No. 09-1403

IN THE
Supreme Court of the United States

ERICA P. JOHN FUND, INC.
F/K/A ARCHDIOCESE OF MILWAUKEE
SUPPORTING FUND, INC.,
Petitioner,
v.

HALLIBURTON CO. AND DAVID J. LESAR,
Respondents.

**On Writ of Certiorari
to the United States Court of Appeals
for the Fifth Circuit**

BRIEF OF 16 PUBLIC PENSION FUNDS AS *AMICI CURIAE* IN SUPPORT OF PETITIONER

BRIAN J. BARTOW
General Counsel
CALIFORNIA STATE TEACHERS
RETIREMENT SYSTEM
100 Waterfront Place
West Sacramento, CA 95605
(916) 414-1724
Counsel for California State Teachers Retirement System

DAVID C. FREDERICK
Counsel of Record
KEVIN J. MILLER
KELLOGG, HUBER, HANSEN,
TODD, EVANS & FIGEL,
P.L.L.C.
1615 M Street, N.W.
Suite 400
Washington, D.C. 20036
(202) 326-7900
(dfrederick@khhte.com)
Counsel for Municipal Employees' Retirement System of Michigan

March 1, 2011

(Additional Counsel Listed Inside)

GREGORY W. SMITH
Chief Operating Officer / General Counsel
COLORADO PUBLIC EMPLOYEES' RETIREMENT ASSOCIATION
1301 Pennsylvania Street
Denver, Colorado 80203
(303) 837-6222
Counsel for Colorado Public Employees' Retirement Association

CATHERINE E. LAMARR
General Counsel
OFFICE OF THE CONNECTICUT TREASURER
55 Elm Street
Hartford, Connecticut 06106
(860) 702-3018
Counsel for Connecticut Retirement Plans and Trust Funds

CYNTHIA L. COLLINS
General Counsel to the Board of Trustees of the Delaware Public Employees' Retirement System
Deputy Attorney General
Carvel State Building
820 N. French Street
6th Floor
Wilmington, Delaware 19801
(302) 577-8405
Counsel for Delaware Public Employees' Retirement System

MICHAEL J. MOQUIN
Chief General Counsel
THOMAS R. PETRONI
Senior Deputy General Counsel
MUNICIPAL EMPLOYEES' RETIREMENT SYSTEM OF MICHIGAN
1134 Municipal Way
Lansing, Michigan 48823
(517) 703-9030
Counsel for Municipal Employees' Retirement System of Michigan

MICHAEL A. CARDOZO
Corporation Counsel of the City of New York
100 Church Street
New York, New York 10007
(212) 788-0745
Counsel for Board of Education Retirement System of the City of New York, New York City Employees' Retirement System, New York City Police Pension Fund, New York Fire Department Pension Fund, and Teachers' Retirement System of the City of New York

NANCY G. GROENWEGEN
General Counsel to Thomas P. DiNapoli, Comptroller of the State of New York and, as such, Trustee of the New York State Common Retirement Fund
110 State Street
Albany, New York 12236
(518) 474-3444
Counsel for New York State Common Retirement Fund

JAY CHAUDHURI
General Counsel & Senior Policy Advisor
NORTH CAROLINA DEPARTMENT OF STATE TREASURER
Albemarle Building
325 North Salisbury Street
Raleigh, N.C. 27603-1385
(919) 508-5176
Counsel for North Carolina Retirement Systems

GERALD GORNISH
Chief Counsel
PENNSYLVANIA PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM
PENNSYLVANIA MUNICIPAL RETIREMENT SYSTEM
GOVERNOR'S OFFICE OF GENERAL COUNSEL
5 N. 5th Street
Harrisburg, Pennsylvania 17101
(717) 720-4912
Counsel for Pennsylvania Public School Employees' Retirement System

SAMUEL S. YUN
Acting Chief Counsel
PENNSYLVANIA STATE EMPLOYEES' RETIREMENT SYSTEM
30 North Third Street
Suite 150
Harrisburg, Pennsylvania 17101
(717) 237-0230
Counsel for Pennsylvania State Employees' Retirement System

ROBERT L. PRATTER
Executive Deputy General Counsel
GOVERNOR'S OFFICE OF GENERAL COUNSEL
333 Market Street, 17th Floor
Harrisburg, Pennsylvania 17101
(717) 787-9352
Counsel for Pennsylvania Public School Employees' Retirement System and Pennsylvania State Employees' Retirement System

H. CRAIG SLAUGHTER
Executive Director
WEST VIRGINIA INVESTMENT MANAGEMENT BOARD
500 Virginia Street, East
Suite 200
Charleston, WV 25301
(304) 345-2672
Counsel for West Virginia Investment Management Board

L. JANE HAMBLEN
Chief Legal Counsel
STATE OF WISCONSIN INVESTMENT BOARD
121 East Wilson Street
Madison, Wisconsin 53703
(608) 266-2381
Counsel for State of Wisconsin Investment Board

SALVATORE J. GRAZIANO
WILLIAM C. FREDERICKS
ANN M. LIPTON
BERNSTEIN LITOWITZ BERGER
& GROSSMANN LLP
1285 Avenue of the Americas
New York, New York 10019
(212) 554-1400

JAY W. EISENHOFER
GEOFFREY C. JARVIS
WILLIAM A. K. TITELMAN
GRANT & EISENHOFER P.A.
485 Lexington Avenue
New York, New York 10017
(646) 722-8500

JASON S. COWART
POMERANTZ HAUDEK
GROSSMAN & GROSS LLP
100 Park Avenue
New York, New York 10017
(212) 661-1000

GLEN DEVALERIO
BERMAN DEVALERIO
One Liberty Square
Boston, Massachusetts 02109
(617) 542-8300

RICHARD A. LOCKRIDGE
KAREN HANSON RIEBEL
LOCKRIDGE GRINDAL NAUEN
P.L.L.P.
100 Washington Avenue South
Minneapolis, Minnesota 55401
(612) 339-6900

DANIEL BERGER
BERGER & MONTAGUE, P.C.
1622 Locust Street
Philadelphia, Pennsylvania 19103
(800) 424-6690

Counsel for Amici

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES iii

INTEREST OF *AMICI CURIAE* 1

INTRODUCTION 2

SUMMARY OF ARGUMENT 3

ARGUMENT 6

I. THE COURT OF APPEALS' RIGID STANDARD FOR PROVING LOSS CAUSATION IS CONTRARY TO THE HOLDING IN *DURA PHARMACEUTICALS V. BROUDO* 6

A. The Court Of Appeals' Holding Is Erroneous 6

B. *Dura* Adopted A Traditional Proximate-Cause Analysis For Loss Causation That Is Inconsistent With The Court Of Appeals' Approach 8

C. A Number Of Other Federal Courts Have Refused To Apply This Unreasonably Narrow Standard For Proving Loss Causation 15

II. THE INFLEXIBLE "CORRECTIVE DISCLOSURE" STANDARD ADOPTED BY THE COURT OF APPEALS WOULD PREVENT INVESTORS FROM RECOVERING LEGITIMATE LOSSES PROXIMATELY CAUSED BY CONDUCT PROHIBITED BY THE SECURITIES LAWS 23

III. THE PROXIMATE-CAUSE STANDARD AND PSLRA PLEADING REQUIREMENTS FOR OTHER ELEMENTS OF A FEDERAL SECURITIES-FRAUD VIOLATION ARE SUFFICIENT TO SCREEN FRIVOLOUS CLASS-ACTION SUITS 31

CONCLUSION 33

APPENDIX

TABLE OF AUTHORITIES

Page

CASES

Alaska Elec. Pension Fund v. Flowserve Corp., 572 F.3d 221 (5th Cir. 2009) 6, 8

Allaire Corp. Sec. Litig., In re, 224 F. Supp. 2d 319 (D. Mass. 2002) 21

Basic Inc. v. Levinson, 485 U.S. 224 (1988) 8

Bastian v. Petron Res. Corp., 892 F.2d 680 (7th Cir. 1990).. 9, 17

Bird v. St. Paul Fire & Marine Ins. Co., 224 N.Y. 47 (1918) 13

Brown v. Earthboard Sports USA, Inc., 481 F.3d 901 (6th Cir. 2007) 17

Caremark, Inc. v. Coram Healthcare Corp., 113 F.3d 645 (7th Cir. 1997) 15

Danis v. USN Communications, Inc., 73 F. Supp. 2d 923 (N.D. Ill. 1999)..........................28, 29

Dura Pharm., Inc. v. Broudo, 544 U.S. 336 (2005) ....*passim*

Emergent Capital Inv. Mgmt., LLC v. Stonepath Group, Inc., 343 F.3d 189 (2d Cir. 2003).. 9, 17

