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Pleading and Proving 'Loss Causation' After *Dura Pharmaceuticals*: What's Happening in the Lower Courts?

BY RICHARD A. ROSEN

In the few short months since the Supreme Court published its decision in *Dura Pharmaceuticals, Inc. v. Broudo*[1] defendants have been quick to seize upon the holding. Arguments that a complaint fails to allege loss causation now feature prominently in motions to dismiss. Indeed, *Dura* is often ''Point I.'' We are also beginning to see *Dura* cited in opinions disposing of summary judgment motions.

Litigators now have the benefit of approximately 37 district court and 5 court of appeals decisions that interpret and apply *Dura*. There are already some significant disagreements among district judges about what the decision requires of plaintiffs (although some of those differences are more apparent than real). This article summarizes and synthesizes the emerging post-*Dura* case law, identifies the key trends and areas of controversy, and offers some recommendations to defense counsel contemplating a motion based on *Dura* and its progeny.

[1] 125 S. Ct. 1627 (2005).

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The *Dura* Decision. In *Dura*, the Supreme Court made clear that allegations that defendants' misrepresentations or omissions caused the price of a security to be *artificially inflated*, standing alone, do not suffice to plead loss causation.

Plaintiffs had alleged false and misleading statements concerning future FDA approval of Dura's new asthmatic spray device.[2] On the last day of the class period, the company announced that its earnings would be lower than expected and the company's stock price fell dramatically.[3] An announcement that the FDA would not approve the spray device did not follow until eight months later.[4] The Supreme Court held that the complaint's spray device claims did not sufficiently allege loss causation because the only allegation about economic loss attributable to the spray device misrepresentation was that plaintiffs ''paid artificially inflated prices for Dura securities'' as a result of that misrepresentation, ''suffered 'damage[s]' thereby.''[5] In particular, the complaint ''*fail[ed] to claim that Dura's share price fell significantly after the truth became known* . . . .''[6]

The court explained that artificial inflation allegations were ''inconsistent with the law's requirement that a plaintiff prove that the defendant's misrepresen-

[2] *Id.* at 1630.
[3] *Id.*
[4] *Id.*
[5] *Id.* at 1630 (emphasis omitted).
[6] *Id.* at 1634 (emphasis added).

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tation (or other fraudulent conduct) proximately caused the plaintiff's economic loss'' and would improperly ''allow recovery where a misrepresentation leads to an inflated purchase price but nonetheless does not proximately cause any economic loss.''[7] In such a case, the court explained, ''if . . . the purchaser sells the shares quickly before the relevant truth begins to leak out, *the misrepresentation will not have led to any loss*.''[8]

As the *Dura* court observed, a lower price can result from many non-actionable factors:

> If the purchaser sells later after the truth makes its way into the market place, an initially inflated purchase *might* mean a later loss. *But that is far from inevitably so*. When the purchaser subsequently resells such shares, even at a lower price, that lower price may reflect, not the earlier misrepresentation, but changed economic circumstances, changed investor expectations, new industry-specific or firm-specific facts, conditions, or other events, which taken separately or together account for some or all of that lower price.[9]

***Dura's* Significance: An Overview.** *Dura* reinforces two requirements for establishing loss causation that many circuit courts had long demanded. *First*, a plaintiff must plead and prove that ''the truth became known'' *before* the stock price drop from which the plaintiff claims a loss.[10]

Second, a plaintiff who claims that the disclosure of the truth caused his losses must identify either the new information conveyed by the disclosure or the material investment risks that had been concealed by the issuer's false statements or omissions. The plaintiff must then tie the disclosure of the new information, or the materialization of the concealed risk, to the subsequent movement of the stock price. In the absence of such a showing, a court cannot tell whether it was the revelation of the previously concealed facts or risks, rather than some other factor (ranging from disappointing sales to an industry-wide collapse), that caused the company's stock to drop.

This point is fundamental to an appreciation of the long-term impact of *Dura*. Leaving aside for a moment whether and to what extent the plaintiff must *plead* facts sufficient to satisfy this standard, at the end of the day a plaintiff is going to have the burden of proving that the defendant's ''misstatement or omission concealed something from the market that, when disclosed, negatively affected the value of the security.''[11]

Judge Scheindlin's decision in *IPO I* illustrates the point concretely. In that case, plaintiffs alleged that defendant underwriting firms worked together in a scheme to discount earnings estimates of fledgling public companies, so that, when the companies beat the estimates, the stock prices would react disproportionately and become inflated.[12] Plaintiffs further alleged that the fraud ended, and investors were damaged, when the public companies failed to continue to beat those forecasts.[13] The plaintiffs pointed to several types of ''disclosing events'' that they alleged revealed the fraud, including actual reports of revenue that were below expectations and announcements by the companies prior to quarterly reports that they would fail to meet expectations.[14]

