NO LOSS, NO PROBLEM: HOW THE SECOND CIRCUIT ALTERED *DURA* AND THE CONCEPT OF ECONOMIC LOSS IN SECURITIES FRAUD CASES IN *ACTICON AG V. CHINA NORTH EAST PETROLEUM HOLDINGS, LTD.*

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I. INTRODUCTION

Is a securities fraud plaintiff precluded as a matter of law from sufficiently pleading *economic loss* and/or *loss causation* if she had the opportunity to sell her stock for a gain subsequent to a defendant-company's corrective disclosure?[1] Recently, in *Acticon AG v. China North East Petroleum Holdings, Ltd.*, the Second Circuit answered in the negative, allowing plaintiffs who alleged securities fraud to progress past the pleading stage despite having the opportunity to sell their stock for a gain on several occasions.[2] This decision abrogated three federal district court decisions within the Second Circuit,[3] and stood in direct contrast to two federal district court decisions from outside the Second Circuit.[4]

Those five federal district courts relied principally on the Supreme Court's decision in *Dura Pharmaceuticals, Inc. v. Broudo*, in which the Court clarified the pleading standard for private securities

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1 *See* 15 U.S.C. § 78u-4(b)(4) (2010) (establishing the pleading requirements for a private securities fraud action under SEC Rule 10b-5); Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 341–42 (2005) (listing the six elements necessary for a private securities fraud action pursuant to § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78a (2006)).

2 Acticon AG v. China N.E. Petroleum Holdings Ltd., 692 F.3d 34, 41–42 (2d Cir. 2012).

3 *See generally In re* China N.E. Petroleum Holdings Ltd. Sec. Litig., 819 F. Supp. 2d 351 (S.D.N.Y. 2011); *In re* Veeco Instruments, Inc. Sec. Litig., No. 05-MD-01695(CM)(GAY), 2007 WL 7630569, at *1 (S.D.N.Y. June 28, 2007); Malin v. XL Capital Ltd., No. 3:03 CV 2001 PCD, 2005 WL 2146089, at *1 (D. Conn. Sept. 1, 2005).

4 *See generally In re* Immucor, Inc. Sec. Litig., No. 1:09-CV-2351-TWT, 2011 WL 384421, at *1 (N.D. Ga. Aug. 29, 2011); Ross v. Walton, 668 F. Supp. 2d 32 (D.D.C. 2009).

actions.[5] In *Dura*, the Court held that the plaintiffs could not sufficiently plead loss causation simply by alleging and then establishing that the stock price was inflated on the day of purchase due to misrepresentation; instead, plaintiffs must prove that the misrepresentation proximately caused their loss.[6] Seemingly extending that principle, the five federal district courts held that when the stock in question returns to or eclipses its pre-disclosure price, the plaintiffs have not suffered any economic loss, and thus cannot sufficiently assert that the defendants' alleged fraud proximately caused any loss.[7] The *Acticon* decision, however, has called into doubt both the district courts' interpretation of *Dura* and the future of private securities actions in which a stock price, despite allegations of fraud, subsequently rises above its purchase price after a corrective disclosure.

This Comment argues that the Second Circuit should have followed the district courts' interpretation of *Dura*, both from a legal and logical standpoint.[8] Part II analyzes the relevant securities laws and the history of loss causation and economic loss.[9] Part III looks at the Supreme Court's decision in *Dura*, the five district court decisions interpreting its revised pleading standard for private securities fraud actions, and the *Acticon* decision.[10] Part IV explains how the Second Circuit misinterpreted *Dura*, why the district courts' interpretation is superior, what the Second Circuit should have done to extend *Dura* and the principles of the relevant securities laws, and the ramifications that will follow.[11] This Comment concludes by suggesting that the Supreme Court clarify the pleading standard for both economic loss and loss causation in private securities fraud cases.[12]

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[5] 544 U.S. at 347–48.

[6] *Id.* at 344–47.

[7] *See, e.g.*, *Ross*, 668 F. Supp. 2d at 42–43 (noting that if a stock "could have been sold at a profit [after the close of the class period], the 'actual economic loss' contemplated in Dura is precluded"); *Malin*, 2005 WL 2146089, at *4 ("[A] price fluctuation without any realization of an economic loss is functionally equivalent to the Supreme Court's rejection of an artificially inflated purchase price alone as economic loss.").

[8] *See infra* Part IV.A.

[9] *See infra* Part II.

[10] *See infra* Part III.

[11] *See infra* Part IV.

[12] *See infra* Part V.

II. THE HISTORY OF ECONOMIC LOSS AND LOSS CAUSATION IN SECURITIES FRAUD ACTIONS

Economic loss and loss causation in securities fraud actions have a relatively short, complex history. Congress passed the Securities Exchange Act of 1934 ("Exchange Act") to regulate secondary markets after the Great Depression.[13] Shortly thereafter, the Securities and Exchange Commission (SEC), in furtherance of § 10(b) of the Exchange Act, promulgated Rule 10b-5, which generally made it unlawful to issue false or misleading statements in relation to the purchase or sale of securities.[14] Since § 10(b) did not explicitly create a private cause of action for plaintiffs, and since the SEC did not define the contours of a 10b-5 action, interpretations of both the statute and the Rule were left primarily to the courts, which have implied a private cause of action for an alleged 10b-5 violation since at least 1946.[15]

Additionally, since Rule 10b-5 is largely a judge-interpreted, judge-made device, the elements of such an action have developed over time. Since at least 1974, however, courts have inferred loss causation as an element of a 10b-5 claim,[16] interpreting it as a concept comparable to the doctrine of proximate cause in tort law.[17] This judicial inference persisted until 1995, when Congress passed the Private Securities Litigation Reform Act ("PSLRA"), which codified loss causation as an explicit element of a Rule 10b-5 claim.[18]

Beyond just codifying the elements of a 10b-5 claim, the PSLRA, given the "uncertainties" of Rule 10b-5 and "conflicting legal standards," also sought to curb abuses of the securities laws, which had manifested itself in the form of many meritless claims over the

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[13] 15 U.S.C. § 78a *et seq.* (2006).

[14] 17 C.F.R. § 240.10b-5 (2006); *see* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 729 (1975).

[15] *See* Herman & MacLean v. Huddleston, 459 U.S. 375, 380 n. 10 (1983) (citing Kardon v. Nat'l Gypsum Co., 69 F. Supp. 512 (E.D. Pa. 1946), as the first court to imply a right of action for an alleged 10b-5 violation).

[16] *See* Schlick v. Penn-Dixie Cement Corp., 507 F.2d 374, 380 (2d Cir. 1974), *cert. denied*, 421 U.S. 976 (1975).

[17] *See* Matthew L. Fry, *Pleading and Proving Loss Causation in Fraud-on-the-Market-Based Securities Suits Post-Dura Pharms.*, 36 SEC. REG. L.J. 31, 33 (2008); *see, e.g.*, Emergent Capital Inv. Mgmt., LLC v. Stonepath Grp., Inc., 343 F.3d 189, 197 (2d Cir. 2003) (comparing loss causation to proximate cause); Castellano v. Young & Rubicam, Inc., 257 F.3d 171, 186 (2d Cir. 2001) (same); Citibank, N.A. v. K-H Corp., 968 F.2d 1489, 1495 (2d Cir. 1994) (same).