Glassman v. Computervision Corp., 90 F.3d 617 (1st Cir. 1996) 28

Greenberg v. Crossroads Sys., Inc., 364 F.3d 657 (5th Cir. 2004)... 6, 8

Holmes v. Securities Investor Protection Corp., 503 U.S. 258 (1992) 12

Indiana State Dist. Council of Laborers & Hod Carriers Pension & Welfare Fund v. Omnicare, Inc., 583 F.3d 935 (6th Cir. 2009), *cert. dismissed*, No. 09-1400, 2010 WL 5638596 (U.S. Nov. 5, 2010) 17

Lentell v. Merrill Lynch & Co., 396 F.3d 161 (2d Cir. 2005) 17

Livid Holdings Ltd. v. Salomon Smith Barney, Inc., 416 F.3d 940 (9th Cir. 2005) 17

Miller v. Asensio & Co., 364 F.3d 223 (4th Cir. 2004) 15

Oracle Corp. Sec. Litig., In re, 627 F.3d 376 (9th Cir. 2010) 18

Oscar Private Equity Invs. v. Allegiance Telecom, Inc., 487 F.3d 261 (5th Cir. 2007) 6, 8

Parmalat Sec. Litig., In re, 375 F. Supp. 2d 278 (S.D.N.Y. 2005) 19, 20, 21, 26

Robbins v. Koger Props., Inc., 116 F.3d 1441 (11th Cir. 1997) 9

Schaaf v. Residential Funding Corp., 517 F.3d 544 (8th Cir. 2008) 17

Semerenko v. Cendant Corp., 223 F.3d 165 (3d Cir. 2000) 9, 15

Suez Equity Investors, L.P. v. Toronto-Dominion Bank, 250 F.3d 87 (2d Cir. 2001) 18

Teachers' Retirement Sys. of Louisiana v. Hunter, 477 F.3d 162 (4th Cir. 2007) 17

Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308 (2007) 32

VeriFone Sec. Litig., *In re*, 784 F. Supp. 1471 (N.D. Cal. 1992), *aff'd*, 11 F.3d 865 (9th Cir. 1993) 28

Vivendi Universal, S.A. Sec. Litig., *In re*, 634 F. Supp. 2d 352 (S.D.N.Y. 2009) 19, 28

Williams Sec. Litig.—WCG Subclass, *In re*, 558 F.3d 1130 (10th Cir. 2009) 16

STATUTES AND RULES

Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 ....1, 6, 9, 15, 31, 32

15 U.S.C. § 78u-4(a)(3)(B)(iii).......... 1

15 U.S.C. § 78u-4(b)(1) 32

15 U.S.C. § 78u-4(b)(2) 32

15 U.S.C. § 78u-4(b)(4) 9

11 U.S.C. § 362.......... 24

Sup. Ct. R.:

Rule 37.3(a).......... 1

Rule 37.6 1

Fed. R. Civ. P. 23 2

LEGISLATIVE MATERIALS

S. Rep. No. 104-98 (1995) 1

OTHER MATERIALS

Andrew Bary, *Yes, This Year's Punk Earnings Do Matter To Investors*, Dow Jones Int'l News (Oct. 20, 2001) 30

Christian Berthelsen, *Texas Power Firm's Shares Falling*, S.F. Chron., June 22, 2001, at B1 29

Richard A. Brealey & Stewart C. Myers, *Principles of Corporate Finance* (4th ed. 1991) 28

Brief of Washington Legal Foundation as *Amicus Curiae* in Support of Petitioners, *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336 (2005) (No. 03-932), 2004 WL 2069563............... 12

Brief for Petitioners, *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336 (2005) (No. 03-932), 2004 WL 2075752 12

Chronicle 100 Leading Companies of Houston, Hous. Chron., May 20, 2001, at 8 29

Peter Edmonston, *Stocks Close Higher As Investors Cheer Earnings News*, Dow Jones Bus. News (Oct. 22, 2001) 30

Enron Shares Drop on SEC Probe, CBS Market Watch (Oct. 22, 2001) 31

Jeff Franks, *Enron Says SEC Inquiry Now Full-Scale Probe*, Reuters (Nov. 1, 2001) 31

C. Bryson Hull:

Enron Head Seeks To Reassure Staff at Meeting, Reuters (Aug. 16, 2001)........................ 30

Enron Seeks To Assuage Investor Fears of Broadband, Reuters (Mar. 23, 2001) 29

Enron Stock Off 8 Percent on False Layoff Talk, Reuters (Mar. 21, 2001) 29

Mark Golden, *'Personal Reasons'? Top, You're Skilling Me*, Dow Jones Energy Serv. (Aug. 17, 2001) 29

W. Page Keeton et al., *Prosser and Keeton on the Law of Torts* (5th ed. 1984) 12

Andrew Kelly, *Enron Stock Falls Sharply After CEO's Resignation*, Reuters (Aug. 15, 2001) 29

Elizabeth Lazarowitz, *U.S. Stocks Struggle with Enron, Mid-East Turmoil*, Reuters (Dec. 3, 2001) 31

James Norman, *Doubts Linger on Enron After CEO's Exit*, Platt's Oilgram News, Aug. 21, 2001, at 1 30

Oral Arg. Tr., *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336 (2005) (No. 03-932), *available at* http://www.supremecourt.gov/oral_arguments/argument_transcripts/03-932.pdf...... 11

Restatement (Second) of Torts (1977)...... 10, 11, 13, 15

Rebecca Smith & John R. Emshwiller, *Enron May Issue More Stock to Cover Obligations*, Wall St. J., Oct. 24, 2001, at A2.......................... 31

Superseding Indictment, *United States v. Skilling, et al.*, Cr. No. H-04-25 (S.D. Tex. filed Feb. 18, 2004) 30

INTEREST OF *AMICI CURIAE*[1]

When it enacted the Private Securities Litigation Reform Act of 1995 ("PSLRA"),[2] Congress expressed a preference that the investor with the largest financial interest should be appointed as the lead plaintiff in a securities-fraud class-action suit. *See* 15 U.S.C. § 78u-4(a)(3)(B)(iii) (creating a "rebuttable presumption" that person with the "largest financial interest in the relief sought by the class" will be appointed lead plaintiff). In doing so, Congress explained that it wanted "to increase the likelihood that institutional investors will serve as lead plaintiffs" and also its belief "that increasing the role of institutional investors in class actions will ultimately benefit the class and assist the courts." S. Rep. No. 104-98, at 11 (1995).

Amici public pension and retirement funds, which are listed by name in Appendix, *infra*, 1a, control more than $700 billion in invested assets on behalf of more than 4.8 million active and retired individual members and beneficiaries. As a result, *amici* and the individuals on whose behalf they invest have a substantial interest in the proper interpretation of the federal securities laws and in the application of the law and this Court's precedents to class-action

---

[1] Pursuant to Supreme Court Rule 37.6, counsel for *amici* represent that no counsel for a party authored this brief in whole or in part and that none of the parties or their counsel, nor any other person or entity other than *amici*, their members, or their counsel, made a monetary contribution intended to fund the preparation or submission of this brief. Pursuant to Rule 37.3(a), counsel for *amici* represent that all parties have filed letters with the Clerk giving blanket consent to the filing of *amicus* briefs.

[2] Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C.).

lawsuits asserting federal securities-law claims, including an interest in ensuring that those laws are not interpreted and applied in a manner that prevents investors from recovering for real economic losses that have been caused by companies or individuals who have engaged in fraudulent and misleading activities in violation of the securities laws.

INTRODUCTION

Amici agree with petitioner that the court of appeals' rule requiring putative class plaintiffs to prove loss causation at the class certification stage is inconsistent with Federal Rule of Civil Procedure 23 and this Court's precedents. We submit this brief, however, to address a different aspect of the court of appeals' decision. In discussing the procedural rule as to what must be proved during class certification, the court, based at least in part on Fifth Circuit precedent, also announced a substantive rule regarding what a plaintiff must prove to show loss causation. *See* App. 121a-122a.

Amici respectfully submit that there is no need in this case for the Court to address whether the Fifth Circuit's discussion of the substantive requirements for proving loss causation is correct. Issues as to the appropriate standard for pleading and proving loss causation are not squarely before the Court, and the procedural issues regarding class certification can be resolved without touching upon the substantive loss-causation test. Because *amici* believe that the loss-causation standard applied by the court of appeals is contrary to this Court's holding in *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336 (2005), however, and because any endorsement of the court of appeals' substantive approach – even implicitly – would be severely detrimental to the interests of *amici* and investors more generally, we write to explain why the Fifth Circuit's approach to loss causation is fundamentally at odds with *Dura* and, if addressed by this Court, should be rejected.

