n recently affirming dismissal of a class action lawsuit alleging claims pursuant to Section 10(b) of the Securities Exchange Act and Securities and Exchange Commission (SEC) Rule 10b-5, the U.S. Court of Appeals for the Ninth Circuit held that the proper pleading standard for the loss causation element of a 10(b) claim is the heightened pleading standard of FRCP 9(b). This standard requires that a complaint plead with particularity the circumstances constituting the fraud or mistake. And more specifically, with respect to loss causation, a complaint must plead specific facts demonstrating a causal connection between the misstatement and the subsequent public disclosure. The Ninth Circuit thereby joins the U.S. Court of Appeals for the Fourth and Seventh circuits in holding that Rule 9(b) applies to pleading loss causation, deepening a split among the circuit courts on this issue. As explained below, if the Supreme Court takes up the issue and affirms the Ninth Circuit’s ruling, this would arm defendants nationwide with another arrow in their quiver to move to dismiss a complaint.

The Ninth Circuit joins the Fourth and Seventh circuits in holding that Rule 9(b) applies to pleading loss causation, deepening a split among the circuit courts on this issue.

Loss causation “is the causal link between the alleged misconduct and the economic harm ultimately suffered by the plaintiff.” When determining whether loss causation has been adequately pleaded, a court typically assesses whether the plaintiff alleged facts sufficient to show a causal connection between a material misstatement made by the defendant and a stock price decline.

In 2005, the Supreme Court addressed the requisite pleading standard for loss causation in Dura Pharmaceuticals v. Broudo. In Dura, the Supreme Court held that plaintiffs bringing 10(b) claims must provide a defendant with some indication of the causal connection between the alleged misrepresentation and the loss suffered. The court made clear that the plaintiff failed to plead loss causation when it alleged only that price inflation was due to a material misrepresentation. Rather, Dura held that plaintiffs are required to allege that a corrective disclosure related to the fraud and that revelation of such fraud caused their economic loss. While noting that “the Federal Rules of Civil Procedure require only ‘a short and plain statement of the claim showing that the pleader is entitled to relief’” Id. at 346, the court neither clearly established which pleading standard should apply to loss causation nor the types of facts required to satisfy that standard. As a result, circuit courts have interpreted the Dura standard under both Rules 8(a) and 9(b).

The Supreme Court revisited loss causation in its 2011 decision in Erica P. John v. Halliburton, which vacated the U.S. Court of Appeals for the Fifth Circuit’s requirement that a plaintiff prove facts demonstrating loss causation to obtain class certification for a securities fraud lawsuit. At the same time, the Supreme Court overruled the Fifth Circuit’s requirement that a plaintiff show it is more likely than not that the negative corrective statement, and no other unrelated negative statements or outside
events, caused the stock price decline. While *Halliburton* established that a plaintiff need not prove loss causation at the class certification stage, it did not speak to the pleading requirement for loss causation or the facts needed to satisfy the pleading requirement. Because the Supreme Court has left this question open, the circuit courts have been left to make that determination on their own.

**The Decision**


Specifically, plaintiffs alleged that contrary to its public disclosures, Apollo’s growth was largely a result of unethical recruitment of unqualified students. The district court granted the defendants’ motion to dismiss the amended complaint for failure to state a claim because the plaintiffs failed to plead adequately that the defendants made any false and misleading statements. Additionally, the plaintiffs failed to plead loss causation because the complaint did not allege facts showing that a corrective disclosure revealed that a past statement was knowingly false.6

On appeal, the Ninth Circuit affirmed dismissal, holding that the alleged misrepresentations were not objectively false but rather “business puffing.” Regarding loss causation, the Ninth Circuit explained that while it is well-established that Rule 9(b) applies to most elements of a securities fraud claim, it is not clear that loss causation is subject to this heightened standard. The Ninth Circuit clarified this issue, however, holding that loss causation also is subject to Rule 9(b).

The court reasoned that: (1) the law on federal securities fraud, including the loss causation element, derives from common-law fraud, and since Rule 9(b) applies to all circumstances of common-law fraud, the same pleading standard should apply to all circumstances of securities fraud; (2) the text of Rule 9(b) itself requires that a party state with particularity the circumstances constituting fraud or mistake and

---

While the Second Circuit has articulated the pleading standard it requires, district courts within the Second Circuit have applied both the Rule 8(a) and 9(b) standards when assessing whether a pleading has met the Second Circuit standard.

---

because loss causation is one of the elements that must be alleged in a securities fraud claim, loss causation is thus part of the “circumstances constituting fraud.” Id. at 35; and (3) applying Rule 9(b) to loss causation “creates a consistent standard through which to assess pleadings in Section 10(b) actions, rather than the piecemeal standard adopted by some courts.” Id.

Although the Apollo court established the pleading requirement for loss causation, it did not shed light on what facts will satisfy the requirement. Instead, because the court found that the plaintiffs did not allege specific statements by the defendants that were made untrue or called into question by subsequent public disclosures, the plaintiffs’ allegations failed to plead loss causation under either Rule 8(a) or 9(b).