[18] Pub. L. No. 104-67, § 101, 109 Stat. 737, 757 (1995) (codi•ed at 15 U.S.C. § 78u-4(b)(4) (2010)).

last few decades.[19] As a result, the PSLRA heightened the pleading standard for securities fraud cases by forcing plaintiffs to plead certain elements with particularity.[20] What is unclear, however, is whether either the PSLRA or the Federal Rules of Civil Procedure require a heightened pleading standard for loss causation—an issue that courts have addressed with varying conclusions.[21]

Although the PSLRA does not explicitly list economic loss as an element of a 10b-5 action, the Supreme Court has interpreted the rule to require plaintiffs to plead economic loss.[22] In fact, in *Dura*, the Court listed the "basic elements" of a § 10(b) claim, and included both economic loss and loss causation.[23] Although listed as independent elements, economic loss and loss causation are often inextricably linked in a 10b-5 case, because a plaintiff must have suffered an economic loss before she can claim that the defendant's alleged fraud is the proximate cause of that loss.[24] To illustrate, the Supreme Court has said that loss causation "requires a plaintiff to show that a misrepresentation that affected the integrity of the market price *also* caused a subsequent economic loss," linking the two elements into one analysis.[25] Thus, for the purposes of this Comment, a court that determines that a plaintiff has failed to sufficiently plead economic loss is sufficiently analogous to another court holding that the plaintiff has failed to plead loss causation since she cannot show that she suffered an economic loss.[26]

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[19] S. REP. NO. 104-98, at 4 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 683–84; *see also Blue Chip*, 421 U.S. at 741 (noting that the potential for abuse of the discovery provisions of the Federal Rules of Civil Procedure may be more likely in cases connected to the Exchange Act than other types of litigation).

[20] *See* 15 U.S.C. § 78u-4(b)(1)–(2) (requiring a plaintiff to plead the requisite state of mind ('scienter') and 'misrepresentation' with particularity).

[21] *See infra* Part IV.B.1.

[22] *See* Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 342 (2005) (citing 15 U.S.C. § 78u-4(b)(4) and including economic loss as one of the six elements of a 10b-5 claim).

[23] *Id.* at 341–42.

[24] *Id.* at 336 ("An inflated purchase price will not by itself constitute or proximately cause the relevant *economic loss* needed to allege and prove 'loss causation.'") (emphasis added).

[25] Erica P. John Fund, Inc. v. Halliburton Co., 131 S. Ct. 2179, 2186 (2011); *see also* Lentell v. Merrill Lynch & Co., 396 F.3d 161, 172 (2d Cir. 2005) (citing Emergent Capital Inv. Mgmt., LLC v. Stonepath Grp., Inc., 343 F.3d 189, 197 (2d Cir. 2003)) (defining loss causation as "the causal link between the alleged misconduct and the economic [loss] ultimately suffered by the plaintiff"), *cert. denied*, 546 U.S. 935, 935 (2005).

[26] *Compare* Ross v. Walton, 668 F. Supp. 2d 32, 44 (D.D.C. 2009) (holding that the plaintiffs "fail[ed] to set forth facts demonstrating actual economic damages

III. *DURA* AND THE FEDERAL COURTS' SUBSEQUENT INTERPRETATIONS OF ITS PRINCIPLES

A. Dura Pharmaceuticals, Inc. v. Broudo

In *Dura*, the plaintiffs brought a 10b-5 case against Dura Pharmaceuticals ("Dura"), alleging that Dura made false statements concerning the expected Food and Drug Administration approval of a new asthmatic spray device, and that these false statements resulted in an artificially inflated stock price.[27] The district court granted Dura's Rule 12(b)(6) motion, holding that the plaintiffs could not sufficiently plead a causal connection between the alleged misrepresentation and the plaintiffs' economic loss.[28] The Ninth Circuit reversed and remanded the case, positing that the plaintiffs could sufficiently plead loss causation merely by alleging that the security's price was inflated at the time of purchase due to the misrepresentation.[29] After granting *certiorari*, the Supreme Court reversed the Ninth Circuit and dismissed the plaintiffs' complaint, concluding that the plaintiffs could not sufficiently plead loss causation or economic loss.[30] Writing for a unanimous Court, Justice Breyer identified three areas where the Ninth Circuit erred: its interpretation of "fraud-on-the-market" cases,[31] its lack of precedential support,[32] and its oversight of important objectives of securities laws.[33]

First, the Ninth Circuit originally held that the plaintiffs need only prove that the stock price was inflated *on the date of purchase* due to the alleged misrepresentation,[34] but the Court held that in a normal "fraud-on-the-market" case, such as this one, an inflated purchase price alone does not proximately cause economic loss.[35]

within the context of *loss causation* as required by Dura") (emphasis added), *with In re* China N.E. Petroleum Holdings Ltd. Sec. Litig., 819 F. Supp. 2d 351, 353–54 (S.D.N.Y. 2011) (noting that "the absence of *economic loss* is sufficient grounds for dismissal [of the complaint]") (emphasis added).

27 *Dura*, 544 U.S. at 336.

28 *Id.* at 340; *In re* Dura Pharms., Inc. Sec. Litig., No. Civ. 99CV0151-L(NLS), 2001 WL 35925887, at *10 (S.D. Cal. Nov. 2, 2001).

29 *Dura*, 544 U.S. at 340; Broudo v. Dura Pharms., Inc., 339 F.3d 933, 939 (9th Cir. 2003).

30 *Dura*, 544 U.S. at 342–46.

31 *Id.* at 342.

32 *Id.* at 343–44.

33 *Id.* at 345.

34 *Broudo*, 339 F.3d at 938.

35 *Dura*, 544 U.S. at 342.

The Court concluded that "as a matter of pure logic," a plaintiff does not suffer any loss at the time of the purchase, since "the inflated purchase payment is offset by ownership of a share that *at that instant* possesses equivalent value."[36] Beyond that, the Court found that the logical link between an inflated purchase price and any subsequent economic loss was not conclusive, as the sale of stock at a lower price after a corrective disclosure "*might* mean a later loss. But that is far from inevitably so."[37] In fact, the Court specifically noted that a lower price could reflect changing economic circumstances or investor expectations rather than a causal connection to the alleged misrepresentation.[38]

Second, the Court pointed out that the Ninth Circuit's central holding lacked precedential support, as private securities fraud actions usually resemble common law fraud actions, which require a plaintiff to show not only that she would not have acted had she known the truth, but that she actually suffered economic loss.[39] Given the requirement that a plaintiff show actual damages, the Court found it unsurprising that other federal courts of appeals had both previously and subsequently rejected the Ninth Circuit's approach.[40] The Court further noted that both the Restatement of Torts and other treatises writers emphasized the need to prove, rather than merely assert, loss causation.[41]

Finally, the Court declared that the Ninth Circuit's holding contravened the purposes and principles of the federal securities laws, which, in the Court's opinion, make private actions available "not to provide investors with broad insurance against market losses, but to protect them against those economic losses that misrepresentations actually cause."[42] Again, the PSLRA requires

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36 *Id.*

37 *Id.*

38 *Id.* at 342–43 (also mentioning that "new industry-specific or firm-specific facts," rather than the alleged fraud, could lead to the declining stock price).

39 *Id.* at 343–44.

