 12-CV-377(KAM)(SMG), 2013 WL 4763430, at *8 (E.D.N.Y. Sept. 5, 2013) (“Plaintiffs neither adequately allege that Rutledge's comments were objectively false, nor that he did not believe them at the time they were made.”); Perry v. Duoyuan Printing, Inc., No. 10 Civ. 7235(GBD), 2013 WL 4505199, at *5 (S.D.N.Y. Aug. 22, 2013) (“Plaintiffs have not offered any facts to allege that Frazer had a subjective belief that its opinions were false.”); Okla. Firefighter Pension & Ret. Sys. v. Student Loan Corp., 951 F. Supp. 2d 479, 497 (S.D.N.Y. 2013) (“Having concluded that *Fait* applies to this case, we find that plaintiffs allege no facts whatsoever to support their argument that defendants did not honestly believe their loan loss reserves were adequate when made.”).

53. *Livingston*, 2013 WL 4763430, at *7–8.

54. *Perry*, 2013 WL 4505199, at *5.

55. *Okla. Firefighter Pension*, 951 F. Supp. 2d at 495.

56. *IBEW Local 90 Pension Fund v. Deutsche Bank AG*, No. 11 Civ 4209(KBF), 2013 WL 1223844, at *14 (S.D.N.Y. Mar. 27, 2013).

and

- (e) A company's statements about the schedule for development of a mine.⁵⁷

I have previously proposed the following evaluation-inference test to differentiate statements of opinion from statements of fact for purposes of invoking the subjective falsity requirement: Does the statement express the speaker's evaluation or inference of facts?⁵⁸ This test, which draws from comparable distinctions in the contexts of defamation and common law fraud, hones in on the "something special" that differentiates opinions from statements of fact.⁵⁹ Applying the evaluation-inference test to the above statements, statements (b)–(d) arguably qualify as opinions because they represent the speaker's subjective evaluation of the state of affairs. Statements (a) and (e) arguably qualify as opinions because they represent the speaker's inference of an unknown fact from known facts. Therefore, although I ultimately agree with these courts' characterizations of these statements as opinions, I nonetheless urge courts to engage in a more meaningful analysis of the fact-opinion distinction in order to ensure that the distinction dovetails appropriately with the rationale underlying the subjective falsity requirement.

VII. PUFFERY IS UNTETHERED

Puffery is broadly defined as "rosy affirmation[s] commonly heard from corporate managers and numbingly familiar to the marketplace."⁶⁰ As Choi and Pritchard's findings and my data set confirm, courts routinely dismiss claims on the basis that puffery is not actionable as securities fraud.⁶¹ Yet, as my data set reflects, courts are divided about the reason that puffery is not actionable, with some courts citing no rationale at all.

The majority view is that puffery is immaterial as a matter of law because no reasonable investor would consider a puffing statement to be important when making an investment decision,⁶² and the minority view

57. *City of Austin Police Ret. Sys. v. Kinross Gold Corp.*, No. 12 Civ 1203(PAE), 2013 WL 1174017, at *18–21 (S.D.N.Y. Mar. 22, 2013).

58. Couture, *Opinions Actionable*, *supra* note 8, at 407.

59. *Id.* at 410.

60. *Shaw v. Digital Equip. Corp.*, 82 F.3d 1194, 1217 (1st Cir. 1996).

61. *See supra* Part III.

62. Couture, *Opinions Actionable*, *supra* note 8, at 416–17; *see, e.g., In re Royal Caribbean Cruises Ltd. Sec. Litig.*, No. 1:11–22855–CIV, 2013 WL 3295951, at *12 (S.D. Fla. Apr. 19, 2013) ("Defendants' discussion of 'healthy demands,' and 'intention to compete successfully' and the 'encouraging' prospect of early bookings are all examples of such puffery on which a reasonable investor would not rely.").

is that puffery is not actionable because it is so vague and general that it is incapable of being proven false.⁶³ I have previously argued that this minority characterization merely identifies a subset of puffery because “any statement that is incapable of falsity is also immaterial because no reasonable investor would rely on such a statement when making an investment decision.”⁶⁴

More concerning than this split between materiality and falsity, however, is that many courts treat the characterization of a statement as puffery as sufficient in and of itself to merit dismissal. Rather than tying the puffery characterization to an element of securities fraud, these courts dismiss claims merely because they are based on non-actionable puffery.⁶⁵ Courts’ reliance on the puffery characterization, especially when untethered from the elements of securities fraud, is a prime example of a substantive law heuristic.⁶⁶

When courts treat the puffery characterization as untethered from the elements of securities fraud, they risk dismissing potentially meritorious claims. For example, the statement “X product is a good product” is a quintessential example of puffery. Yet, if a CEO made this statement with knowledge that the product was subject to a massive recall, the seemingly puffing statement would actually be materially misleading and thus actionable.⁶⁷ Therefore, I urge courts to tether their puffery analysis to the elements of securities fraud, lest they sweep the puffery brush too broadly and dismiss potentially meritorious claims.