SUMMARY OF ARGUMENT

I. The Court made clear in *Dura* that the common-law concept of "proximate cause" is the appropriate standard for establishing loss causation in a securities-fraud case. 544 U.S. at 346. It held that, where plaintiffs allege that false or misleading statements caused them to purchase securities at an inflated price, they also must allege facts demonstrating that the stock price subsequently declined for reasons connected to the earlier misrepresentations – for example, because the "truth" had begun to "leak out" or had otherwise "ma[de] its way into the marketplace." *Id.* at 342. In so holding, the Court did not prescribe any particular type of information or "truth" that would have to be disclosed to the market regarding the prior representations in order to trigger loss causation.

In this case, the court of appeals announced a standard for proving loss causation that is contrary to *Dura* and that is far more restrictive than the "proximate cause" test adopted by this Court. The Fifth Circuit held that a securities-fraud plaintiff must show that the decline in a defendant's fraudulently inflated stock price followed a very specific type of "corrective disclosure" – essentially a disclosure by the company that admitted the actual falsity of its prior disclosures. *See* App. 121a (holding that "plaintiffs must prove the corrective disclosure shows the misleading or deceptive nature of the prior positive statements"). This rigid test would not allow plaintiffs to establish loss causation in cases where the truth regarding the falsity of the prior representations began to "leak out" in more subtle ways that did not on their face admit that the prior statements were false. Nor would it permit recovery where the very risks that were concealed by the false statements were reasonably foreseeable consequences of those statements and later materialized to cause the stock's price to fall – a test some courts call the "materialization of the concealed risk." For example, where a company falsely inflates its financial statements and thereby conceals the risk that it soon will face insolvency, its subsequent bankruptcy filing would be a materialization of the risk that it previously had concealed, and investor losses would be recoverable under a proximate-cause theory. But, if the bankruptcy filing was not preceded by a "corrective disclosure" admitting that the prior financial statements were false, the Fifth Circuit's approach would deny recovery of even these reasonably foreseeable losses. That approach would lead to inequitable results.

The Fifth Circuit's erroneous standard also would create perverse incentives for companies that have engaged in securities fraud. Those companies arguably could insulate themselves from liability by refraining from correcting past misstatements or otherwise admitting their unlawful conduct until a time when the harmful effects of the past activity had already driven down their stock price – for example, waiting to admit to an accounting fraud until after they filed for bankruptcy or after they have suffered other financial harms that had been concealed by the past misleading statements.

Thus, not only is the Fifth Circuit's test fundamentally inconsistent with *Dura*, but numerous other federal courts before and after *Dura* have refused to impose a similarly inflexible standard and have rejected arguments urging adoption of such an approach. Those courts apply a standard that is more in line with traditional notions of proximate cause.[3]

II. Application of a standard like the one imposed by the court below would deny recovery for legitimate investor losses proximately caused by false and misleading statements. Several real-world and hypothetical examples of securities frauds establish that point. Under the Fifth Circuit's "corrective disclosure" test, investors with otherwise meritorious claims wrongly would be denied recovery of real, reasonably foreseeable economic losses flowing from the fraud. Indeed, as discussed below, even investors who sustained losses as a result of the massive Enron fraud would be precluded from recovering the vast majority of those losses under the court of appeals' approach.

III. The Fifth Circuit's standard not only misstates the law, but also is unnecessary as a bright-line test to screen potentially frivolous suits. Other elements

---

[3] Although petitioner does not directly take on the Fifth Circuit's substantive loss-causation standard, it is apparent that it also agrees that loss causation is more complex than the rigid "corrective disclosure" standard articulated by the court below. Petitioner has argued why merits discovery is necessary for proof of loss causation. *See* Pet. Br. 55-56; *see also id.* at 50 (noting that "loss causation has been compared to the tort concept of proximate cause") (internal quotations omitted). Indeed, applying the proper standard for proving loss causation, it is even more apparent why the Fifth Circuit's procedural rule also is erroneous. Because the proximate-cause approach often will be fact-intensive and require discovery into complex issues about foreseeability and causation, those issues are particularly inappropriate for resolution during class certification.

of securities-fraud actions, including the heightened pleading requirements for scienter and the need to identify misstatements with particularity in accordance with the PSLRA, are more than adequate congressional safeguards against unmeritorious claims.

ARGUMENT

I. THE COURT OF APPEALS' RIGID STANDARD FOR PROVING LOSS CAUSATION IS CONTRARY TO THE HOLDING IN *DURA PHARMACEUTICALS V. BROUDO*

A. The Court Of Appeals' Holding Is Erroneous

In reaching its procedural holding that a putative class-action plaintiff must prove loss causation "at the class certification stage by a preponderance of all admissible evidence," App. 115a (internal quotations omitted), the Fifth Circuit also explained the substantive rule it applied to analyze whether petitioner had met the burden in this case. Relying on Fifth Circuit precedent,[4] the court held that, in addition to a showing that it purchased stock at an artificially inflated price, a plaintiff also must demonstrate a corrective disclosure admitting the falsity of prior representations following which the price of the stock declined. The court explained that, "[b]y relying on a decline in price following a corrective disclosure as proof of causation, a plaintiff need prove that its loss resulted directly *because* of the correction to a prior misleading statement." App. 116a-117a.

---

[4] Specifically as relevant to the loss-causation discussion, see *Alaska Electrical Pension Fund v. Flowserve Corp.*, 572 F.3d 221 (5th Cir. 2009) (per curiam); *Oscar Private Equity Investments v. Allegiance Telecom, Inc.*, 487 F.3d 261 (5th Cir. 2007); and *Greenberg v. Crossroads Systems, Inc.*, 364 F.3d 657 (5th Cir. 2004).

Particularly troubling was the court of appeals' articulation of the precise and very narrow type of information that would have to be disclosed to the public to trigger a decline in the stock price for which an investor could recover. The court held that, "[w]hen confronted with allegedly false financial predictions and estimates, the district court must decide whether the corrective disclosure more probably than not shows that the original estimates or predictions were designed to defraud." App. 122a. The court further explained that "plaintiffs must prove the corrective disclosure shows the misleading or deceptive nature of the prior positive statements" and that "the truth revealed by the corrective disclosure must show that the defendant more likely than not misled or deceived the market with earnings misstatements that inflated the stock price." App. 121a-122a.

Thus, under the Fifth Circuit's standard of loss causation, plaintiffs must show that defendant's stock price fell in response to the disclosure of the actual falsity of its prior statements and that those statements "were designed to defraud." App. 122a. Indeed, it is not enough under the court's standard that a stock price declines because of a subsequent disclosure of adverse underlying financial realities that previously were concealed by the fraud. Nor does it appear that the court's standard would permit information slowly to leak out in more subtle or less direct ways and thereby cause the stock price decline. Rather, the "corrective" disclosure itself must demonstrate that the prior statements were actually false when made and led directly to the price decline.[5]

---

[5] The standard the court of appeals articulated in this case appears to be even more restrictive than that articulated in the Fifth Circuit precedent that the court purported to apply. In

The court of appeals then applied its overly restrictive disclosure requirement to conclude that statements alleged to have related to such prior falsehoods nevertheless did not demonstrate that the prior statements were false. For example, although petitioner alleged that Halliburton's asbestos reserves had been intentionally understated, the court nevertheless concluded that Halliburton's subsequent announcements that it would increase those same reserves did not on their face "show that those prior reserve estimates were intentionally misleading." App. 126a. Thus, although Halliburton's increases to the same reserves caused a decline in the stock price, *see* App. 124a-125a, the court did not treat them as corrective disclosures and found no loss causation.