The Court put its finger squarely on the deficiency of the complaint:

> That *expectation* [of continuing upside earnings surprises] though, is not the scheme plaintiffs allege. It is merely an expression of the market's belief that the securities were valuable. The fact that an event—in this case, a failure to meet earnings forecasts or a statement foreshadowing such a failure—disabused the market of that belief does not mean that the event disclosed the alleged scheme to the market. In other words, a failure to meet earnings forecasts has a *negative* effect on stock prices, but not a *corrective* effect. Such a failure does not imply that defendants concealed a scheme to depress earnings estimates and drive up prices. It does not disclose the scheme; therefore, it cannot correct the artificial inflation caused by the scheme.[15]

As we will see, this issue is where one of the main *Dura* battle lines is being drawn: what is the nature of the new information that can ''count'' as a *corrective* disclosure for purposes of establishing loss causation?

What is the Pleading Burden that Plaintiff Must Shoulder? Although *Dura* inarguably establishes that a plaintiff must both plead and prove loss causation, the courts are already split on just what this burden entails at the pleading stage. The difficulty of discerning the nature of the pleading requirement is exacerbated because the facts of *Dura* presented an extreme and thus relatively easy case, once the underlying principle is established. Perhaps for this reason, the Supreme Court's opinion includes rather loose and casual language in discussing what must be plead. The Court observed that

> ''it should not prove burdensome for a plaintiff who has suffered an economic loss to provide a defendant with some indication of the loss and the causal connection that the plaintiff has in mind. At the same time, allowing a plaintiff to forego giving any indication of the economic loss and proximate cause that the plaintiff has in mind would bring about harm of the very sort the statutes seek to avoid.''[16]

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[7] *Id.* at 1633.

[8] *Id.* at 1631 (emphasis added).

[9] *Id.* at 1631-32 (emphasis added).

[10] A handful of cases address pleadings that do not even attempt to plead loss causation, but appear to rely exclusively on the price inflation theory *Dura* squarely rejected. Unsurprisingly, these complaints have been found insufficient. *See e.g., In re Business Objects S.A. Sec. Litig.*, 2005 WL 1787860, at *9 (N.D. Cal. July 27, 2005) (finding plaintiffs' allegations regarding loss causation insufficient where the plaintiffs alleged that ''in reliance on the integrity of the market, they paid inflated prices for Business Objects' publicly traded securities''); *Reding v. Goldman Sachs & Co.*, 382 F. Supp. 2d 1112, 1126 (E.D. Mo. 2005) (holding no loss causation where the plaintiffs do no more than allege that ''material misrepresentations and/or omissions'' were done ''knowingly or recklessly,'' and as a result, ''the market price of the securities covered by Goldman Sachs was artificially inflated''); *Joffee v. Lehman Bros., Inc.*, 2005 WL 1492101, at *8-9 (S.D.N.Y. June 23, 2005) (dismissing complaint because plaintiffs failed to allege any causal connection between alleged misrepresentations and stock price decline); *Knollenberg v. Harmonic Inc.*, 2005 WL 2980628, at *9 (9th Cir. Nov. 8, 2005) (no allegation of loss caused by misrepresentation).

[11] *In re Initial Public Offering Sec. Litig.*, 2005 WL 1162445, at *3 (S.D.N.Y. May 6, 2005) (''*IPO I*'') (quoting *Lentell v. Merrill Lynch & Co., Inc.*, 396 F.3d 161, 173 (2d Cir. 2005).

[12] *Id.* at *1-2.

[13] *Id.*

[14] *Id.* at *3.

[15] *Id.* (emphasis in original).

[16] *Dura*, 125 S. Ct. at 1634.

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It is, I believe, nothing but wishful thinking for plaintiffs to say that the language of *Dura* exempts them from pleading the factual basis for the causal link between the issuer's misstatement or omission and the losses they have sustained.

As a consequence, some district courts post-*Dura* have contented themselves with the simplistic bromide that the pleading standard is not supposed to be rigorous, so that it is effectively enough if the plaintiffs plead the formulaic words of loss causation.[17] This approach can't be right; and, indeed, it represents a distinctly minority view.