63. Couture, *Opinions Actionable*, *supra* note 8, at 417; *see, e.g., In re Am. Apparel*, No. CV 10-06352MMM(JCGx), 2013 WL 174119, at *29 n.182 (C.D. Cal. Jan. 16, 2013) (“Charney’s ‘virtually seamless’ comment, for example, appears to be puffery rather than an actionable misrepresentation of fact . . .”).

64. Couture, *Opinions Actionable*, *supra* note 8, at 417.

65. *E.g., Livingston v. Cablevision Sys. Corp.*, No. 12-CV-377(KAM)(SMG), 2013 WL 4763430, at *10 (E.D.N.Y. Sept. 5, 2013) (“Third, and finally, Rutledge’s statement that Cablevision ‘can continue to provide superior products, superior customer service, and compete aggressively, and continue to grow’ is quintessential inactionable puffery.”); *Rescue Mission of El Paso, Inc. v. K-Sea Transp. Partners L.P.*, No. 12-cv-00509 (WHW), 2013 WL 3087078, at *16 (D.N.J. June 14, 2013) (“Defendant Dowlings remarked, ‘we think the long-term future of the company is still very bright and promising.’ This statement is a general expression of corporate optimism inactionable as a matter of law.”); *City of Austin Police Ret. Sys. v. Kinross Gold Corp.*, No. 12 Civ. 1203(PAE), 2013 WL 1174017, at *16 (S.D.N.Y. Mar. 22, 2013) (“These rosy but general portraits of Kinross’s due diligence do not rise to the level of an actionable misstatement. They are puffery.”).

66. *See* Stephen M. Bainbridge & G. Mitu Gulati, *How Do Judges Maximize? (The Same Way Everybody Else Does-Boundedly): Rules of Thumb in Securities Fraud Opinions*, 51 EMORY L.J. 83, 86, 119–22 (2002) (demonstrating how the puffery doctrine is an example of one of the four materiality-based heuristics).

67. *See* Couture, *Opinions Actionable*, *supra* note 8, at 430–31 (comparing the use of “great” in puffery scenarios when the speaker does or does not know of a product defect).

VIII. WHAT RULE 11 FINDINGS MANDATE?

The PSLRA mandates that, upon “final adjudication of the action,” a court make specific findings in the record about each party’s and attorney’s compliance with Federal Rule of Civil Procedure 11(b).⁶⁸ If the court finds that a party violated Rule 11(b), the PSLRA requires the court to impose sanctions⁶⁹ and creates a rebuttable presumption that the award of attorneys’ fees and costs is the “appropriate sanction.”⁷⁰

Yet, courts are largely ignoring this Rule 11 findings mandate.⁷¹ Thirty-nine of the opinions in my data set disposed of the case in its entirety, thus triggering the mandate. Courts made Rule 11 findings in only four of those cases. In one case, the court entered a finding that plaintiffs’ counsel had violated Rule 11.⁷² In two cases, the court found that the parties and attorneys had complied with Rule 11.⁷³ In one case, the issue of potential Rule 11 violations is still pending before the court.⁷⁴

The open question is: why are courts disregarding the PSLRA’s mandate to make Rule 11 findings?⁷⁵

68. 15 U.S.C. § 78u-4(c)(1) (2012). Under Rule 11(b), an attorney’s signature on papers filed with the court certifies that, “to the best of the person’s knowledge, information, and belief, formed after an inquiry reasonable under the circumstances,” his or her legal contentions are “warranted by existing law or by a nonfrivolous argument for extending, modifying, or reversing existing law or for establishing new law” and his or her “factual contentions have evidentiary support or, if specifically so identified, will likely have evidentiary support after a reasonable opportunity for further investigation or discovery.” FED. R. CIV. P. 11(b).

69. 15 U.S.C. § 78u-4(c)(2) (“If the court makes a finding under paragraph (1) that a party or attorney violated any requirement of Rule 11(b) . . . as to any complaint, responsive pleading, or dispositive motion, the court shall impose sanctions on such party or attorney in accordance with Rule 11 . . .”).

70. *Id.* §§ 78u-4(c)(3)(A)(i)–(ii).

71. See M. Todd Henderson & William H.J. Hubbard, *Do Judges Follow the Law? An Empirical Test of Congressional Control over Judicial Behavior* 6 (Coase-Sandor Inst. for Law & Econ., Working Paper No. 671, 2014), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2377351 (examining a dataset of over 1000 securities).

72. See *In re AOL, Inc. Repurchase Offer Litig.*, No. 12 Civ. 3497(DLC), 2013 WL 4441516, at *1 (S.D.N.Y. Dec. 5, 2013) (“This Opinion concludes that plaintiff’s counsel must be sanctioned for filing a frivolous complaint.”).