B. *Dura* Adopted A Traditional Proximate-Cause Analysis For Loss Causation That Is Inconsistent With The Court Of Appeals' Approach

In *Dura*, the Supreme Court addressed a split of authority that had developed in the circuit courts in the wake of *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), as to what is required to prove loss causation

---

Oscar, the court held that plaintiffs must prove only that the subsequent disclosure of negative "'truthful'" information was "'related'" to the prior alleged false statements and "'that it is more probable than not that it was this negative statement, and not other unrelated negative statements, that caused a significant amount of the decline.'" 487 F.3d at 266 (quoting *Greenberg*, 364 F.3d at 666); *but see id.* at 270 (requiring "proof of a corrective disclosure's significant contribution to a price decline"). Similarly, in *Flowserve*, the court held that a plaintiff "is not required" to show that the market learned that prior statements were, in fact, fraudulent, and it rejected defendant's position that "a fraud causes a loss only if the loss follows a corrective statement that specifically reveals the fraud." 572 F.3d at 230-31.

in a fraud-on-the-market case. The Ninth Circuit in the *Dura* case had held that a securities-fraud plaintiff in such cases could prove that the defendant's fraud caused the plaintiff's economic loss by alleging only that the price of the security "*on the date of purchase* was inflated because of the misrepresentation." 544 U.S. at 338 (internal quotations omitted). Unlike the Ninth Circuit, however, the majority of the other circuits required plaintiffs to prove more than mere price inflation at the time of the purchase to establish loss causation. In those circuits, plaintiffs also would have to establish some connection between the fraud and the security's subsequent decline in value.[6]

The Supreme Court agreed with the majority of the circuits that the mere allegation that the fraud inflated the price of the security, without more, was insufficient to show loss causation. *See id.* at 342, 346. It held that, where the plaintiff's loss results from a stock price decline, the plaintiff must show that the decline was "proximately caused" by the fraud. *Id.* at 346. In reaching that conclusion, the Court observed the requirement under the PSLRA that the plaintiff bears the burden of proving that the defendant's fraud "caused the loss for which the plaintiff seeks to recover." 15 U.S.C. § 78u-4(b)(4). The Court also opined that securities-fraud actions "resemble in many (but not all) respects common-law deceit and misrepresentation actions." 544 U.S. at 343; *see also id*. at 345 (a securities claim is a "judicially implied cause of action with roots in the common law"). The

[6] *See, e.g.*, *Emergent Capital Inv. Mgmt., LLC v. Stonepath Group, Inc.*, 343 F.3d 189, 198-99 (2d Cir. 2003); *Semerenko v. Cendant Corp.*, 223 F.3d 165, 184-85 (3d Cir. 2000); *Bastian v. Petron Res. Corp.*, 892 F.2d 680, 683-85 (7th Cir. 1990); *Robbins v. Koger Props., Inc.*, 116 F.3d 1441, 1447-49 (11th Cir. 1997).

Court then reviewed the relevant guidance in the Restatement (Second) of Torts (1977) ("Restatement"), which "set[s] forth the judicial consensus," 544 U.S. at 344, and other judicial and secondary sources concerning the common law's loss-causation requirements. This led the Court to conclude that securities-fraud plaintiffs must "allege and prove the traditional elements of causation and loss." *Id.* at 346.

Because the plaintiff in *Dura* had not pleaded anything more than the allegation that, because of defendant Dura's prior misrepresentations, the plaintiff had paid an "artificially inflated purchase price" for Dura's stock, the Court concluded that this was not itself a "relevant economic loss" and could not establish loss causation. *Id.* at 347. Missing from the complaint were any allegations that linked the subsequent decline in the stock price to Dura's misrepresentations. That is, the complaint failed to allege that "Dura's share price fell significantly after the truth became known." *Id.*

In holding that the plaintiff's allegations were insufficient, the Court explained what it had in mind that would be required to prove that a decline in the stock's price was proximately caused by a subsequent disclosure of the "truth" concerning the alleged misrepresentations – that is, the disclosure of the underlying realities that had been concealed by the false statements. Rather than requiring any single statement or any particular type of corrective disclosure or content thereof, however, the Court recognized that loss causation could be shown from price declines where "the relevant truth begins to leak out" or where "the truth makes its way into the marketplace." *Id.* at 342. Likewise, the Court quoted the Restatement's discussion of the liability of "a person who 'misrepresents the financial condition of a corporation in order to sell its stock.'" *Id.* at 344 (quoting Restatement § 548A cmt. b). The Restatement explains that a corporation becomes liable to an investor "for the loss that he sustains when the facts as to the finances of the corporation become generally known and as a result the value of the shares is depreciated on the market, because that is the obviously foreseeable result of the facts misrepresented." Restatement § 548A cmt. b.

The Fifth Circuit's standard cannot be reconciled with this Court's discussion and holding in *Dura*. The Fifth Circuit's rule requiring a specific "corrective disclosure" admitting the falsity of prior representations followed by a price decline is far more restrictive and narrow than this Court's recognition that relevant information might not be disclosed starkly in a single "correction," but instead could "leak out" over time and gradually "make[] its way into the marketplace."[7] As discussed below, *see infra* Part II, the court of appeals' standard would prevent recovery in numerous cases where investors incurred real losses as evidenced by declining stock prices caused by gradual or subtle revelations of facts that made it clear over time that a company's prior statements were false. Securities frauds can be extremely complex and can be "revealed" to the public in myriad ways. Thus, the related causation

[7] Similarly, at oral argument, Justice Breyer observed that the relevant truth concerning prior misstatements might "come[] out in subtle ways as well as direct ways." Oral Arg. Tr. at 54, *Dura* (Jan. 12, 2005) (No. 03-932), *available at* http://www.supremecourt.gov/oral_arguments/argument_transcripts/03-932.pdf.

issues cannot be pigeon-holed into one catch-all, inflexible rule like that imposed by the Fifth Circuit.

This Court's discussion in *Dura* makes it clear that the court of appeals' rigid approach is not what this Court had in mind.[8] By invoking the far more flexible common-law principles of proximate causation as the appropriate standard, this Court recognized that the standards for proving loss causation in securities cases are flexible enough to meet the particular facts of specific cases. Indeed, this Court previously has concluded that analysis of "proximate cause" is not limited to one particular approach, but instead is a common-law concept that takes "many shapes" and "reflects 'ideas about what justice demands, or of what is administratively possible and convenient.'" *Holmes v. Securities Investor Protection Corp.*, 503 U.S. 258, 268 (1992) (quoting W. Page Keeton et al., *Prosser and Keeton on the Law of Torts* § 41, at 264 (5th ed. 1984) ("*Prosser and Keeton*")). Commentators likewise have observed that "there are countless variations of theory in this area of the law" and that proximate causation's idea of a "foreseeable" harm is one of the law's more "flexible concepts." *Prosser and Keeton* § 42, at 273-74; *see id.* § 41, at 263 (noting

[8] The petitioners and several of their *amici* in *Dura* urged the Court to adopt the very same bright-line "corrective disclosure" approach that the Fifth Circuit has since imposed. *See* Brief for Petitioners at 14, 17, *Dura* (No. 03-932), 2004 WL 2075752; Brief of Washington Legal Foundation as *Amicus Curiae* in Support of Petitioners at 24, *Dura* (No. 03-932), 2004 WL 2069563 (arguing that "a plaintiff is required to plead that a corrective disclosure or disclosures removed the artificial inflation from the market price of the security and thereby caused an economic loss"). This Court opted, instead, for the more general proximate-causation standard and otherwise concluded that it "need not, and do[es] not, consider other proximate cause or loss-related questions." 544 U.S. at 346.

that, "despite the manifold attempts which have been made to clarify the subject," there is not "any general agreement as to the best approach"). As Justice Cardozo explained while still on the New York Court of Appeals, "[t]here is nothing absolute in the legal estimate of causation. Proximity and remoteness are relative and changing concepts." *Bird v. St. Paul Fire & Marine Ins. Co.*, 224 N.Y. 47, 55 (1918) (Cardozo, J.). The Fifth Circuit's "corrective disclosure" approach attempts to impose an inflexible standard in an area where flexibility is required.

Indeed, one of the illustrations in the section of the Restatement invoked by *Dura* plainly contradicts the Fifth Circuit's position that there must be a corrective disclosure revealing falsity of prior statements to establish causation:

> A, seeking to buy bonds for investment, approaches B. B offers A the bonds of X Oil Corporation, fraudulently misrepresenting its financial condition. In reliance upon these statements, A buys the bonds. After his purchase conditions in the oil industry become demoralized and as a result of financial losses the X Oil Corporation becomes insolvent. Because of the insolvency A suffers a pecuniary loss greater than that which would have resulted from the deterioration of conditions in the industry alone. It is found that if the financial condition of the Corporation had been as represented it would probably have weathered the storm and not become insolvent. B is subject to liability to A for the additional pecuniary loss resulting from the insolvency.

Restatement § 548A cmt. b, illus. 2. Nothing in the Restatement's approach requires a corrective disclosure to precede the insolvency or other losses for the plaintiff to establish proximate cause.

Nor can the Fifth Circuit's application of the corrective-disclosure standard be justified by reliance on the discussion in *Dura* that recognized that not all subsequent price declines will be related to the prior misrepresentations. In *Dura*, the Court observed that such declines could be the result of "changed economic circumstances, changed investor expectations, new industry-specific or firm-specific facts, conditions, or other events," 544 U.S. at 343, essentially recognizing that intervening causes might, in some cases at least, sever the causal chain. The court of appeals' narrow definition of what constitutes a corrective disclosure led to its conclusion that even disclosures that were alleged to be closely related to the prior misrepresentations – for example, the understated asbestos reserves discussed, *supra*[9] – were, in effect, intervening causes that severed the causal chain. But, again, traditional concepts of proximate causation and intervening causes do not lend themselves to such a narrow approach.