Given the nature of the allegations in *Dura*—namely, a total absence of any allegation causally linking plaintiffs' investment losses to the misrepresentations at issue—the Supreme Court did not need to consider in any detail what a complaint that *did* attempt to plead loss causation must actually say in order to satisfy the statutory requirements of the PSLRA.[18]

Indeed, the Court concluded that ''for argument's sake,'' even if Rule 9(b) did *not* apply and the securities statutes contained *no* heightened pleading requirements (plainly a counter-factual hypothetical designed to underscore its point), the *Dura* complaint did not pass muster because it did not comply with even the most basic notice pleading standards of Rule 8 of the Federal Rules of Civil Procedure.[19]

So, where does this leave us? It is, of course, common ground that the plaintiff must plead some ''causal connection'' or ''causal link'' between the alleged misrepresentations and the economic loss suffered by the plaintiff.[20] Thus, in *D.E. & J. Limited Partnership v. Conaway*,[21] the Sixth Circuit pointed out that the complaint relied on a causation theory ''remarkably like'' that rejected in *Dura*. In particular, the plaintiff did not plead that the alleged accounting fraud became known to the market on any particular day, did not estimate the damages the alleged fraud caused and did not connect the fraud with the ultimate disclosure and loss. And plaintiff's allegation that the company's stock priced dropped by $1 upon the company's bankruptcy filing, ten months after the class period began, did not ''provid[e] the defendants with notice of what the relevant economic loss might be or of what the causal connection might be between the loss and the misrepresentation.''[22]

The fact is that virtually every decision examined by this article engages in a fairly rigorous and critical examination of the pleading. It is, I believe, nothing but wishful thinking for plaintiffs to say that the language of *Dura* exempts them from pleading the factual basis for the causal link between the issuer's misstatement or omission and the losses they have sustained.

Some cases pose relatively straightforward claims that are not hard to analyze, for example, where plaintiffs can point to an immediate and sharp stock price drop in response to new adverse information that comes directly from the company.[23] But even here, a plaintiff who is relying on the theory that the defendants' own new disclosure revealed the omitted facts or the concealed risk must be prepared to identify that disclosure with some specificity in its pleading and to describe the information that is new.

As courts before and after *Dura* have recognized, the requirement of pleading and proving loss causation would be rendered meaningless if a plaintiff could simply wave in the general direction of a 10-K, press release, news report, analyst report, or other document and claim that *somewhere* in that often-lengthy document is found the ''truth'' that corrected a defendant's fraud.[24]

This requirement is especially likely to be enforced at the pleading stage when there are a large number of confounding events and contemporaneous non-actionable disclosures of bad news, all of which are likely to have played a role in the price decline at issue.[25]

[17] *See e.g., In re Synovis Life Technologies, Inc. Sec. Litig.*, 2005 WL 2063870, at *4 (D. Minn. Aug. 25, 2005) (citing *Dura* and stating that the Supreme Court has recognized that ''ordinary pleading rules are not meant to impose a great burden upon a plaintiff''); *Montalvo v. Tripos Inc.*, 2005 WL 2453964, at *10 (E.D. Mo. Sept. 30, 2005) (same); *In re Omnivision Technologies, Inc.*, 2005 WL 1867717, at *5 (N.D. Cal. July 29, 2005) (holding loss causation satisfied even though plaintiffs alleged only that they purchased stock at inflated prices and suffered damages ''when revelation of the true facts caused a decline in the value of their investments''); *In re Unumprovident Corp. Sec. Litig.*, 2005 WL 2206727, at *30 (E.D. Tenn. Sept. 12, 2005) (accepting plaintiffs' argument at the pleading stage that the disclosures at issue revealed at least some details suggesting the possibility of prior misrepresentations, and concluding that plaintiff had met its ''minimal'' burden of notice pleading, ''though just barely'').

[18] *See, e.g., In re Initial Pub. Offering Sec. Litig.*, 2005 WL 1529659, at *1 (S.D.N.Y. June 28, 2005) (''*IPO II*'')(''*Dura* did not establish what *would* be a sufficient loss causation pleading standard; it merely established what was *not*'') (emphasis in original); *Accord, e.g., In re The Warnaco Group, Inc. Sec. Litig.*, 388 F. Supp. 2d 307, 317 (S.D.N.Y. 2005).

[19] *Dura*, 125 S. Ct. at 1634.

[20] *See D.E. & J Ltd. P'ship v. Conaway*, 133 F. App'x 994 (6th Cir. 2005); *In re Acterna Corp. Sec. Litig.*, 378 F. Supp. 2d 561 (C.D. Md. 2005).

[21] 133 F. App'x at 1000.

[22] *Id.*; *Accord Acterna* 378 F. Supp. 2d at 587, (under *Dura*, ''loss causation requires the plaintiff to point to some causal link between the alleged misrepresentations and an economic loss suffered by the plaintiff'').