73. *Livingston v. Cablevision Sys. Corp.*, No. 12–CV–377(KAM)(SMG), 2013 WL 4763430, at *13 (E.D.N.Y. Sept. 5, 2013) (“The court finds that Plaintiffs’ arguments, tenuous as they may be, are not frivolous, even though they lack factual support.”); *In re Omnicare, Inc. Sec. Litig.*, No. 11–cv–173–DLB–CJS, 2013 WL 1248243, at *17 (E.D. Ky. Mar. 27, 2013) (“[T]he PSLRA ‘mandate[s] imposition of sanctions for frivolous litigation.’ . . . The Court has conducted this review and finds the parties and attorneys have not violated the mandates of Rule 11(b).” (citation omitted)).

74. *Boca Raton Firefighters’ & Police Pension Fund v. Devry Inc.*, No. 10 C 7031, 2013 WL 1286700, at *13 (N.D. Ill. Mar. 27, 2013) (“We will give the plaintiffs an opportunity to address the defendants’ arguments before making our findings under § 78u-4(c)(1).”).

75. See Henderson & Hubbard, *supra* note 71, at 14–18 (testing various hypotheses for

One explanation is that courts are not in the habit of making rulings that neither party has requested. Other than the court's obligation to sua sponte consider its own subject matter jurisdiction,⁷⁶ it is unusual for a court to make a ruling that neither party has requested. To quote Chief Justice John Roberts, the court's job is usually to "call balls and strikes and not to pitch or bat."⁷⁷ The PSLRA's mandate is an anomaly because, rather than requiring either party to request that the court make Rule 11 findings, it is self-executing. Of course, nothing prevents a party from requesting that the court comply with the PSLRA's mandate. Indeed, the defendants did just that in two of the cases in my data set in which the court made Rule 11 findings.⁷⁸ In those cases where the parties do not so request, however, the court may simply be unaware of the statutory mandate to make Rule 11 findings, especially if the court has not had significant prior experience with securities cases.⁷⁹

A second explanation is that courts are civilly disobeying Congress because they resent the intrusion into their discretion about when to expend the judicial resources to make findings about an attorney's compliance with Rule 11(b).⁸⁰ Separate and apart from the PSLRA, a court has the power under Rule 11(c)(3) to, on its own initiative, "order an attorney, law firm, or party to show cause why conduct specifically described in the order has not violated Rule 11(b)."⁸¹ Under Rule 11(c)(4), a sanction imposed on the court's own initiative may include nonmonetary directives or an order to pay a penalty into court (but not

courts' failure to make these mandatory Rule 11 findings).

76. 13 CHARLES ALAN WRIGHT ET AL., FEDERAL PRACTICE AND PROCEDURE JURISPRUDENCE § 3522 (3d ed. 2013) ("Even if the parties remain silent, a federal court, whether trial or appellate, is obliged to notice on its own motion its lack of subject matter jurisdiction . . .").

77. Chris Cillizza, *John Roberts, Umpire*, WASH. POST, June 28, 2012, http://www.washingtonpost.com/blogs/the-fix/post/john-roberts-umpire/2012/06/28/gJQAx5ZM9V_blog.html.

78. *In re Omnicare, Inc. Sec. Litig.*, 2013 WL 1248243, at *5 ("Defendants argue the Complaint should be dismissed because Plaintiff failed to satisfy the reasonable investigation requirement of Rule 11 . . ."); *Boca Raton Firefighters' & Police Pension Fund*, 2013 WL 1286700, at *13 ("The defendants have asked us to impose sanctions against the plaintiffs. We will give the plaintiffs an opportunity to address the defendants' arguments before making our findings under § 78u-4(c)(1).").

79. See Henderson & Hubbard, *supra* note 71, at 14 ("The learning account—that generalist judges learn about law over time as they get more experience with securities cases—gets some traction.").

80. See *id.* at 21 ("[O]ne might judge the PSLRA misguided insofar as it insists that judges make findings that in most cases neither the parties nor the judge would think are anything more than a waste of time. A collective decision, whether conscious or not, to avoid a pointless exercise seems to be at worst what a judge might, in other contexts, call 'harmless error.'").

81. FED. R. CIV. P. 11(c)(3).

an award of attorneys' fees).⁸² Therefore, courts already possess the authority to make Rule 11 findings, and they may prefer to exercise that authority only when warranted.

CONCLUSION

I hope that this journey around the world of securities fraud in eighty motions to dismiss provides guidance to litigants, courts, and scholars on this ever-evolving area of law. In addition, I hope that these remarks make a compelling case for the extraordinary importance of courts' opinions on motions to dismiss in the evolution of the substantive and procedural law of securities fraud, inspiring other scholars to join me in studying these opinions. Indeed, this area is so rich that my eight observations are only the beginning of this discussion.

In closing, I would like to thank the Loyola University Chicago School of Law's Institute for Investor Protection and Institute for Law and Economic Policy for sponsoring this worthwhile discussion, my fellow panelists for sharing their thought-provoking comments, and the *Loyola Law Journal* for editing and publishing my remarks.

82. FED. R. CIV. P. 11(c)(4) ("The sanction may include nonmonetary directives; an order to pay a penalty into court; or, if imposed on motion and warranted for effective deterrence, an order directing payment to the movant of part or all of the reasonable attorney's fees and other expenses directly resulting from the violation.").