40 *Id.* at 344; *see, e.g.*, Emergent Capital Inv. Mgmt., LLC v. Stonepath Grp., Inc., 343 F.3d 189, 198 (2d Cir. 2003) (concluding that allegations of an inflated purchase price alone could not satisfy pleading loss causation); Semerenko v. Cendant Corp., 223 F.3d 165, 185 (3d Cir. 2000) (same); Robbins v. Koger Props., Inc., 116 F.3d 1441, 1448 (11th Cir. 1997) (same).

41 *Dura*, 544 U.S. at 344–45; *see* W. PAGE KEETON, DAN B. DOBBS, ROBERT E. KEETON & DAVID G. OWEN, PROSSER AND KEETON ON THE LAW OF TORTS § 110, p. 767 (5th ed. 1984); RESTATEMENT (SECOND) OF TORTS §548A cmt. b, at 107 (1977).

42 *Dura*, 544 U.S. at 345; *cf.* Basic Inc. v. Levinson, 485 U.S. 224, 252 (1988) (White, J., concurring in part and dissenting in part) ("[A]llowing recovery in the

plaintiffs to "specify" each misleading statement,[43] plead certain elements with particularity,[44] and carry the burden of proving that the defendant's misrepresentations "caused the loss for which the plaintiff seeks to recover damages."[45] Given these statutory requirements, the Court concluded that the Ninth Circuit's approach would "allow recovery where a misrepresentation leads to an inflated purchase price but nonetheless does not proximately cause any economic loss. That is to say, it would permit recovery where . . . two traditional elements. . . are missing."[46]

Due largely to these three concerns, the Court ultimately reversed the Ninth Circuit, holding that the plaintiffs' complaint was insufficient to state a claim for relief.[47] Importantly, however, the Court left two issues undecided: what types of specific facts a 10b-5 plaintiff must produce in order to sufficiently plead loss causation,[48] and whether a heightened pleading standard, pursuant to the PSLRA or the Federal Rules of Civil Procedure, applies to loss causation.[49] As a result of these two issues, the lower federal courts have interpreted *Dura* in various ways, culminating in the Second Circuit's recent decision in *Acticon*.[50]

*B. Post-*Dura *Cases Involving Economic Loss and Loss Causation*

Although the *Dura* Court left the two aforementioned issues unresolved or unclear, various federal district courts—including the district court decision that *Acticon* reversed[51]—have interpreted *Dura*'s principles and framework in the same fashion—one diametrically opposed to the Second Circuit's interpretation.

face of affirmative evidence of nonreliance
. . . would effectively convert Rule 10b-5 into a scheme of investor's insurance. There is no support in the Securities Exchange Act, the Rule, or our cases for such a result.") (citations omitted) (internal quotation marks omitted).

[43] 15 U.S.C. § 78u-4(b)(1) (2010).

[44] 15 U.S.C. § 78u-4(b)(2).

[45] 15 U.S.C. § 78u-4(b)(4).

[46] *Dura*, 544 U.S. at 346.

[47] *Id.* at 342–46.

[48] *Id.* at 346 (declining to address separate proximate cause or loss-causation arguments).

[49] *Id.* (assuming, for argument's sake, that the securities statutes do not impose a heightened pleading standard, but noting that the plaintiffs' complaint is insufficient under either a Rule 8 or Rule 9 analysis).

[50] *See infra* Part III.C.

[51] *See generally In re* China N.E. Petroleum Holdings Ltd. Sec. Litig., 819 F. Supp. 2d 351 (S.D.N.Y. 2011).

1. *Malin v. XL Capital Ltd.*

Decided just a few months after *Dura*, *Malin* was the first case to interpret and apply *Dura* to a situation where the allegedly inflated stock price almost or fully recovered subsequent to a corrective disclosure.[52] In *Malin*, the plaintiffs alleged a Rule 10b-5 violation, asserting that the defendants issued false and misleading statements concerning the company's financial circumstances, leading to an inflated share price that fell after subsequent disclosures.[53] Furthermore, in an attempt to distinguish *Dura*, the plaintiffs suggested that not only was there an inflated price, but that the price drop was causally related to the subsequent disclosure.[54]

In response, however, the defendants presented evidence that the share prices fully recovered just a few months after the class period ended.[55] With that in mind, the court posited that the defendants' evidence negated the plaintiffs' inference that there was a causal connection between the misleading statements and the price drop.[56] In its central holding, the *Malin* court ruled that "a price fluctuation without any realization of an economic loss is functionally equivalent to [*Dura*'s] rejection of an artificially inflated purchase price alone as economic loss. *If the current value is commensurate to the purchase prices, there is no loss, regardless of whether the purchase price was artificially inflated.*"[57] As a result, the court granted the defendants' 12(b)(6) motion to dismiss the amended complaint.[58]

2. *In re Veeco Instruments, Inc. Securities Litigation*

In *In re Veeco*, the lead plaintiff and defendants presented the court with several motions *in limine* concerning alleged misrepresentations in Veeco's press releases.[59] In the defendants' motion to preclude the lead plaintiff's damages expert from offering certain calculations as to potential damages, the defendants first asked the court to prevent the expert from arguing that the damages

[52] *See generally* Malin v. XL Capital Ltd., No. 3:03 CV 2001 PCD, 2005 WL 2146089, at *1 (D. Conn. Sept. 1, 2005).

[53] *Id.*

[54] *Id.* at *3.

[55] *Id.* at *4.

[56] *Id.*

[57] *Id.* (emphasis added).

[58] *Malin*, 2005 WL 2146089, at *4.

[59] *See generally In re* Veeco Instruments, Inc. Sec. Litig., No. 05-MD-01695 (CM)(GAY), 2007 WL 7630569, at *1 (S.D.N.Y. June 28, 2007).

provision of the PSLRA was a means of measuring actual damages.[60] In the defendants' estimation, the PSLRA provided a cap on damages, rather than a measure of damages.[61] The court agreed, holding that § 21(D) of the PSLRA imposed a cap on the damages available to plaintiffs, rather than measuring the amount of damages.[62]

Second, the defendants argued that the expert should not be allowed to take into account any damages for shares sold after the corrective disclosure at a price equal to or greater than the allegedly inflated share price.[63] Again, the court agreed with the defendants, noting that the plaintiff's damages expert also agreed when he stated in his expert report that "[i]f either the inflation or price increased over the holding period for any particular share, the share was not damaged, so the damage for that share is zero."[64]

Finally, the defendants asked the court to preclude expert testimony regarding any damages for the then-unsold shares that were purchased prior to the corrective disclosure.[65] The court first noted that neither the PSLRA nor *Dura* imposed a "sell to sue" requirement, but then reasoned that, under *Dura*, a plaintiff must nevertheless still prove that she suffered an economic loss.[66] In that regard, the court directly relied on the *Malin* court's interpretation of *Dura*—that a plaintiff holding stock that was commensurate to its purchase price suffered no damages, even if the purchase price was artificially inflated.[67] Thus, the court held that "[p]laintiffs who chose to retain their shares past the point when the stock price first recovered [to its purchase price] can prove no economic loss that is attributable to any of the defendants' alleged misrepresentations."[68] Significantly, the court further noted that this analysis was in accord with the lead plaintiff's own damages expert's conclusion that a plaintiff suffers no damages if a share price increases over the holding period.[69] As a result, the court ultimately granted the defendants' motion *in limine* to prevent the plaintiff's damages expert