[23] *See, e.g., Yanek v. Staar Surgical Co.*, 388 F. Supp. 2d 1110, 1132 (C.D. Cal. 2005) (holding loss causation pleading requirement satisfied when the plaintiff alleged an 18% price decline immediately after the defendant company disclosed that it had received a letter from the FDA that made known previously undisclosed problems with its manufacturing facilities).

[24] *See discussion below on isolating the impact of corrective disclosures.*

[25] *See, e.g., In re Tellium, Inc. Sec. Litig.*, 2005 WL 1677467, at *27 (D.N.J. June 30, 2005) (plaintiffs pointed to class period disclosures, but failed to allege how defendants' misrepresentations, as opposed to industry-wide stock price decline, caused losses). However, in *Livid Holdings Ltd. v. Salomon Smith Barney*, 416 F.3rd 940, 944 (9th Cir. 2005), which involved the private sale of a privately traded stock, the court held *Dura* was not controlling. This makes no sense. *Dura* is not about proving reliance. Even a plaintiff who receives a di-

What Disclosures and Events Can Reveal the Truth and Satisfy *Dura?* The courts are somewhat divided on the types of disclosures or events that may constitute the ''revelation of the truth'' for *Dura* purposes.

Several courts seem to require a showing that ''a significant stock price decline immediately following the announcement that reveals the fraud to the public.''[26] On this view of the world, only an acknowledgment *by the issuer* that its prior disclosure was inaccurate or that the business had suffered a set back attributable to a risk that was previously concealed, furnishes a sufficiently clear link to the reasons for the stock price decline. For example, in *Acterna*,[27] the court dismissed the complaint because the plaintiffs failed to allege that there had been a significant stock price decline immediately following the announcement that revealed the fraud to the public.

However, other district courts have *rejected* the proposition that the only disclosure that is relevant for *Dura* purposes is a corrective disclosure made by the company itself. According to these judges, the corrective disclosure may be revealed by some other source. In addition, on this interpretation, *Dura* can also be satisfied if a risk that was previously concealed ''materializes.'' The risk can come to pass and can cause the price to drop without the issuer's speaking at all.

For example, in *Teamsters Local 445 Freight Division Pension Fund v. Bombardier*,[28] decided by the same judge who wrote the opinions in the *IPO* cases, the plaintiffs alleged that the defendant sold asset-backed securities by making misrepresentations in its prospectuses about the rigor of its underwriting process in evaluating the underlying collateral. This misrepresentation concealed the fact that the collateral pool contained a substantial number of high risk loans.[29] As the court explained, on the plaintiff's theory, ''the concealed risk materialized when the collateral pool experienced high delinquency rates and repossession on a sustained basis.''[30] Although the issuer never conceded the falsity of the prospectus descriptions of the collateral and its underwriting practices, the company's earnings fell and the value of plaintiff's investments declined.[31] Judge Scheindlin held that loss causation had been adequately pleaded, stating that an allegation of a corrective disclosure and resulting price decrease may be sufficient, but is not necessary, to establish loss causation.[32] Here, instead, *Dura* was satisfied because the alleged misstatement in the prospectus concealed a condition or event which then occurred, and it is the materialization of that condition or event that caused the loss.[33]

rect oral misrepresentation in a face-to-face transaction, on which he reasonably relies, is *also* going to be required to show loss causation.

[26] *Acterna*, 378 F. Supp. 2d at 587 (citing *D.E. & J Ltd. P'ship*, 284 F. Supp. 2d at 748-49, *aff'd*, 133 F. App'x 994 (6th Cir. 2005)).

[27] 378 F. Supp. 2d at 587.

[28] 2005 WL 2148919, at *12 (S.D.N.Y. Sept. 6, 2005) (Scheindlin, J.).

[29] *Id.*

[30] *Id.*

[31] *Id.*

[32] *Id.*

[33] *Id.*

The opinions in *In re Parmalat Securities Litigation*[34] are in accord, holding that ''loss causation does not . . . require a corrective disclosure followed by a price decline.'' In *Parmalat I*,[35] the issuer's financial statements were disclosed to have overstated assets and understated debt by billions of dollars. The truth came to light when the company could not pay certain maturing bonds; bankruptcy rapidly followed.[36] Parmalat's accountants argued that, because no misrepresentation by them was the proximate cause of the stock price drop and that their role only came to light after the price decline, plaintiffs had not pled loss causation.[37] The court held that although a corrective disclosure may be sufficient to plead loss causation, it is not necessary.[38] Here, the complaint satisfied *Dura* because the auditors certified that the financial statements of the company fairly presented its financial condition, while in fact those financials overstated shareholders' equity by more than 8 billion euros and significantly understated its debt.[39] According to the court, Parmalat's inability to pay off maturing bonds was the materialization of the risk that was concealed by the phony financials—a risk that was foreseeable.[40]

