

## Amid a Flood of Securities Class-Actions, The Supreme Court Must Act

The high court's review would restore national uniformity on loss-causation analysis.

BY ELAINE GOLDENBERG

In 2018, nearly one in 10 S&P 500 companies were the target of a securities class-action suit, and the number of those suits has more than doubled in the last four years. In the face of that onslaught of litigation, it is critical that courts maintain the protections against frivolous private securities suits that Congress put in place in the Private Securities Litigation Reform Act (PSLRA). Among those protections is a codification in 15 U.S.C. § 78u-4(b) (4) of the “loss causation” requirement—that is, the requirement of proof that a defendant’s alleged misrepresentation “caused the loss for which the plaintiff seeks to recover damages.” A company’s stock price may of course decline for a variety of reasons having nothing to do with fraud, including ordinary industry developments or changes in economic circumstances, and companies are not responsible for providing investors with broad insurance against market losses.

In a recent decision, however, the U.S. Court of Appeals for the Ninth Circuit effectively read the loss-causation requirement out of existence.



U.S. Supreme Court building

Photo: Diego M. Radzinski/ALM

The Ninth Circuit ruled in 2018 in *First Solar v. Mineworkers Pension Scheme* that loss causation does not require any showing of a revelation of fraud to the market, or even any showing of a revelation of the facts concealed by an alleged misrepresentation. Indeed, the Ninth Circuit asserted, a plaintiff may prove loss causation simply “by showing that the stock price fell upon the revelation of an earnings miss, even if the market was unaware at the time that fraud had concealed the miss.”

In so ruling, that court placed itself in direct conflict with a number of other federal circuits.

Although the other courts of appeals are not themselves in full agreement about exactly what is required to establish loss causation, they do agree on one thing: a plaintiff must show that the market became aware of the existence of fraud or, at the very least, of the facts that the defendant allegedly misrepresented. Because the market does not react to information of which it is not aware, in the absence of such a showing there is no basis for believing that a drop in stock price and an investor's resulting loss has anything to do with any misrepresentation by the defendant.

The Ninth Circuit's rejection of that correct understanding of the law is likely to result in the very harms that Congress sought to avoid when it enacted the PSLRA. As the U.S. Supreme Court recognized in *Central Bank of Denver v. First Interstate Bank of Denver* in 1994, securities cases present a "danger of vexatiousness different in degree

and in kind from that which accompanies litigation in general." A weakened loss-causation requirement is likely to give rise to a greater number of meritless suits and make it harder to dispose of such suits at the pleading stage. In turn, defendants will be under greater pressure to settle even vexatious suits, thus diverting resources that could be put to more beneficial uses and creating ripples of damaging economic uncertainty.

### **Restoring Uniformity**

That is a circumstance that cries out for Supreme Court review. The court's review would restore national uniformity on loss-causation analysis and likely would reaffirm the principle, previously set forth by the court in 2005 in *Dura Pharmaceuticals v. Broudo*, that a defendant should be held responsible only for "economic losses that misrepresentations actually cause." The U.S. Solicitor General has recommended against a grant of certiorari in *First Solar*, asserting

that the circuits are already uniform in declining to require proof of a revelation to the market that the defendant acted with scienter—fraudulent intent—as a component of establishing loss causation.

That is no doubt true, but it is beside the point. The question that urgently needs resolution by the Supreme Court is whether revelation of a misrepresentation is necessary in order to establish the causal connection that the PSLRA requires. In the absence of resolution by the high court, private securities suits will continue to multiply, the loss-causation question will continue to be resolved differently in different areas of the country, and the business community and the economy as a whole will suffer.

*Elaine Goldenberg is an appellate partner in the D.C. office of Munger, Tolles & Olson. She has argued 12 cases in the U.S. Supreme Court and has worked on numerous securities cases in that court and others.*