[60] *Id.* at *6.
[61] *Id.*
[62] *Id.*
[63] *Id.*
[64] *Id.*
[65] *In re Veeco*, 2007 WL 7630569, at *7.
[66] *Id.*
[67] *Id.*
[68] *Id.*
[69] *Id.*

from portraying the damages provisions of the PSLRA as a means of calculating damages rather than as a cap on damages.[70]

3. Ross v. Walton

In this 2009 case, the plaintiffs purchased Allied Capital stock over a fifteen month period before Allied made a corrective disclosure that caused the stock price to drop from $33 at the beginning of January 10, 2007, to $31.58 at the end of that day, to $27.79 at the opening on January 11.[71] Additionally, in the ninety days that followed, Allied's stock never closed at a price above $32.[72] Consequently, the plaintiffs sought damages pursuant to the Exchange Act and the PSLRA.[73]

Apparently conceding that there was no "sell to sue" rule, the defendants instead presented evidence that the stock was trading at a profit one month before the plaintiffs filed their amended complaint.[74] Therefore, the defendants relied on *Malin*'s "commensurate value" holding, arguing that the plaintiffs should be precluded from pleading loss causation.[75] In this case, similar to the plaintiffs in *Malin*, the plaintiffs argued that they need only allege that a misrepresentation caused a facially plausible price drop.[76] The *Ross* court disagreed with the plaintiffs, noting that it was "unaware of any authority in which actual economic loss was found when the stock value returned to pre-disclosure prices and could have been sold at a profit just after the class period."[77] In fact, the court acknowledged that it was undisputed that the plaintiffs could have sold their stock for a profit on at least three occasions in June 2007, a few months after the plaintiffs had filed their complaint.[78] Thus, while the court agreed that there was no "sell to sue" rule, it concluded that *Malin*'s interpretation of *Dura* was correct, in that *Dura*'s rationale precludes a plaintiff from pleading "actual economic loss" if the stock could have been sold for a profit after the corrective disclosure.[79] The court

[70] *Id.* at *7, *9.
[71] Ross v. Walton, 668 F. Supp. 2d 32, 35–36, 41 (D.D.C. 2009).
[72] *Id.* at 41.
[73] *Id.* at 35.
[74] *Id.* at 42.
[75] *Id.*; *see* Malin v. XL Capital Ltd., No. 3:03 CV 2001 PCD, 2005 WL 2146089, at *4 (D. Conn. Sept. 1, 2005).
[76] *Ross*, 668 F. Supp. 2d at 42–43.
[77] *Id.* at 43.
[78] *Id.*
[79] *Id.*

further asserted that, "[l]ogically, a plaintiff cannot demonstrate the amount the purchaser overpaid if the stock value rose greater than the purchase price on multiple occasions."[80]

Finally, the court noted that since a § 10(b) claim involves fraud, the plaintiffs must, pursuant to Federal Rule of Civil Procedure 9(b),[81] plead the circumstances giving rise to fraud with particularity.[82] Nevertheless, since the plaintiffs could have sold their shares for a profit on various occasions after filing their complaint, the court found that "even under the Rule 8(a)(2) 'facially plausible' standard, Plaintiffs cannot demonstrate economic loss beyond a simple fluctuation in value or, at best, an artificially inflated purchase price, specifically rejected by *Dura*."[83] As a result, the court granted the defendants' Rule 12(b)(6) motion, concluding that the fact that the plaintiffs could have sold their stock for a gain precluded them from pleading loss as a matter of law.[84]

4. In re Immucor, Inc. Securities Litigation

In this motion for reconsideration, the plaintiff claimed that the court erroneously dismissed its claim that Immucor violated § 10(b) of the Exchange Act by making false and misleading statements with regard to its compliance with FDA regulations.[85] In its initial order, the court held that the plaintiff was precluded from pleading economic loss and loss causation since Immucor's share price "quickly rebounded" to pre-disclosure levels after each corrective disclosure.[86] The plaintiff argued that the court's conclusion was a "clear error of law," but the court, relying on both *Ross* and *Malin*—where the stock prices reached or eclipsed the plaintiffs' purchase prices—denied the plaintiff's motion for reconsideration.[87] Specifically, even though the plaintiff tried to distinguish this case from *Ross* and *Malin*, the court held that:

> [G]iven the many factors that can affect share price, contrasting the price immediately before the corrective disclosure . . . and the price shortly thereafter provides the

[80] *Id.*
[81] FED. R. CIV. P. 9(b).
[82] *Ross*, 668 F. Supp. 2d at 38.
[83] *Id.* at 43.
[84] *Id.*
[85] *In re* Immucor, Inc. Sec. Litig., No. 1:09 CV 2351 TWT, 2011 WL 3844221, at *1 (N.D. Ga. Aug. 29, 2011).
[86] *Id.* at *2.
[87] *Id.* at *2–3.

> most relevant comparison for evaluating whether the stock price dropped significantly following the corrective disclosure and whether the disclosure caused the drop in price.[88]

As a result, the court affirmed the dismissal of the FDA-related securities fraud claims due to the plaintiff's inability to plead actual economic loss or loss causation.[89]

5. In re China North East Petroleum Holdings Ltd. Securities Litigation

In *In re China North East*, the lead plaintiff, Acticon, purchased approximately sixty thousand shares of China North East Petroleum Holdings Ltd. ("NEP") over the course of five months—January 2010 to May 2010.[90] Ultimately, Acticon spent $434,950 for those sixty thousand shares, resulting in an average price of $7.25 per share.[91] Following those purchases, NEP made multiple corrective disclosures to its financial statements from prior years, leading Acticon to file suit against NEP for violations of § 10(b) and Rule 10b-5.[92] NEP issued its final corrective disclosure on September 1, 2010,[93] but NEP stock closed above approximately $7.25 on twelve separate days between October and November 2010.[94] Seizing on that fact, the district court determined that, because the plaintiffs could have sold their shares for a profit on multiple occasions following the corrective disclosures, *Dura*'s principles—and *Malin*'s persuasive interpretation of those principles—precluded the plaintiffs from pleading economic loss.[95]

Alternatively, the plaintiffs argued that they should be able to sue based on the losses suffered from the sales of stock they made between December 2010 and May 2011.[96] In response, the court recognized that the plaintiffs had suffered a loss, but ultimately held

88 *Id.* at *2. The court's language seems to imply that Immucor's stock never fully recovered to its pre-disclosure price, but the court had previously said that the stock did "quickly rebound[] to pre-disclosure levels after each of the FDA-related disclosures." *Id.*

89 *Id.* at *3.

90 *In re* China N.E. Petroleum Holdings Ltd. Sec. Litig., 819 F. Supp. 2d 351, 353 (S.D.N.Y. 2011).

91 *Id.*

92 Acticon AG v. China N.E. Petroleum Holdings Ltd., 692 F.3d 34, 36 (2d Cir. 2012).

93 *In re China*, 819 F. Supp. 2d at 353.