**The Circuit Split**

The Ninth Circuit is not the first court to conclude that the pleading requirements of Rule 9(b) apply to loss causation. The Fourth and Seventh circuits along with a district court in the Sixth Circuit have reached the same conclusion7 without explicitly defining the standard beyond explaining that a plaintiff need only allege the defendant’s conduct was a substantial cause of its injury. The Fourth Circuit also makes clear that the specificity sufficient to plead loss causation varies depending on the facts and circumstances of each case.8 On the other hand, the Fifth Circuit and a district court in the Third Circuit have reached the opposite conclusion, holding that a plaintiff need only satisfy Rule 8(a)’s “short and plain statement” requirement to plead loss causation,9 which can be satisfied by a plaintiff alleging a facially plausible relationship between the fraudulent statement and plaintiff’s economic loss.

Several circuit courts, including the U.S. Court of Appeals for the Second Circuit, have yet to rule on which pleading standard applies to loss causation. In fact, the Second Circuit has established its own “heightened” standard that does not apply either Rule 8(a) or 9(b). In *ATSI v. Shaar Fund*, 493 F.3d 87, 106 (2d Cir. 2007), the court held that to plead loss causation, a plaintiff must allege facts showing that the loss was foreseeable and was caused by a materialization of the risk that was concealed by the fraudulent statement. While the Second Circuit has articulated the pleading standard it requires, district courts within the Second Circuit have applied
both the Rule 8(a) and 9(b) standards when assessing whether a pleading has met the Second Circuit standard.\footnote{10}

As in the Ninth Circuit, other courts that have addressed the differing pleading standards have generally not reached the question of which rule applies because they have found that the allegations satisfied either both or neither of Rules 8(a) and 9(b). Massachusetts Ret. Sys. v. CVS Caremark\footnote{11} is one example. There, the U.S. Court of Appeals for the First Circuit noted that the facts alleged satisfied both rules. The complaint arose from a merger between the defendants, CVS and Caremark.

Specifically, plaintiffs alleged that CVS’s statement that it had quickly and successfully integrated the two businesses misled investors with respect to the merger’s success and the post-merger company’s ability to integrate CVS’s and Caremark’s prescription benefits manager computer systems. Subsequently, CVS announced on an earnings call that (i) it had lost significant contracts from major clients due to problems with the integration of the computer systems, (ii) it would not meet anticipated dates for the project without a rational basis, and (iii) the president and chief architect of the merger planned to resign.

Following this disclosure, CVS’s stock price declined by approximately 20 percent. The First Circuit found that the plaintiffs adequately pleaded loss causation because the allegations indicated the stock price decline was causally related to the defendants’ corrective disclosure.

On the other hand, in Coyne v. Metabolix,\footnote{12} the district court in Massachusetts found that the plaintiff’s allegations failed under Rule 8(a) and thus did not reach Rule 9(b). The complaint stemmed from a joint venture entered into between bioscience engineering company, Metabolix, and its funding source, which the funding source could unilaterally terminate if it determined the projected return from the joint venture was “too uncertain.” Specifically, the plaintiff alleged that the defendant’s disclosure with respect to the viability of the joint venture was misleading because it failed to reveal product quality issues and made optimistic statements regarding anticipated dates for the project without a rational basis.

The plaintiff further alleged that the true nature of the joint venture was disclosed in a press release that revealed that the funding source was withdrawing from the joint venture because the projected returns were too uncertain. After publication of such press release, the stock price declined by approximately 57 percent. The court found that plaintiff failed to plead loss causation because it did not connect the current negative information to the earlier false or misleading statement.

**Conclusion**

Although some circuit courts have ruled on the pleading standard for loss causation, many have continued to leave open the question of whether to apply Rule 8(a), Rule 9(b) or another standard. While the Ninth Circuit announced in Apollo that it stands with the Fourth and Seventh circuits in applying Rule 9(b)’s heightened standard, its decision provides little guidance with respect to what facts are necessary to plead loss causation. Because a plaintiff must allege defendant’s conduct was a substantial cause of its injury to plead loss causation adequately, defendants in circuits that apply Rule 9(b) would be well-served by requesting that the court take judicial notice of alternative causes for the stock price decline to show that plaintiff has not pleaded facts to show that it is more likely than not that the loss was attributable to the alleged fraud as opposed to other factors.

Given the Supreme Court’s recent enthusiasm for taking up securities cases, particularly where there is a circuit split, this issue may eventually make its way there. If the Supreme Court were to agree with the Fourth, Seventh and Ninth circuits and hold that Rule 9(b) applies to loss causation, then plaintiffs would be required to allege more highly particularized facts to satisfy this element and defendants could have even greater latitude to offer alternative explanations for the stock price decline to rebut a plaintiff’s attempt to satisfy its burden.

**References**

11. See Massachusetts Ret. Sys. v. CVS Caremark, 716 F.3d at 239 n. 6.