The analysis in *Bombardier* and *Parmalat* does not open the door to loss causation claims unanchored to traditional principles. In each case, the revelation that a major risk facing the issuer had been concealed by false statements of present fact led directly and immediately to a precipitous stock price decline. The court had no basis to conclude that other confounding events or news—such as additional company-specific information or industry-wide or general market phenomena—could explain some or all of the price movements at issue.[41]

It is still the law that the mere fact that a company's *actual* performance falls below the market's expectations, even where those expectations were fostered by

[34] *In re Parmalat Sec. Litig.*, 376 F. Supp. 2d 472, 510 (S.D.N.Y. 2005); *In re Parmalat Sec. Litig.* 375 F. Supp. 2d 278, 305-306 (S.D.N.Y. 2005) (''*Parmalat I*'').

[35] 375 F. Supp. 2d at 306-07.

[36] *Id.* at 307.

[37] *Id.* at 306.

[38] *Id.*

[39] *Id.*

[40] *Id.* at 305-06.

[41] For a decision that appears to get this issue completely wrong, *see Stumpf v. Garvey*, 2005 WL 2127674, at *12-13 (D.N.H. Sept. 2, 2005). There, the court held that, for pleading purposes, it was the revelation that there was a greater supply of bandwidth (and less demand) than defendant had predicted, flooding the market with excess capacity, that caused the stock price to drop.

Note to Readers

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optimistic predictions by the company, cannot properly count as the revelation of the "truth" or the materialization of a risk. That is so because the disappointing performance does not disclose that the prior prediction was *false*.[42] Any more expansive reading of the cases would also be completely inconsistent with the safe harbor for forward-looking statements in the PSLRA and the long line of cases applying that statute and its judge-made analogue, the "bespeaks caution" doctrine.[43]

Isolating the Price Impact of the Corrective Statement. In a majority of cases, the disclosure of the previously omitted fact, or the materialization of the risk, will not occur in a vacuum, unaccompanied by other news (good and bad). Issuer statements to the market often convey new information (say, about the outlook for next year) in the very same news release that reflects the disclosure challenged by plaintiffs. And the disclosures often come against the background of significant simultaneous exogenous developments in the industry or the economy generally, all of which can affect the stock price. Ultimately, it is clear that it is the plaintiff's burden to isolate the price impact of the omitted or misstated information and that failure to do so will make the suit vulnerable to a summary judgment motion.

Almost all courts have proven very receptive to the argument that, even at the pleading stage, the plaintiff must plead facts sufficient to allow the court to determine that it was the corrective disclosure (or materialization of the risk) and not some other factor that is responsible for the price drop. Defense counsel must therefore separately scrutinize *each* of the disclosures and events by means of which the complaint allege that the truth was revealed, in order to determine whether a *Dura* argument is available.

In *In re The Warnaco Group Securities Litigation*,[44] plaintiffs failed to allege facts on the basis of which the court could separate out that portion of the stock price drop attributable to the materialization of an improperly concealed risk and that portion of the drop attributable to other (non-actionable) bad news. The *Warnaco* court meticulously and separately analyzed each corrective disclosure and each fact that was alleged to have reflected the materialization of a concealed risk, with a view to determining if the complaint had linked that particular disclosure to a stock price drop. By way of example, plaintiffs alleged that the auditors failed to disclose certain accounting errors by the company. But the court noted that the particular errors in question were only publicly corrected *after* the company's bankruptcy and thus could not have played any role in the fall in stock price or the company's ultimate demise.[45]

In *Conaway*, the Sixth Circuit also emphasized that "the observation that a stock price dropped on a particular day . . . is not the same as an allegation that a defendant's fraud caused the loss."[46] There, the plaintiffs had alleged that a press release issued the day the defendant company filed for bankruptcy caused the claimed losses, pointing to the stock price drop following the press release.[47] In affirming the district court's dismissal of the complaint, the court stated that the plaintiffs had "done nothing more than note that a stock price dropped after a bankruptcy announcement, never alleging that the market's acknowledgement of prior misrepresentations caused that drop."[48]

Just as it will be important to examine each alleged corrective disclosure to determine if the information is genuinely new, it will be critical to evaluate whether each new disclosure is genuinely "corrective." If the new company announcement is simply conveying bad news that causes the price to drop, but that bad news reflects a current development and does not *falsify* prior statements, it doesn't satisfy *Dura*.

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[42] *See, e.g., Swack v. Lehman Bros., Inc.*, No. 03-10907-NMG, slip op. at 7 (D. Mass. Aug. 17, 2005) (discrepancy between actual performance of company and bullish recommendation of analyst did not reveal the "relevant truth" that analyst recommendations were dishonest).