94 *Id.*

95 *Id.*

96 *Id.*

that the plaintiffs could not impute their loss to any of NEP's alleged misrepresentations.[97] To that end, the court posited that "[a] plaintiff who forgoes a chance to sell at a profit following a corrective disclosure cannot logically ascribe a later loss to devaluation caused by the disclosure."[98] Thus, the court granted the defendant's three motions to dismiss the consolidated complaint, becoming the fifth district court out of five to interpret *Dura* as precluding pleading loss causation/economic loss when the stock price had approached or eclipsed the purchase price subsequent to a corrective disclosure.[99]

C. Primary Case: Acticon AG v. China North East Petroleum Holdings Ltd.

After the *In re China* plaintiffs appealed the district court's decision, the Second Circuit, in a matter of first impression, reversed the district court, holding that the plaintiffs were not precluded as a matter of law from pleading economic loss just because the stock price had risen higher than the investors' average purchase price subsequent to the corrective disclosures.[100] Specifically, the Second Circuit noted that the district court's limitation on damages was inconsistent with both the "out of pocket" measure of damages traditionally used in § 10(b) actions and with the "bounce back" damages cap in the PSLRA.[101]

First, the Second Circuit observed that the "out of pocket" measure of damages has traditionally been used to determine economic loss in § 10(b) cases.[102] Under that measure, "a defrauded buyer of securities is entitled to recover only the excess of what he paid over the value of what he got."[103] Moreover, the Second Circuit reasoned that the Supreme Court has adopted the "out of pocket" measure of damages, defining it as "the difference between the fair value of" the plaintiff's purchase and the fair value of what the plaintiff would have received absent the fraud.[104] As a result, the Second Circuit determined that the district court erred by failing to apply the "out of pocket" method of damages, asserting that, aside

[97] *Id.*
[98] *Id.*
[99] *In re China*, 819 F. Supp. 2d at 354.
[100] Acticon AG v. China N.E. Petroleum Holdings Ltd., 692 F.3d 34, 34, 36 (2d Cir. 2012).
[101] *Id.* at 39.
[102] *Id.* at 38.
[103] *Id.* (quoting Levine v. Seilon, 439 F.2d 328, 334 (2d Cir. 1971)).
[104] *Id.* (quoting Affiliated Ute Citizens v. United States, 406 U.S. 128, 155 (1972)).

from the "bounce back" provision in the PSLRA, Congress had not otherwise altered the traditional method for calculating damages.[105]

The Second Circuit further held that the district court's conclusion was inconsistent with the PSLRA's "bounce back" provision, which caps the amount of damages a plaintiff can receive in a securities fraud action.[106] Under that provision, a plaintiff's damages cannot exceed the difference between the plaintiff's purchase price of the security and the security's average trading price in the ninety days following the final corrective disclosure.[107] Thus, the Second Circuit concluded that Acticon would have only been precluded from pleading loss causation under the PSLRA if NEP's average trading price over the ninety days following the last corrective disclosure would have exceeded the plaintiffs' purchase price.[108]

In addition to these two apparent inconsistencies, the Second Circuit determined that the *Malin* line of reasoning—on which the trial court below relied—incorrectly interpreted *Dura*.[109] According to the Second Circuit, those interpretations erroneously used as their starting point the Court's observation that "at the moment the transaction takes place, the plaintiff has suffered no loss; the inflated purchase payment is offset by ownership of a share that at that instant possesses equivalent value."[110] After reiterating that *Dura* did not affect the traditional "out of pocket" measure of damages, the Second Circuit posited that "a share of stock that has regained its value after a period of decline is not functionally equivalent to an inflated share that has never lost value . . . [because] it assumes that if there are any intervening losses, they can be offset by intervening gains."[111]

To that end, NEP argued that the security price recovery indicated that the market was unaffected by the corrective disclosures, and that the disclosures were thus unconnected to the plaintiffs' claimed losses.[112] At this stage of the litigation, however, the Second Circuit drew all reasonable inferences in favor of Acticon, and instead determined that the plaintiffs here, unlike the plaintiffs

[105] *Id.* at 39.
[106] *Acticon*, 692 F.3d at 38–39; *see also* 15 U.S.C. § 78u-4(e)(1) (2010).
[107] 15 U.S.C. § 78u-4(e)(1).
[108] *Acticon*, 692 F.3d at 39 (citing *In re* Mago Fin. Corp. Sec. Litig., 213 F.3d 454, 461 (9th Cir. 2000)).
[109] *Id.* at 40–41.
[110] *Id.* (quoting Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 342 (2005) (emphasis omitted)).
[111] *Id.* at 41.
[112] *Id.* at 39–40.

in *Dura*, had alleged more than an artificially inflated price—they had alleged that NEP's stock dropped as a result of the corrective disclosures.[113] Thus, since the Second Circuit found that the plaintiffs were not precluded from pleading economic loss as a matter of law, it reversed the trial court's grant of summary judgment for NEP.[114]

IV. HOW THE *ACTICON* DECISION IS INCONSISTENT WITH THE LANGUAGE AND PRINCIPLES OF *DURA*

After five federal district courts had uniformly interpreted *Dura* as precluding a plaintiff from pleading economic loss and/or loss causation when a security price recovers following a corrective disclosure, the Second Circuit's *Acticon* decision turned that interpretation on its head, concluding the exact opposite and creating confusion for both courts and commentators. This Comment argues that the district courts' interpretation was superior as a matter of legal interpretation and in relation to the goals and principles of securities laws. Finally, this Comment also considers the consequences of the Second Circuit's decision moving forward.

A. *The Second Circuit Misinterpreted and Misapplied Supreme Court Jurisprudence in* Acticon

In its rejection of the district courts' interpretation of *Dura*, the Second Circuit took umbrage with their damages analyses, essentially concluding that they had used the wrong starting point, and/or had misapplied the applicable measure of damages.[115] Specifically, the Second Circuit's assertion that the "out of pocket" measure of damages is traditionally used for § 10(b) cases is problematic for two reasons. First, even if one accepted this proposition, loss causation would still be an issue.[116] Second, one could reasonably argue that

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113 *Id.* at 40–41.

114 *Acticon*, 692 F.3d at 41–42.

115 *Id.* at 38–41 (analyzing the "traditional out of pocket" measure of damages for §10(b) cases, and concluding that the *Malin* court's interpretation of *Dura* was inconsistent with that measure).

116 In fairness, the district court below based its holding on the premise that the plaintiffs could not plead economic loss as a matter of law, so the Second Circuit limited its holding to the same element. Theoretically, however, the district court, on remand, could determine that even though the plaintiffs were not precluded from pleading economic loss as a matter of law, that they had not sufficiently shown that the defendants' corrective disclosures were the proximate cause of the plaintiffs' "loss." *See supra* Part II (linking the elements of economic loss and loss causation and determining that a plaintiff must essentially prove that she has suffered a loss before showing that the defendant's actions proximately caused that loss).

Acticon is distinguishable because it presents the unusual circumstances where the stock price appears to have been unaffected—or the market unconcerned—despite allegations of fraud.

Despite these considerations, even the Second Circuit's reliance on the "out of pocket" measure of damages is questionable. For example, the *Acticon* court asserted that the Supreme Court had "adopted the out-of-pocket measure of damages" in *Affiliated Ute Citizens v. United States*,[117] but *Affiliated Ute* is readily distinguishable from *Acticon*, as the former primarily concerned the misstatement of a material fact in fraudulently-induced sales of stock in relation to Rule 10b-5 and the Ute Indian Supervision Termination Act.[118] Additionally, the Supreme Court language on which the Second Circuit relied in *Acticon* concerned damages under the damages provision of § 28 of the Exchange Act,[119] not § 10(b).[120] Finally, in their brief to the Supreme Court, the *Dura* plaintiffs specifically quoted *Affiliated Ute* and its conclusion that the measure of damages should be "the difference between the fair value of all that the . . . seller received and the fair value of what he would have received had there been no fraudulent conduct."[121] Although the Supreme Court did not explicitly address this contention in *Dura*, the Court did hold for the defendants, which should be interpreted as the Court implicitly considering and rejecting this argument and its assessment of the supposedly relevant measure of damages.[122] In that vein, since the Supreme Court was not persuaded by this argument in *Dura*, it is unlikely that it would find the same argument—and the Second Circuit's reliance on it—persuasive in the present, but admittedly different, securities fraud case.