As the Restatement section cited by this Court recognized, even where there are other intervening events *not caused by or related to* the original misstatements, that does not preclude recovery:

> In determining what is foreseeable as a result of the misrepresentation, the possibility of intervening events is not to be excluded altogether. Thus, when the financial condition of a corporation is misrepresented and it is subsequently driven into insolvency by reason of the depressed condition of an entire industry, which has no

[9] *See also* Pet. Br. 55.

> connection with the facts misrepresented, it may still be found that the misrepresentation was a legal cause of the recipient's loss, since it may appear that if the company had been in sound condition it would have survived the depression, and hence that a loss of this kind might reasonably have been expected to follow.

Restatement § 548A cmt. b; *see also Semerenko*, 223 F.3d at 186 ("It is well established that not every intervening cause is sufficient to break the chain of causation.").[10]

Because the Fifth Circuit failed to apply the traditional proximate-cause standard adopted by *Dura*, it also functionally concluded that subsequent disclosures made by Halliburton were intervening causes that prevented a finding of loss causation without considering, under the appropriate proximate-cause analysis, whether the prior false statements were a substantial cause of the stock decline.

C. A Number Of Other Federal Courts Have Refused To Apply This Unreasonably Narrow Standard For Proving Loss Causation

Both before and after *Dura*, a number of federal courts have considered similar loss-causation issues

---

[10] In any event, other circuits hold that, to plead loss causation, a securities-fraud plaintiff need not "plead that all of its loss can be attributed to the false statement of the defendant." *Caremark, Inc. v. Coram Healthcare Corp.*, 113 F.3d 645, 649 (7th Cir. 1997); *see Miller v. Asensio & Co.*, 364 F.3d 223, 232 (4th Cir. 2004) (holding that the PSLRA requirement to prove that a fraud caused damages "does not require a plaintiff to prove that the defendant's fraud was the *sole* cause of the plaintiff's loss"); *Semerenko*, 223 F.3d at 186-87 ("So long as the alleged misrepresentations were a substantial cause of the inflation in the price of a security and in its subsequent decline in value, other contributing forces will not bar recovery.").

and arguments in securities-fraud cases. These courts have concluded that economic loss can be established without proof of a specific corrective disclosure that admitted a prior false statement.

For example, the Tenth Circuit has held that, although "[l]oss causation is easiest to show when a corrective disclosure reveals the fraud to the public and the price subsequently drops," this is not required under *Dura*. *In re Williams Sec. Litig.—WCG Subclass*, 558 F.3d 1130, 1137 (10th Cir. 2009). As the *Williams* court observed, "*Dura* did not suggest that this was the only or even the preferred method of showing loss causation," because "it acknowledged that the relevant truth can 'leak out,' which would argue against a strict rule requiring revelation by a single disclosure." *Id.* (citation omitted).

The Second Circuit likewise has applied, since even before *Dura*, a loss-causation standard that more readily can accommodate the varying circumstances in which fraud occurs. Indeed, the standard within the Second Circuit is much more in line with the "proximate cause" standard that *Dura* endorsed than the narrow one adopted by the court of appeals here. In addition to recognizing cases where a corrective disclosure of fraud or falsity might directly cause a price decline and investor loss, the Second Circuit also recognizes the viability of loss-causation claims in situations where risks previously concealed by a defendant's false statements later materialize and cause share prices to drop.

In *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161 (2d Cir. 2005), the court explained that "[w]e have described loss causation in terms of the tort-law concept of proximate cause, *i.e.*, 'that the damages suffered by plaintiff must be a foreseeable consequence of any misrepresentation or material omission.'" *Id.* at 172-73 (quoting *Emergent Capital*, 343 F.3d at 197). And "a misstatement or omission is the 'proximate cause' of an investment loss if the risk that caused the loss was within the zone of risk *concealed* by the misrepresentations and omissions alleged by a disappointed investor." *Id.* at 173.[11] This is sometimes referred to as a "materialization of the concealed risk." *Id.*[12]

---

[11] *See also Schaaf v. Residential Funding Corp.*, 517 F.3d 544, 550-52 (8th Cir. 2008) (agreeing with *Lentell* that plaintiffs could prevail by proving that a loss "was foreseeable and caused by the materialization of the concealed risk"); *Teachers' Retirement Sys. of Louisiana v. Hunter*, 477 F.3d 162, 187 n.3 (4th Cir. 2007) (acknowledging "that a plaintiff could successfully allege loss causation by pleading that a previously concealed risk materialized, causing the plaintiff's loss"); *Bastian*, 892 F.2d at 685-86 (Posner, J.) (endorsing a loss-causation theory based on materialization of a risk concealed by earlier fraudulent statements).

[12] Although the majority of the circuits that have addressed the issue – including the Second, Fourth, Seventh, Eighth, and Tenth Circuits – have concluded that loss causation can be established even where there is not a corrective disclosure followed by a stock price decline, the law is less clear in the Sixth and Ninth Circuits. *See*, *e.g.*, *Indiana State Dist. Council of Laborers & Hod Carriers Pension & Welfare Fund v. Omnicare, Inc.*, 583 F.3d 935, 944 (6th Cir. 2009) (holding that plaintiff's allegations did not "explain how the [prior] statements were revealed to be false and thereby caused a drop in the stock price"), *cert. dismissed*, No. 09-1400, 2010 WL 5638596 (U.S. Nov. 5, 2010). *But see Brown v. Earthboard Sports USA, Inc.*, 481 F.3d 901, 920 (6th Cir. 2007) (observing that "[l]oss causation . . . has been likened to proximate cause in tort law" and citing analysis in *Lentell* for risks that had been "concealed"). *Also compare Livid Holdings Ltd. v. Salomon Smith Barney, Inc.*, 416 F.3d 940, 949 (9th Cir. 2005) (holding loss causation was adequately alleged where plaintiff asserted defendants misrepresented the financial situation of the company, which "was

In *Suez Equity Investors, L.P. v. Toronto-Dominion Bank*, 250 F.3d 87 (2d Cir. 2001), the court applied that standard. Investors in a company alleged both that defendant concealed from them the principal executive's lack of managerial ability and that the risk inherent in his lack of abilities materialized when the company subsequently incurred liquidity problems and failed. *See id.* at 93-94. Although there was no "corrective disclosure" or admission that the prior representations were false, the Second Circuit nevertheless concluded that the plaintiffs adequately had alleged loss causation because the company's subsequent collapse and the plaintiffs' resulting damages "were a foreseeable consequence" of the concealed information. *Id.* at 96-98.

One district court in the Second Circuit explained the difference between the "corrective disclosure" and the "materialization of the risk" theories as follows:

> The classic example of a loss-inducing event is a corrective disclosure by the company itself. A corrective disclosure is traditionally an admission by the company that one or more of its previous statements were false or misleading followed by a corrected, truthful and complete version of those statements. The event need not take this form, however. The event could be a credit ratings downgrade or the collapse of the company. For an event to qualify as a materialization of the risk, it need only disclose part of the

---

directly related to the actual economic loss it suffered" when the company went bankrupt), *with In re Oracle Corp. Sec. Litig.*, 627 F.3d 376, 392 (9th Cir. 2010) ("Loss causation is established if the market learns of a defendant's fraudulent act or practice, the market reacts to the fraudulent act or practice, and a plaintiff suffers a loss as a result of the market's reaction.").

> truth that was previously concealed by the fraud. A ratings downgrade reveals the risk of deteriorating liquidity, and the failure to obtain agency approval may reveal the risk of a non-viable product. Unlike corrective disclosures, these events do not identify specific company statements as false or misleading. But if the company had previously concealed its liquidity condition or the failure of its product by making false or misleading statements, these events may be sufficiently related to the fraud to qualify as materializations of the risk.

In re Vivendi Universal, S.A. Sec. Litig., 634 F. Supp. 2d 352, 363-64 (S.D.N.Y. 2009) (citations and footnote omitted).

In *Vivendi*, the plaintiffs alleged that certain defendants through various false statements had concealed "massive amounts of debt" that posed a risk to the company's liquidity. *Id.* at 354. They also presented evidence that the company's "true liquidity condition" was subsequently revealed in a series of events – including downgrading of its credit ratings and unexpected asset sales. *See id.* at 356-57. Notwithstanding the court's conclusion that none of the subsequent events could be considered "corrective disclosures," it nevertheless held that the plaintiffs had sufficient evidence that those events were the materialization of the previously concealed liquidity problems to create genuine issues of fact for trial. *Id.* at 367-69.