[43] For a comprehensive discussion of the statute and doctrine, refer to my articles: Richard A. Rosen, "The Safe Harbor for Forward-Looking Statements in the Courts, May 2003 Through October 2004: Does *Asher* Change the Rules?," 36 Sec. Reg. & L. Rep. (BNA) 2135 (Dec. 6, 2004); Richard A. Rosen, "Safe Harbor for Forward-Looking Statements in the Courts: A Scorecard in the Courts From January 2002 Through April 2003," 35 Sec. Reg. & L. Rep. (BNA) 1000 (June 16, 2003).

[44] 388 F. Supp. 2d at 317-18.

[45] *Id.* at 317.

[46] 133 F. App'x at 1001-02. For other cases that adopt this approach, *see, e.g., Morgan v. Axt, Inc.*, 2005 WL 2347125, at *16 (N.D. Cal. Sept. 23, 2005) (holding that the plaintiffs' allegations regarding loss causation are insufficient where the stock price fluctuated significantly during class period, and had at some points dropped lower than the price level reached in reaction to the corrective disclosure); *In re Tellium*, 2005 WL 1677467, at *27 (complaint fails to link decline in stock price to misrepresentation, as opposed to severe decline in stock prices in entire telecommunications sector); *In re Cree, Inc. Sec. Litig.*, 2005 WL 1847004, at *12 (M.D.N.C. 2005) (court examines challenged disclosure and determines that virtually all of the information at issue had previously been disclosed by company in contemporaneous SEC filings); *Davidoff v. Farina*, 2005 WL 2030501, at *16 (S.D.N.Y. Aug. 22, 2005) (carefully analyzing the substance of company announcement and stock price reaction to determine if disclosure actually corrected prior representation, or whether instead stock price fell as part of general decline in business sector); *Sekuk Global Enterprises v. KVH Enterprises, Inc.*, 2005 WL 1924202, at *16-17 (D.R.I. Aug. 11, 2005) (scrutinizing substance of press release to determine whether it constitutes a corrective disclosure); *In re Gilead Sciences Sec. Litig.*, 2005 WL 2649200, at *8 (N.D. Cal. Oct. 11, 2005) (carefully analyzing each public statement's substance and ensuing stock market reaction and assessing reasonableness and logic of plaintiffs' theory of loss causation before concluding that they were "too attenuated to withstand scrutiny under *Dura*"); *In re Verisign Corp. Sec. Litig.*, 2005 WL 2893783, at *7 (N.D. Cal. Nov. 2, 2005) (separately analyzing five different categories of alleged misstatements and omissions and concluding, based on substantive review of content of each alleged corrective disclosure, that plaintiffs had satisfied *Dura* as to claims of improper revenue recognition attributable to related party transactions, but finding that no causal links to losses had adequately been pled as to claims concerning timelines of writedowns, propriety of accounting, segment reporting and sales data); *In re Retek Inc. Securities*, 2005 WL 3059566, at *3-5 (D. Minn. Oct. 21, 2005) (examining content of press release to evaluate whether it was a "corrective disclosure" and determining that it concerns the same products and sales as those allegedly misrepresented and that the stock price dropped by more than $10 on the following day).

[47] *Id.* at 1000-01.

[48] *Id.*

The emerging case law also underscores the importance of examining the stock price performance before, during and after the statement is made, again with a view to attacking the pleading under *Dura*. Illustratively, the Court in *In re Compuware Securities Litigation*[49] granted the defendants' motion to dismiss, having found that a press release announcing a good will impairment was not a corrective disclosure for *Dura* purposes because the plaintiff did not allege that a price decline had immediately accompanied this disclosure. The court refused to speculate as to what portion of the loss, if any, should be attributed to the disclosure as opposed to other factors.

Similarly, in *Acterna*,[50] *Dura* was not satisfied because, although the Company's stock price had declined by 94% during the class period, the complaint itself acknowledged that the entire industry section had experienced a significant slowdown and that the company had disclosed a steady decline in sales, orders and revenues during the class period. And on the day the company revealed the good will impairment about which plaintiffs complained, the stock price rose from 33¢ to 43¢ in the course of intra-day trading, only to close at 32¢.[51]

Even the cases that appear at first blush to go the other way actually do follow this same granular approach. Thus, in *In re Geopharma Incorporated Securities Litigation*,[52] defendants argued that the stock price had actually *increased* after the alleged corrective disclosures and hypothesized that any artificial inflation could be attributed to other possible cases. The court rejected this argument and sustained the complaint, holding that the defendants had overstated the nature of the plaintiffs' burden at the pleading stage, and finding that the plaintiffs were not required to *exclude* other possible causes of the artificial price inflation.[53]