Furthermore, the Second Circuit posited that the district courts'—specifically, the *Malin* court's—reasoning was inconsistent with the "out of pocket" measure of damages and the PSLRA's "bounce back" provision.[123] In the Second Circuit's estimation, the *Malin* court erroneously took as its starting point *Dura*'s observation

[117] *Acticon*, 692 F.3d at 38 (citing Affiliated Ute Citizens v. United States, 406 U.S. 128, 155 (1972)).

[118] *Affiliated Ute*, 406 U.S. at 128–33.

[119] 15 U.S.C. § 78bb (2006)

[120] *Acticon*, 692 F.3d at 38 (citing *Affiliated Ute*, 406 U.S. at 155).

[121] Respondents' Brief, Dura Pharms., Inc. v. Broudo, 544 U.S. 336 (2005) (No. 03-932), 2004 WL 2671450, at *18 (quoting *Affiliated Ute*, 406 U.S. at 154–55).

[122] *Dura*, 544 U.S. at 344, 347–48.

[123] *Acticon*, 692 F.3d at 39.

that "at the moment the transaction takes place, the plaintiff has suffered no loss[, as] the inflated purchase payment is offset by ownership of a share that *at that instant* possess equivalent value."[124] In support of its own interpretation of the PSLRA and the relevant measure of damages, the Second Circuit noted that:

> a share of stock that has regained its value after a period of decline is not functionally equivalent to an inflated share that has never lost value . . . [because] [i]n the absence of fraud, the plaintiff would have purchased the security at an uninflated price and would have also benefitted from the unrelated gain in stock price.[125]

This interpretation, while ostensibly logical, seems to have been foreclosed by *Dura* when the Supreme Court held that:

> [w]hen 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 . . . . *The same is true in respect to a claim that a share's higher price is lower than it would otherwise have been . . . .*[126]

Echoing that sentiment and standing in accord with the Supreme Court, the SEC—which promulgated Rule 10b-5—asserted that, under these circumstances, a plaintiff does not suffer any loss at the time of purchase since she can immediately sell the shares without a loss.[127] In light of these assertions, not only does the Second Circuit's logic seem unconvincing—and possibly foreclosed—but the district courts' analyses seem superior, since it extends the principles of both *Dura* and the SEC.

As a result, the reasoning in a case like *Ross v. Walton* should have been more persuasive to the Second Circuit. Read broadly, *Ross* is fairly analogous to *Acticon*—the plaintiffs had a chance to sell their securities for a profit after the class period ended but elected not to.[128] In *Ross*, the court held that "if the stock's value was commensurate to the pre-disclosure trading price after the close of the class period [and] could have been sold at a profit, the 'actual

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[124] *Id.* at 40 (quoting *Dura*, 544 U.S. at 342).

[125] *Id.* at 41.

[126] *Dura*, 544 U.S. at 342–43 (emphasis added).

[127] Brief for the United States as Amicus Curiae Supporting Petitioners, Dura Pharms., Inc. v. Broudo, 544 U.S. 336 (2005) (No. 03-932), 2004 WL 2069564, at *21–22.

[128] Ross v. Walton, 668 F. Supp. 2d 32, 42–43 (D.D.C. 2009).

economic loss' contemplated in *Dura* is precluded."[129]

The *Ross* court further noted that even if there was "loss"—the issue in *Acticon*—*Dura* still requires a plaintiff to show that it was the corrective disclosure and not "one of the [other] 'tangle of factors' that affect[ed] price."[130] The *Ross* court then summarized its analysis by concluding that "[l]ogically, a plaintiff cannot demonstrate the amount the purchaser overpaid if the stock value rose greater than the purchase price on multiple occasions."[131] Thus, these assertions mesh with and extend *Dura*'s conclusion that the securities fraud statutes are not meant to "provide investors with broad insurance against market losses, but to protect them against those economic losses that misrepresentations actually cause."[132] In this respect, and as an integral part of this overarching debate, the Court's reasoning was based on economic *loss*, so it seems logical that a prospective *gain* would extend the Court's analysis and yield no remedy for the plaintiffs in *Acticon*.[133]

Additionally, the Second Circuit should have given more credence—if it paid any attention at all—to the plaintiff's damages expert in *In re Veeco*.[134] In that case, the *plaintiff's* damages expert concluded that "[i]f either the inflation or price increased over the holding period for any particular share, that share was not damaged, so the damage for that share is zero."[135] As a result, the court ultimately concluded that any "[p]laintiffs who chose to retain their shares past the point when the stock price first recovered to the value at which the shares were purchased, can prove no economic loss that is attributable to any of the defendants' alleged misrepresentations"—a conclusion that the *In re Veeco* court noted comported with the damages expert's deductions.[136]

Furthermore, the *Acticon* decision seems to stand in contrast to the Court's attempt to narrow Rule 10b-5 in *Dura*. Specifically, the Court seemed to "err[] on the side of preventing valid suits instead of allowing invalid suits."[137] Additionally, "[b]y attempting to prevent

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[129] *Id.* at 43.
[130] *Id.*
[131] *Id.*
[132] *Dura*, 544 U.S. at 345.
[133] *See id.*
[134] *See In re* Veeco Instruments, Inc. Sec. Litig., No. 05-MD-01695(CM)(GAY), 2007 WL 7630569, at *6–7 (S.D.N.Y. June 28, 2007).
[135] *Id.* at *6.
[136] *Id.* at *7.
[137] Matthew L. Fry, *Pleading and Proving Loss Causation in Fraud-on-the-Market-Based*

'largely' groundless suits along with completely groundless suits . . . the Supreme Court appears to provide courts guidance to error on the side of dismissing suits with [tenuous causal connections],"[138] an issue that certainly comes into play when a security's price equals or exceeds a plaintiff's purchase price after the end of the class period.

Finally, the Second Circuit noted, as part of its conclusion, that it was not aware of any federal appellate court or Supreme Court cases that had applied *Malin*'s interpretation of *Dura* and the securities fraud laws to cases where a stock price reached or exceeded a plaintiff's purchase price subsequent to a corrective disclosure.[139] This observation seems overstated, however, as there do not appear to be any federal appellate court or Supreme Court cases that have adopted the Second Circuit's reasoning when applied to an analogous situation. In fact, this was an issue of first impression for the Second Circuit[140]—which includes Wall Street within its jurisdiction—so the lack of support for *Malin*'s reasoning at the federal appellate levels should be neither dispositive nor persuasive. Regardless, for the aforementioned reasons, the Second Circuit has misinterpreted *Dura* and the relevant securities laws, and the district courts' analyses of *Dura* are superior.