Another instructive case is *In re Parmalat Securities Litigation*, 375 F. Supp. 2d 278 (S.D.N.Y. 2005), which involved a massive fraud and eventual collapse and bankruptcy of the Italian dairy conglomerate, a fraud "that reportedly involved the understatement of Parmalat's debt by nearly $10 billion and the overstatement of its net assets by $16.4 billion." *Id.* at 282. Following the company's bankruptcy, a class of the company's investors sued the company's accountants for securities fraud. The defendants moved to dismiss, arguing, *inter alia*, that the plaintiffs had not adequately pleaded loss causation because they had not alleged that "a corrective disclosure about [the defendants'] prior misrepresentations caused the company's collapse." *Id.* at 305. But the court rejected the defendants' arguments. First, it observed that "[a]n allegation that a corrective disclosure caused the plaintiff's loss may be sufficient to satisfy the loss causation requirement. It is not, however, necessary." *Id.* (footnote omitted). It then noted that the plaintiffs had alleged that the defendants had misrepresented through their audit reports Parmalat's financial condition, and that "[a]mong the risks concealed by these reports was that Parmalat had massive undisclosed debt and was unable to service it." *Id.* at 306-07. The court concluded that "Defendants reasonably could have foreseen that Parmalat's inability to service its debt would lead to a financial collapse" and that "[t]he concealed risk materialized when Parmalat suffered a liquidity crisis . . . and was unable to pay bonds as they came due." *Id.* at 307. Thereafter, the company's share prices plummeted. Although the underlying fraud was not revealed until a few weeks *after* the shares became worthless,[13] the

[13] The bankruptcy filing was in late December 2003, and the opinion stated that "the true extent [of] the fraud was not revealed to the public until February – after Parmalat shares were worthless." 375 F. Supp. 2d at 284, 307. Although immediately prior to bankruptcy, and after the stock's trading had been suspended by Italian regulators, the company announced that a bank account it previously had disclosed "did not exist,"

court considered that "immaterial where, as here, the risk allegedly concealed by defendants materialized during that time and arguably caused the decline in shareholder and bondholder value." *Id.*

Finally, *In re Allaire Corp. Securities Litigation*, 224 F. Supp. 2d 319 (D. Mass. 2002), provides another example of a case where real economic loss was proximately caused by a company's false statements, but where the Fifth Circuit's approach would deny recovery. There, the plaintiffs alleged that Allaire, a publicly traded software company, made false statements about one of its software programs, knowingly concealing problems about that program and thereby "paint[ing] a rosy picture for the future" that depended on sales of the product. *Id.* at 323. The plaintiffs alleged that they paid inflated prices for Allaire's stock as a result. Subsequently, the stock price declined after Allaire disclosed poorer-than-expected sales, which the plaintiffs alleged was a result of the faulty product. *Id.* at 338. There was no "corrective disclosure" at the time of the stock price decline admitting that prior statements were false or even revealing the problems with the software. But the court concluded that the plaintiffs adequately had alleged loss causation because the information regarding the product defects "[o]bviously . . . would have impacted sales" and "[t]o suggest otherwise is to insult the Court's intelligence." *Id.* at 339.

As the foregoing examples illustrate, a number of courts before and after *Dura* have refused to apply

---

id. at 284, it is clear the court concluded there had been no corrective disclosures leading to the investors' losses. The facts also make clear that, even before trading had been suspended, the "company's stock had lost half its value" when the company could not meet its debt obligations. *Id.*

a loss-causation analysis that is as narrow and inflexible as that articulated by the Fifth Circuit.[14] Instead, they have implemented what *Dura* itself recognized – a "proximate cause" standard that, in the context of securities cases, does not lend itself to one catch-all fact pattern or approach. Indeed, it is apparent that in many of these cases involving real shareholder losses caused by fraudulent conduct, the Fifth Circuit's standard would deny them recovery.

Moreover, the Fifth Circuit's standard also would create perverse incentives for companies that have engaged in securities fraud. If those companies are liable only for declines in stock price that follow a specific type of corrective disclosure, they will have strong incentives to make more obscure disclosures that do not admit the falsity of prior statements or to delay admitting their prior misconduct until after the stock price has declined due to the materialization of the risks they concealed. This, in turn, would thereby allow securities-fraud violators to benefit from further misleading and deceptive conduct while avoiding the types of transparent communications the securities laws generally are designed to promote.

---

[14] Furthermore, and as noted above, even other panels in the Fifth Circuit have articulated the loss-causation standard in a far less rigid manner. *See supra* note 5.

II. THE INFLEXIBLE "CORRECTIVE DISCLOSURE" STANDARD ADOPTED BY THE COURT OF APPEALS WOULD PREVENT INVESTORS FROM RECOVERING LEGITIMATE LOSSES PROXIMATELY CAUSED BY CONDUCT PROHIBITED BY THE SECURITIES LAWS

As several cases above recognized, the "corrective disclosure" approach to loss causation may be appropriate in some circumstances. That is, the corrective-disclosure standard might be appropriate in cases that follow a clean pattern involving: (a) a false statement inflating the price of the stock; (b) a subsequent admission or correction of the prior false statement – for example, a restatement of previous financial results, or a finding of fraud in connection with prior disclosures; and (c) a decline of the stock price shortly after the corrective disclosure.

But as is also clear from the foregoing cases, the corrective-disclosure approach is too rigid to apply in all cases. To the extent the court of appeals intended that this be the only method by which investors can prove loss causation, the Fifth Circuit announced far too rigid a standard. Relying exclusively on a rigid corrective-disclosure standard would preclude recovery in numerous other cases where there can be no doubt that substantial investor losses were proximately caused by securities fraud.

A couple of examples illustrate the point.

<u>Bankruptcy</u>. First, there will be cases where a company fraudulently misrepresents and inflates its financial condition in its financial statements and other disclosures. These inflated figures might conceal the reality that the company is, in fact, insolvent or in a precarious financial condition; and they might

lead investors reasonably to believe the company is a sound investment. By providing this misleading information, the company will have caused investors to pay inflated prices for its stock and also might have caused some investors to purchase stock that they would not have bought at all if the truth were known. In other words, there will be fraud-induced inflation inherent in the stock price. Under *Dura*, this alone would not establish loss causation.

But if the company could maintain the fiction only for so long and subsequently was forced to file for bankruptcy, most if not all of the fraudulent inflation of the stock price quickly would evaporate, and the stock would be left worthless or nearly worthless. Investors obviously would suffer real economic loss as a result. Assume, too, that investors could prove[15] that the prior inflation of the financial statements concealed the risk that later materialized – i.e., that, had the company not issued false statements, it would have been apparent that bankruptcy was likely.

For Scenario A, assume that the company's bankruptcy was not preceded by a "corrective disclosure" revealing that its prior statements were false. Indeed, in filing for bankruptcy, the company could blame changed economic conditions or any other number of factors – none of which would disclose that its financial representations *in the past* had been false. Perhaps only well after the filing of bankruptcy and the decline in the stock price would there

---

[15] Although there is an automatic stay upon the filing of a bankruptcy petition, *see* 11 U.S.C. § 362, investors could sue third parties who participated in the fraud (advisors to the company or others), or the bankruptcy trustee might seek to recover from culpable individuals on behalf of the company and its stakeholders.

be an investigation and announcement that there had been fraud affecting prior financial statements, or only later would the company restate those historical results. At the time of these corrective disclosures, however, there might be *no* further decline in the stock price, because the worthless stock could not decrease further. Under the Fifth Circuit's approach, the investors likely could not recover any or a substantial portion of their losses, because they could not show a stock price decline following the "corrective disclosure."

By contrast, under Scenario B, assume that, at the same time it filed for bankruptcy, the company issued a corrective disclosure regarding its prior representations, including a restatement of its financial statements and an admission of fraud in connection with them. Again the stock would decline precipitously, and this time investors likely could recover under the Fifth Circuit's theory of loss causation, because this decline would follow, rather than precede, the corrective disclosure.

The fact that investors could not recover in Scenario A, but could under Scenario B, yields incongruous results, and it demonstrates why the Fifth Circuit's approach is too rigid and narrow. The court's approach would preclude recovery for the investors in Scenario A even though they suffered *the exact same economic loss* as the investors in Scenario B, and even though it could be shown that the loss – the bankruptcy and the sharp decline in stock price – was the result of *the exact same prior misrepresentations*. The only difference would be the timing of the company's corrective disclosure, not the proximate cause of the investors' injury.