Geopharma is in fact in no way inconsistent with the cases discussed above. An examination of the factual allegations makes clear that on Dec. 1, the company issued a press release that caused a dramatic spike in the stock price. Later that same day, the FDA, in response to media inquiries, made an *erroneous* statement about the company that caused the price to plummet. On Dec. 2, the company corrected *both* misstatements in its own Dec. 1 release and the errors in the FDA statement, as a result of which the stock price rose again, but *not* to the level it had reached at the close on Dec. 1. Most important, the defendant was not able to identify any specific fact or news, other than its own statements and those of the FDA, that had contributed to the price fluctuations in controversy.[54]

On those facts, it is wholly unsurprising that the court would sustain the complaint against a *Dura* challenge. All the court is saying is that the plaintiff, at the pleading stage, does not have the affirmative duty to *exclude* any and all other possible factors that may influence price. This cannot be understood to mean that if defendants *do* identify other relevant information contemporaneously released by the company or otherwise learned by the market, and/or show that the company's stock price had been in decline *before* the revelation, such information is irrelevant or may not be considered by the court for *Dura* purposes.[55]

The Relevant Truth Must Be Revealed Before Stock Price Drops. Plaintiffs normally have a huge economic incentive to plead as long a class period as possible. Not only does this yield a class that is larger in absolute terms, but the longer class period will often encompass the date when the issuer's share price was at its peak. Many such complaints will be vulnerable to attack under *Dura* on the ground that, on the face of the pleading itself, it is clear that at least some significant portion of the decline in stock price during the class period occurred *before* any corrective disclosure and is therefore not recoverable under *Dura*.

Indeed, it is commonplace for complaints to include a section headed ''the truth begins to emerge.'' That allegation is a tacit admission that, *prior* to the disclosure being highlighted, there was *no* corrective disclosure at all.

For example, in *Schleicher v. Wendt*,[56] the court dismissed the complaint where the ''truth'' about the matters plaintiffs claimed were misrepresented did not come out publicly until *after* the end of the class period. Because the ''stock had long since hit bottom before these alleged misrepresentations became known, *Dura* could not be satisfied.''[57]

The Ninth Circuit's first decision applying *Dura* is also directly on point. In *In re Daou Systems, Inc.*,[58] plaintiffs alleged that defendants engaged in accounting fraud during a class period extending from February 1997 to October 1998.[59] The first disclosures that allegedly revealed the fraud, however, were not issued until August 1998.[60] The Ninth Circuit held that plaintiffs had not pleaded loss causation as to the share price decline between the start of the class period and August 1998.[61] As the court explained, ''any loss suffered between $34.375 and $18.50 cannot be considered causally related to [defendant's] allegedly fraudulent ac-

[49] 386 F. Supp. 2d 913, 918 (E.D. Mich. 2005).
[50] 387 F. Supp. 2d at 588.
[51] *Id.*; *see also Collier v. Aksys, Ltd.*, 2005 WL 1949868, at *12 (D. Conn. Aug. 15, 2005) (dismissing complaint by short seller for failure to satisfy *Dura* because stock price *dropped* when truth is disclosed, ''precisely the opposite reaction to the materialization of the concealed risk'' that a short needs to show loss causation); *United States v. Olis*, __ F.3d __, 2005 WL 2842077 (5th Cir., Oct. 31, 2005) (reversing sentence imposed in criminal case because, in calculating loss attributable to defendant's conduct, court failed to account for fact that two thirds of company's stock price drop occurred either *before* the revelation of the problems attributable to defendants' work or more than a week *after* such disclosure).
[52] 2005 WL 2431518, at *11-12 (S.D.N.Y. Sept. 30, 2005).
[53] *Id.*
[54] *Id.*
[55] *Accord In re Bristol-Myers Squibb Sec. Litig.*, 205 WL 2007004, at *21-22 (D.N.J. Aug. 17, 2005) (rejecting proposition that plaintiff must rule out all possible alternative explanations for stock price reaction to curative disclosure on ground that it is ''an impossible burden to satisfy'').
[56] 2005 WL 166871, at *4 (S.D. Ind. July 14, 2005).
[57] *Id.*; *see also Bennett v. H&R Block Fin. Advisors, Inc.*, 2005 WL 2811757, at *3 (N.D. Cal. Oct. 27, 2005) (loss causation not pleaded where the ''truth'' had been disclosed to the market and had already adversely affected the market price of the bonds *before* the press releases on which plaintiffs relied).
[58] 411 F.3d 1006 (9th Cir. 2005).
[59] *Id.* at 1012-13.
[60] *Id.* at 1026.
[61] *Id.* at 1026-27.