B. *The Second Circuit Could Have Exacted a Heightened Pleading Standard on the Plaintiffs for Proving Economic Loss and/or Could Have Constructed Loss Causation Under the PSLRA Differently*

Even if the Second Circuit found the district courts' interpretation of *Dura* unpersuasive, it could have still ruled for the defendants in two ways. First, the court could have required the plaintiffs to plead economic loss and loss causation consistent with

Securities Suits Post-Dura Pharmaceuticals, 36 SEC. REG. L.J. 31, 48 (2008), *available at* http://hayboo.com/files/Publication/e19c0362-4e02-4672-b469-23791b644cfd/Presentation/PublicationAttachment/7f515f2d-d66c-442b-8582280bf1b53360/Pleading%2520and%2520Proving%2520Loss%2520Causation%2520in%2520Fraud-On-The-Market_Based%2520Securities%2520Suits%2520Po.pdf.

[138] *Id.* at 62.

[139] Acticon AG v. China N.E. Petroleum Holdings Ltd., 692 F.3d 34, 41 (2d Cir. 2012).

[140] Jennifer L. Achilles & Sara R. Wolff, *Second Circuit Holds that Stock Price Rebound after Disclosure of Fraud Does Not Negate Inference of Economic Loss at Pleading Stage of Securities Fraud Suit* (Aug. 23, 2012), REEDSMITH.COM, http://www.reedsmith.com/Second-Circuit-Holds-that-Stock-Price-Rebound-after-Disclosure-of-Fraud-Does-Not-Negate-Inference-of-Economic-Loss-at-Pleading-Stage-of-Securities-Fraud-Suit-08-23-2012/.

Federal Rule of Civil Procedure 9(b). Next, the Second Circuit could have construed the term "loss causation" for 10b-5 claims consistently with the PSLRA's definition of loss causation for § 12(a) claims under the Securities Act of 1933 ("the Securities Act"). This section analyzes how both determinations could have affected the outcome of *Acticon*.

1. Heightened Pleading Standard for Economic Loss/Loss Causation

At the outset, the Second Circuit acknowledged in *Acticon* that, "[a]fter *Dura*, it is unclear whether the plaintiffs must satisfy the 'short and plain statement of the claim' standard demanded by Rule 8(a)(2) or the more stringent heightened pleading requirements of Rule 9(b) in pleading economic loss."[141] The court then recognized that it could not find any federal circuit court decisions that addressed heightened pleading for economic loss, but that it had found a few decisions pertaining to the standard for loss causation.[142] Specifically, the Second Circuit noted that the Fourth Circuit had imposed a heightened pleading standard for loss causation, the Fifth Circuit had not, and the Ninth Circuit had found it unnecessary to decide.[143] As a result, the Second Circuit held that "[b]ecause we find that the price fluctuations here would not rebut an inference of economic loss under either standard, we, like the Ninth Circuit, find it unnecessary to resolve this issue at this time."[144]

While the consequences of punting on the heightened pleading standard issue are analyzed in greater depth *infra*,[145] the Second Circuit could have—and perhaps should have—adopted a heightened pleading standard for proving economic loss and loss causation, a determination that would have changed the outcome of the case. The first issue is whether the PSLRA itself requires a heightened pleading standard for these elements. This argument can be dismissed, as the PSLRA explicitly provides that a plaintiff must "state with particularity" the facts surrounding both a material misstatement or omission and state of mind.[146] Thus, one would reasonably expect that if Congress intended to exact a heightened pleading standard for economic loss and/or loss causation, it would

[141] *Acticon*, 692 F.3d at 37.
[142] *Id.* at 38.
[143] *Id.* (citations omitted).
[144] *Id.*
[145] *See infra* Part IV.C.
[146] *See* 15 U.S.C. §§ 78u-4(b)(1)(B), (b)(2)(A) (2010).

have done so in the statute.

Whether the Federal Rules of Civil Procedure necessitate a heightened pleading standard, however, is another matter. For example, in *Ross v. Walton*, the court reasoned that "[b]ecause a claim under § 10(b) involves fraud, [Federal Rule of Civil Procedure] 9(b) requires plaintiffs to plead 'the circumstances constituting fraud' with particularity."[147] This reasoning is persuasive for a few reasons. First, before the PSLRA codified the elements of a § 10(b) claim, those private actions largely resembled common law fraud cases.[148] Second, as part of a plaintiff's *prima facie* case, a plaintiff must still plead *scienter*—a staple of common law fraud cases[149]—with particularity.[150] In that respect, it seems logical to determine that because § 10(b) claims sound in fraud, both traditionally and currently, the Federal Rules of Civil Procedure would require heightened pleading. In fact, this logic is both persuasive and seems to comport with Supreme Court jurisprudence given the emphasis that the Court placed on the similarities between common law fraud and § 10(b) cases in *Dura*.[151]

Alternatively, in *Katyle v. Penn National Gaming, Inc.*, the Fourth Circuit set forth some compelling reasons for why the Federal Rules of Civil Procedure demand a heightened pleading standard for loss causation in 10b-5 cases.[152] Specifically, the Fourth Circuit cited Supreme Court precedent, which noted that, "[p]rior to the enactment of the PSLRA, the sufficiency of a complaint for securities fraud was governed not by [the general pleading standard of] Rule 8, but by the heightened pleading standard set forth in Rule 9(b)."[153] Now, since the PSLRA explicitly provides for a heightened pleading standard for a few elements, the Fourth Circuit reasoned that the statute supersedes Rule 9(b) in those regards.[154] Since the PSLRA was silent as to the rest of the elements, however, the Fourth Circuit

[147] Ross v. Walton, 668 F. Supp. 2d 32, 38 (D.D.C. 2009).

[148] *See* Basic, Inc. v. Levinson, 485 U.S. 224, 253 (1988) ("In general, the case law developed in this Court with respect to § 10(b) and Rule 10b-5 has been based on doctrines with which we, as judges, are familiar: common-law doctrines of fraud and deceit.").

[149] *See* Aaron v. SEC, 446 U.S. 680, 705 (1980) (Blackmun, J., concurring in part and dissenting in part) (noting that common law fraud cases typically require proof of *scienter*).

[150] *See* 15 U.S.C. § 78u-4(b)(2)(A).

[151] Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 343–45 (2005).

[152] 637 F.3d 462, 471–72 n.5 (4th Cir. 2011).

[153] *Id.* at n.5 (quoting Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 319 (2007)).

[154] *Id.*

asserted that the statute does not affect past Supreme Court jurisprudence, meaning that Rule 9(b) still applies to those elements.[155]

In *Dura*, the Supreme Court had the opportunity to clarify the PSLRA's effect on the requisite pleading standard for loss causation, but the Court opted not to, determining that the plaintiffs could not satisfy the pleading standard under either Rule 8 or Rule 9.[156] Given that deduction, the Court assumed, "for *argument's sake*, that neither the Rules nor the securities statutes impose any special further requirement in respect to the pleading of proximate causation or economic loss."[157] Nevertheless, absent further Supreme Court clarification, the Fourth Circuit's interpretation—decided six years after *Dura*—seems the most reasonable. As a result, the Second Circuit, although under no obligation to accept the Fourth Circuit's logic, would have been justified if it had adopted a similar view.