This example is not just hypothetical. The *Parmalat* case, discussed earlier, *see supra* pp. 19-21, among many others, is similar to this fact pattern, where there was no corrective disclosure before the company's collapse. Yet, unlike the holding in *Parmalat*, which concluded that the plaintiffs had alleged a viable claim for loss causation, the Fifth Circuit's standard would deny recovery to the investors in *Parmalat* entirely, notwithstanding that the alleged fraud inflated that company's assets and equity by *billions of dollars* and was alleged to have concealed the very risks that led directly to Parmalat's bankruptcy. That result makes no sense as either a legal or an economic matter.

<u>Gradual Declines in Value</u>. Another set of cases may involve situations where the company has falsely reported financial results for some period of time and it takes a while for the market to learn of the actual fraud – as opposed to receiving more innocent-sounding information that, in effect, reduces the fraudulent inflation of the company's stock price.

For example, assume that the company for several quarters inflates its revenue by improperly recording sales that should have been recorded in future periods – effectively "stealing" from the future to make current results look better than they really are. This intentional acceleration of revenue permits the company to continue to meet analysts' expectations and thereby fraudulently inflates the stock price. Again, investors purchase the stock at an inflated price but do not yet have a recoverable loss under *Dura*. Assume, however, that the company cannot continue fraudulently to accelerate its sales numbers forever – perhaps the scheme is becoming too big, and the culpable individuals fear they will be discovered.

But the company obviously does not want to admit to the scheme or to "correct" its previously filed public financial statements. As a result, it decides to "bleed" slowly the fraudulent excess off its financial statements, for example, by writing off false accounts receivables as uncollectible (rather than admitting they were fictional to begin with) or by reducing estimates of future income (rather than admitting that past income was falsely inflated). To avoid suspicion, the company takes these actions over several months or quarters.

All of these actions might be viewed negatively by the market and result in a steady decline in stock price. And all might relate directly to the prior false statements and inflation of revenues, although none would be a corrective disclosure that the company's past disclosures were false. Finally, assume that only *after* the company has successfully "bled" off the fraudulent excess – and after the company's stock price has adjusted down to the true, fraud-free value of the enterprise – is it revealed that there was fraud in connection with prior years' results. But because the market now is correctly valuing the company's stock based on results that are no longer fraudulently inflated, there might be little or no further decline in the stock price as a result of the correction of the historical results.[16] This is because, according to corporate finance theory, a company's stock price reflects the value of its anticipated *future* discounted

[16] Another way in which the company might prevent a stock decline following a "corrective" disclosure is to couple the bad news with positive developments, such that the bad news is effectively diluted.

cash flows,[17] and the company's previous "leakage" of its losses already would have provided the market with sufficient information with which to judge those cash flows.

Again, the Fifth Circuit's standard would deny recovery in these circumstances, notwithstanding that there are real, reasonably foreseeable economic losses as evidenced by investors' overpayment for fraudulently inflated stock and the subsequent loss in value as the fraud is bled off the books. But because there was no single corrective disclosure or even a series of disclosures preceding the decline in the stock's value, there would be no loss causation.

This hypothetical scenario again is not far from the facts of cases discussed previously, including *Vivendi*, *see supra* pp. 18-19, where the company had fraudulently concealed massive amounts of debt and then subsequent events – like the downgrade in its credit ratings and disposition of its assets – drove down the stock price prior to any correction of historical statements or results.[18]

---

[17] *See, e.g.*, *Glassman v. Computervision Corp.*, 90 F.3d 617, 626 (1st Cir. 1996) (holding that a securities "[p]rice can be characterized as a present value calculation of the firm's future streams of earnings or dividends"); *In re VeriFone Sec. Litig.*, 784 F. Supp. 1471, 1479 (N.D. Cal. 1992) ("[S]ecurities prices on the national exchanges reflect . . . the expected future cash flows from the security."), *aff'd*, 11 F.3d 865 (9th Cir. 1993); *see also* Richard A. Brealey & Stewart C. Myers, *Principles of Corporate Finance* 63 (4th ed. 1991) ("Value today always equals future cash flow discounted at the opportunity cost of capital.").

[18] This was also the case in *Danis v. USN Communications, Inc.*, 73 F. Supp. 2d 923 (N.D. Ill. 1999), where the court rejected the defendants' argument that the plaintiff could not prove loss causation when the stock price did not drop upon the company's disclosure of its "true financial state," because it was

Indeed, one of the largest financial frauds in history, Enron, unwound in a similar fashion, where the fraudulently inflated stock price declined over time in reaction to events and information that would not be considered corrective disclosures. In the process, tens of billions of dollars of stakeholder investments evaporated. Enron's stock price peaked at more than $90 per share in August 2000.[19] Throughout the first three quarters of 2001, however, that price declined on various bad news and rumors regarding its operations, including, for example, discussion of "payment issues" involving a power plant in India, layoff rumors involving its broadband business, revelation that the broadband unit was not going to grow as fast as predicted, and other general questions about its ability to sustain its historic growth rate.[20] One particularly large stock price drop came in August 2001, when CEO Jeffery Skilling announced his resignation for "purely personal reasons," resulting in an approximate 7% drop in the stock price in a single day.[21] Skilling was later exposed and indicted as one of

---

alleged that "the market responded to and 'corrected' the price of [the] stock over the better part of a year as bits and pieces of negative information became available and it became apparent that [the company] was not capable of performing as originally represented." *Id.* at 943.

[19] *See* Andrew Kelly, *Enron Stock Falls Sharply After CEO's Resignation*, Reuters (Aug. 15, 2001).

[20] *See*, *e.g.*, C. Bryson Hull, *Enron Stock Off 8 Percent on False Layoff Talk*, Reuters (Mar. 21, 2001); C. Bryson Hull, *Enron Seeks To Assuage Investor Fears of Broadband*, Reuters (Mar. 23, 2001); *Chronicle 100 Leading Companies of Houston*, Hous. Chron., May 20, 2001, at 8; Christian Berthelsen, *Texas Power Firm's Shares Falling*, S.F. Chron., June 22, 2001, at B1.

[21] Mark Golden, *'Personal Reasons'? Top, You're Skilling Me*, Dow Jones Energy Serv. (Aug. 17, 2001).

the chief perpetrators of the Enron fraud.[22] And the fraud he helped to create and perpetuate plainly concealed the risk that eventually materialized – that he would be forced out of the company as it all began to unravel. But his fellow co-conspirator, Kenneth Lay, at the same time continued to perpetuate the fraud and provided assurances that all was well at Enron, characterizing Enron's business as "strong."[23]

From February 1, 2001, to late August of that year, Enron's stock slid from approximately $80 per share to $43, an approximate 46% decline that was estimated to wipe out some $28 billion in shareholder value.[24] When the company announced in October 2001 that it was taking a charge to earnings and equity of more than $1 billion, the stock was trading at less than $25 per share.[25] Yet there still had been no "corrective disclosure" of the massive accounting fraud at Enron or that prior reported results were false. On October 22, 2001, after tens of billions of investors' dollars already had been lost, Enron announced that the United States Securities and Exchange Commission ("SEC") was conducting an informal inquiry into certain related-party transactions. This was arguably the first "corrective disclosure" that there was potential improper activity,

---

[22] *See* Superseding Indictment, *United States v. Skilling, et al.*, Cr. No. H-04-25 (S.D. Tex. filed Feb. 18, 2004).

[23] *See* C. Bryson Hull, *Enron Head Seeks To Reassure Staff at Meeting*, Reuters (Aug. 16, 2001).

[24] *See* James Norman, *Doubts Linger on Enron After CEO's Exit*, Platt's Oilgram News, Aug. 21, 2001, at 1.

[25] *See* Andrew Bary, *Yes, This Year's Punk Earnings Do Matter To Investors*, Dow Jones Int'l News (Oct. 20, 2001); Peter Edmonston, *Stocks Close Higher As Investors Cheer Earnings News*, Dow Jones Bus. News (Oct. 22, 2001).

though even then Enron stated that its actions had been proper.[26] On October 31, 2001, Enron disclosed that the SEC inquiry had become a full-scale investigation.[27] Following further deterioration in the stock, the company finally collapsed and filed for bankruptcy in December 2001.[28]

Even assuming that the late October 2001 announcement of an SEC inquiry would qualify as a "corrective disclosure" after which investors could recover for the remaining decline in stock price, it is clear that the Fifth Circuit's standard would prevent Enron's investors from recovering the vast majority of their losses. The Enron debacle readily reveals why this Court should reject the Fifth Circuit's standard.