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counting methods because before the revelations began in August 1998, the true nature of [defendant's] financial condition had not yet been disclosed.''[62]

As a practical matter, then, it will usually be possible for defendants to argue that, at a minimum, the court should hold that, as a matter of law, there can be no recovery by any class member for any portion of the stock price drop that *precedes* that disclosure date.[63] Additionally, the court should be asked to dismiss *all* claims for damages on behalf of anyone who sold between the first day of the class period and the market close on the day *before* that corrective disclosure.[64]

What all this means for defense counsel is that a *Dura* argument at the pleading stage has to be deployed with discrimination. Depending on the number and strength of your other arguments, the intellectual capacity and other idiosyncrasies of your judge and the viability of *Dura*-based arguments directed to the corrective disclosures identified in the complaint, there *may* be circumstances in which you are better off, at the Rule 12(b)(6) motion stage, confining your *Dura* argument to an effort to knock out the early part of the class period before the first corrective disclosure is even alleged. In many cases, this rather less ambitious motion not only will have a higher likelihood of success than an effort to ''swing for the fences,'' but it will quite often result in dramatically limiting the magnitude of your client's damages exposure.[65]

***Dura* at the Summary Judgment Stage.** The mere fact that plaintiff wins the motion to dismiss has nothing to do with whether plaintiffs will win at the summary judgment stage. Although there is very little law to date, the few cases that have had occasion to discuss this issue have made it clear that plaintiff whose pleading survives a 12(b)(6) motion will have to *prove* the causal link between the defendants' misstatement or omission and his loss, and will be required to carry the burden of filtering out other factors that contributed to the price drop.[66]

Conclusion. Even in the short time since *Dura* was decided, a large volume of case law has applied to its core principle. Over the next year or so, we can expect that the most hotly contested issue will involve the types of statements and events, other than those made by the issuer itself, that ''count'' as truth—revealing disclosures for *Dura* purposes.

[62] *Id.* at 1027.

[63] This does not mean that the class must be limited to persons who purchased *after* the disclosure date; investors who purchased in the early part of the class period while the stock price was allegedly artificially inflated may still have suffered a compensable loss, but it will be limited to that portion of the stock price drop that occurred after the first disclosure date and which thus has been causally linked to the corrective disclosure. *But see In re Royal Dutch/Shell Transp. Sec. Litig.*, 380 F. Supp. 2d 509, 557 (D.N.J. 2005) (holding that purchasers who have not yet sold their securities cannot survive the motion to dismiss under *Dura*, since any losses would be ''speculative, at best'').

[64] *See In re Worldcom, Inc. Sec. Litig.*, 2005 WL 2293190, at *23 (S.D.N.Y. Sept. 21, 2005) (finding that the losses claimed by class members who sold their stock prior to the date that the alleged financial misstatements were made were not recoverable since there had not yet been a materialization of a concealed risk at the time the securities were sold); *In re Sawtek Inc. Sec. Litig.*, 2005 WL 2465041, at *12 (M.D. Fla. Oct. 6, 2005) (same). *Cf. In re Veritas Software Corp. Sec. Litig.*, 2005 WL 3096079, at *8 (N.D. Cal. Nov. 15, 2005) (approving settlement that allocated some consideration to ''in and out'' traders because terms were reached prior to *Dura* at time law was unclear).

[65] By the same token, it will sometimes be possible to obtain dismissal under *Dura* of the claims of those class members who purchased *after* the corrective disclosure. For example, in *Royal Dutch Shell*, the district court granted the motion to dismiss in part and denied it in part, essentially carving up the class depending on when the purchase date occurred. *See* 380 F. Supp. 2d 509, 556-57 (D.N.J. 2005); *Accord In re Sawtek*, 2005 WL 2465041, at *12 (noting that class members who purchased after the corrective disclosure did not pay an inflated price for their shares).

[66] *See, e.g., Ray v. CitiGroup Global Markets*, 2005 WL 2659102, at *3 (N.D. Ill. Oct. 18, 2005) (granting summary judgment for defendant on *Dura* grounds because plaintiff offered only ''theoretical possibilities,'' as opposed to evidence through expert opinion or otherwise, that company's poor performance was attributable to the subject matter of the misrepresentations, and because stock price had collapsed before fraud came to light). For two cases denying *Dura*-based summary judgment motions, *see In re Loewen Group Sec. Litig.*, __ F. Supp. 2d __, 2005 WL 2660349, at *7 (E.D. Pa. Oct. 18, 2005) (with cursory analysis); *In re Bristol-Myers Squibb Sec. Litig.*, 2005 WL 2007004, at *21-22 (D.N.J. Aug. 17, 2005) (relying principally on expert testimony).