III. THE PROXIMATE-CAUSE STANDARD AND PSLRA PLEADING REQUIREMENTS FOR OTHER ELEMENTS OF A FEDERAL SECURITIES-FRAUD VIOLATION ARE SUFFICIENT TO SCREEN FRIVOLOUS CLASS-ACTION SUITS

The Fifth Circuit's rigid approach cannot be justified on policy grounds or based on an argument that a more stringent loss-causation requirement is necessary to screen out unmeritorious suits. In addition to the fact that such policy determinations are for Congress, not the courts, to make, Congress already

---

[26] *See Enron Shares Drop on SEC Probe*, CBS MarketWatch (Oct. 22, 2001); Rebecca Smith & John R. Emshwiller, *Enron May Issue More Stock to Cover Obligations*, Wall St. J., Oct. 24, 2001, at A2.

[27] Jeff Franks, *Enron Says SEC Inquiry Now Full-Scale Probe*, Reuters (Nov. 1, 2001).

[28] Elizabeth Lazarowitz, *U.S. Stocks Struggle with Enron, Mid-East Turmoil*, Reuters (Dec. 3, 2001).

has imposed, and this Court already has recognized, other elements of securities-fraud actions that accomplish the screening objective.[29] In *Dura* itself, the Court recognized that the PSLRA requires securities-fraud plaintiffs to "'specify' each misleading statement; that they set forth the facts 'on which [a] belief' that a statement is misleading was 'formed'; and that they 'state with particularity facts giving rise to a strong inference that the defendant acted with the required statement of mind'" – i.e., scienter. 544 U.S. at 345 (quoting 15 U.S.C. § 78u-4(b)(1), (2)) (alteration in original). As this Court also has recognized, the requirement to plead elements like scienter with particularity and in a manner that "giv[es] rise to a strong inference that the defendant acted with the required state of mind" is a requirement with some teeth. *See Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 323-24 (2007). Moreover, at summary judgment, the courts can hold plaintiffs to rigorous standards for proving loss causation in complex cases, requiring expert testimony and detailed analyses of movements in stock prices. *See*, *e.g.*, *Williams*, 558 F.3d at 1136-43 (analyzing plaintiffs' expert report at length under the materialization-of-the-risk approach and affirming grant of summary judgment on finding of no loss causation).

Although the PSLRA requires a securities-fraud plaintiff to prove that the defendant's fraudulent conduct "caused the loss for which the plaintiff seeks to recover," 15 U.S.C. § 78u-4(b)(4), there is no justification or need for imposing an inflexible and narrow loss-causation standard that is far more

---

[29] These elements generally are evaluated at the motion to dismiss and summary judgment stages, not at class certification.

restrictive than the "proximate cause" standard adopted by this Court in *Dura* and applied by various other federal courts.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted,

DAVID C. FREDERICK
Counsel of Record
KEVIN J. MILLER
KELLOGG, HUBER, HANSEN, TODD, EVANS & FIGEL, P.L.L.C.
1615 M Street, N.W.
Suite 400
Washington, D.C. 20036
(202) 326-7900
(dfrederick@khhte.com)

BRIAN J. BARTOW
General Counsel
CALIFORNIA STATE TEACHERS RETIREMENT SYSTEM
100 Waterfront Place
West Sacramento, CA 95605
(916) 414-1724
Counsel for California State Teachers Retirement System

GREGORY W. SMITH
Chief Operating Officer / General Counsel
COLORADO PUBLIC EMPLOYEES' RETIREMENT ASSOCIATION
1301 Pennsylvania Street
Denver, Colorado 80203
(303) 837-6222
Counsel for Colorado Public Employees' Retirement Association

CATHERINE E. LAMARR
General Counsel
OFFICE OF THE CONNECTICUT TREASURER
55 Elm Street
Hartford, Connecticut 06106
(860) 702-3018
Counsel for Connecticut Retirement Plans and Trust Funds

MICHAEL J. MOQUIN
Chief General Counsel
THOMAS R. PETRONI
Senior Deputy General Counsel
MUNICIPAL EMPLOYEES' RETIREMENT SYSTEM OF MICHIGAN
1134 Municipal Way
Lansing, Michigan 48823
(517) 703-9030
Counsel for Municipal Employees' Retirement System of Michigan

CYNTHIA L. COLLINS
General Counsel to the Board of Trustees of the Delaware Public Employees' Retirement System
Deputy Attorney General
Carvel State Building
820 N. French Street
6th Floor
Wilmington, Delaware 19801
(302) 577-8405
Counsel for Delaware Public Employees' Retirement System

MICHAEL A. CARDOZO
Corporation Counsel of the City of New York
100 Church Street
New York, New York 10007
(212) 788-0745
Counsel for Board of Education Retirement System of the City of New York, New York City Employees' Retirement System, New York City Police Pension Fund, New York Fire Department Pension Fund, and Teachers' Retirement System of the City of New York

NANCY G. GROENWEGEN
General Counsel to Thomas P. DiNapoli, Comptroller of the State of New York and, as such, Trustee of the New York State Common Retirement Fund
110 State Street
Albany, New York 12236
(518) 474-3444
Counsel for New York State Common Retirement Fund

JAY CHAUDHURI
General Counsel & Senior Policy Advisor
NORTH CAROLINA DEPARTMENT OF STATE TREASURER
Albemarle Building
325 North Salisbury Street
Raleigh, N.C. 27603-1385
(919) 508-5176
Counsel for North Carolina Retirement Systems

GERALD GORNISH
Chief Counsel
PENNSYLVANIA PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM
PENNSYLVANIA MUNICIPAL RETIREMENT SYSTEM
GOVERNOR'S OFFICE OF GENERAL COUNSEL
5 N. 5th Street
Harrisburg, Pennsylvania 17101
(717) 720-4912
Counsel for Pennsylvania Public School Employees' Retirement System

SAMUEL S. YUN
Acting Chief Counsel
PENNSYLVANIA STATE EMPLOYEES' RETIREMENT SYSTEM
30 North Third Street
Suite 150
Harrisburg, Pennsylvania 17101
(717) 237-0230
Counsel for Pennsylvania State Employees' Retirement System

ROBERT L. PRATTER
Executive Deputy General Counsel
GOVERNOR'S OFFICE OF GENERAL COUNSEL
333 Market Street, 17th Floor
Harrisburg, Pennsylvania 17101
(717) 787-9352
Counsel for Pennsylvania Public School Employees' Retirement System and Pennsylvania State Employees' Retirement System

H. CRAIG SLAUGHTER
Executive Director
WEST VIRGINIA INVESTMENT MANAGEMENT BOARD
500 Virginia Street, East
Suite 200
Charleston, WV 25301
(304) 345-2672
Counsel for West Virginia Investment Management Board

L. JANE HAMBLEN
Chief Legal Counsel
STATE OF WISCONSIN INVESTMENT BOARD
121 East Wilson Street
Madison, Wisconsin 53703
(608) 266-2381
Counsel for State of Wisconsin Investment Board

SALVATORE J. GRAZIANO
WILLIAM C. FREDERICKS
ANN M. LIPTON
BERNSTEIN LITOWITZ BERGER & GROSSMANN LLP
1285 Avenue of the Americas
New York, New York 10019
(212) 554-1400

JAY W. EISENHOFER
GEOFFREY C. JARVIS
WILLIAM A. K. TITELMAN
GRANT & EISENHOFER P.A.
485 Lexington Avenue
New York, New York 10017
(646) 722-8500

JASON S. COWART
POMERANTZ HAUDEK GROSSMAN & GROSS LLP
100 Park Avenue
New York, New York 10017
(212) 661-1000

GLEN DEVALERIO
BERMAN DEVALERIO
One Liberty Square
Boston, Massachusetts 02109
(617) 542-8300

RICHARD A. LOCKRIDGE
KAREN HANSON RIEBEL
LOCKRIDGE GRINDAL NAUEN P.L.L.P.
100 Washington Avenue South
Minneapolis, Minnesota 55401
(612) 339-6900

DANIEL BERGER
BERGER & MONTAGUE, P.C.
1622 Locust Street
Philadelphia, Pennsylvania 19103
(800) 424-6690

March 1, 2011

Counsel for Amici

APPENDIX

List of Amici

Board of Education Retirement System of the City of New York

California State Teachers Retirement System

Colorado Public Employees' Retirement Association

Connecticut Retirement Plans and Trust Funds

Delaware Public Employees' Retirement System

Municipal Employees' Retirement System of Michigan

New York City Employees' Retirement System

New York City Police Pension Fund

New York Fire Department Pension Fund

New York State Common Retirement Fund

North Carolina Retirement Systems

Pennsylvania Public School Employees' Retirement System

Pennsylvania State Employees' Retirement System

Teachers' Retirement System of the City of New York

West Virginia Investment Management Board

State of Wisconsin Investment Board