2. An Alternative Construction of the PSLRA Could Have Defeated the Plaintiffs' Complaint in *Acticon*

Although it is unclear whether the defendants in *Acticon* raised the following argument, the defendants could have prevailed on an alternative interpretation of the PSLRA and its definition of "loss causation." The Second Circuit's decision in *Acticon* is premised on economic loss grounds, but, again, for the purposes of this Comment, the two elements go hand-in-hand, since even a plaintiff who can prove economic loss must still show that the defendant's alleged fraud was the proximate cause of that loss.[158]

As to that alternative interpretation, in the petitioner-defendant's brief to the Supreme Court in *Dura*, it argued that, under the principle of uniformity, the Court should consistently apply the PSLRA's definition of loss causation in § 105, which amended and applied to § 12(a)(2) cases under the Securities Act,[159] with the term "loss causation" used in Rule 10b-5 cases.[160] Currently, the difference is that § 105 of the PSLRA provides an affirmative defense to § 12(a)(2) cases if the defendant can prove lack of loss causation.[161]

155 *Id.*

156 *Dura*, 544 U.S. at 346.

157 *Id.* (emphasis added).

158 *See supra* Part II.

159 *See* 15 U.S.C. § 77l(a) (2006).

160 Brief of Petitioners, Dura Pharms., Inc. v. Broudo, 544 U.S. 336 (2005) (No. 03-932), 2004 WL 2075752, at *18–21.

161 *See* 15 U.S.C. § 77*l*(b) (2006).

Under § 105 of the PSLRA, § 12 plaintiffs cannot recover damages if the defendant "proves that any . . . or all of the [recoverable] amount . . . represents [something] other than the depreciation in value of the subject security resulting from [the alleged material misstatements or omissions]."[162] If this definition of loss causation were applied to § 10(b) claims as well, then a defendant could defeat a Rule 10b-5 claim by showing that the security price subsequent to the end of the class period equaled or exceeded the plaintiff's purchase price. Although the Supreme Court did not address this argument in *Dura*, the SEC appears to support this construction, because it argued in its amicus brief to the Court that the PSLRA's definition of loss causation should be consistent for both § 10(b) cases under the Exchange Act and § 12 cases under the Securities Act.[163]

Even if the defendant in *Acticon* did not raise this argument, the Second Circuit could have considered it as part of its overall analysis of the PSLRA. Regardless, this interpretation, which is seemingly supported by the SEC, could be used in the future to defeat the Second Circuit's interpretation and to uphold the five district courts' rulings.

C. *The Consequences of the* Acticon *Decision*

In *Acticon*, the Second Circuit ultimately determined that "[b]ecause we find that the price fluctuations here would not rebut an inference of economic loss under either standard, we, like the Ninth Circuit, find it unnecessary to resolve this issue at this time."[164] This Comment previously discussed why the Second Circuit could or should have adopted a pleading standard for economic loss and loss causation that was consistent with Rule 9(b),[165] but absent such a proclamation, the Second Circuit's decision to abstain from deciding the issue is also problematic for two reasons. First, the Second Circuit's conclusion that the price fluctuations would not have rebutted an inference of economic loss is questionable, and second, its decision to punt on the issue, theoretically, leaves the decision up to the district courts within the Second Circuit.

162 *Id.*

163 Brief for the United States as Amicus Curiae Supporting Petitioners, Dura Pharms., Inc. v. Broudo, 544 U.S. 336 (2005) (No. 03-932), 2004 WL 2069564, at *25–26.

164 Acticon AG v. China N.E. Petroleum Holdings Ltd., 692 F.3d 34, 38 (2d Cir. 2012).

165 *See supra* Part IV.B.1.

By failing to specify a standard, however, one can envision the tension that would arise if a district court within the Second Circuit determined that Federal Rule of Civil Procedure 9(b) applied to a case analogous to *Acticon*, and thus concluded that the plaintiff had failed to sufficiently plead economic loss or loss causation. In this scenario, the district court—perhaps relying on logic similar to that of the Fourth Circuit in *Katyle*—would likely be reversed by the Second Circuit, based on *Acticon*.[166] Thus, one could reasonably argue that the Second Circuit, by passing on the issue, impliedly supported the less stringent pleading standard, suggesting a more plaintiff-friendly approach to 10b-5 cases within the Second Circuit.

Next, the Second Circuit held that Acticon had satisfied the pleading requirements set forth in *Dura*, since it had "alleged something more than the mere fact that it purchased NEP shares at an inflated price; specifically, it allege[d] that the price of NEP stock dropped after the alleged fraud became known."[167] This conclusion seems partly premised on the PSLRA's "bounce back" provision and the average stock price over the ninety days following the final corrective disclosure, but since the "bounce back" provision is a damages *cap*, this conclusion is questionable for a few reasons.

First, it begs the question whether the Second Circuit would find that a plaintiff had met the pleading standard for a § 10(b) claim if the security price rose immediately after the corrective disclosure—for example, the very next day after a corrective disclosure. If that were the case—that an immediate gain would break any causal link between the alleged fraud and any "loss"—then how immediately must the gain occur? In *Acticon*, NEP's stock eclipsed the plaintiffs' purchase price on twelve different occasions, with the first instance occurring as soon as a month after the final corrective disclosure.[168] Following that logic, it seems that a plaintiff could sufficiently plead a § 10(b) claim so long as the stock price did not *immediately* rise after a corrective disclosure. If this analysis overextends the Second Circuit's logic, however, the alternative view seems to be an arbitrary determination of how long after a corrective disclosure a stock price can recover before it falls outside of *Acticon*'s holding—one week? Two weeks? Seemingly not one month, though, or NEP would have

[166] *See generally Acticon*, 692 F.3d 34.

[167] *Id.* at 40.

[168] *In re* China N.E. Petroleum Holdings Ltd. Sec. Litig., 819 F. Supp. 2d 351, 353 (S.D.N.Y. 2011).

prevailed.[169]

Next, the Second Circuit was persuaded to dismiss NEP's motion to dismiss because the plaintiffs had alleged "something more" than the *Dura* plaintiffs, who had merely claimed an inflated stock price;[170] namely, the plaintiffs in *Acticon* had alleged that "the price of NEP stock dropped after the alleged fraud became known."[171] As a result, this seems to suggest that any plaintiff who can both claim that she purchased securities at an artificially inflated price and can point to evidence that the stock price dropped after a corrective disclosure has met the pleading standards. By this logic, though, it seems *too easy* for plaintiffs to meet the pleading standard in an analogous § 10(b) case. To illustrate, while publicly traded companies may occasionally have to issue corrective disclosures, not all of them will be pursuant to nefarious actions by the company.[172] Under a broad interpretation of the Second Circuit's holding, however, all a plaintiff has to do—assuming all other 10b-5 elements are equal—is show that there was both a corrective disclosure and an immediate drop in the stock price. Therein lies a problem, though, because the security in question might have dropped on that particular day for reasons completely unrelated to the corrective disclosure—for example, poor earnings in the relevant quarter from a properly filed form, industry-wide news affecting all relevant stock prices, or the potential merger of the company-in-question's two biggest competitors. As it now stands, however, a corrective disclosure coupled with a drop in stock price seems sufficient to plead economic loss and/or loss causation under *Acticon*.[173] While satisfying the pleading standard in the federal court system is not meant to be an arduous task,[174] *Acticon*'s holding may inevitably lead to more frivolous lawsuits—the very thing that

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[169] *See id.*

[170] *Acticon*, 692 F.3d at 40.

[171] *Id.*

[172] *See* Michael Coffino & Marc Goldich, *To Bundle or Not to Bundle: Public Company Strategies in Packaging Corrective Disclosures in Press Releases* (2008), http://www.adlawbyrequest.com/2008/07/articles/forums/to-bundle-or-not-to-bundle-public-company-strategies-in-packaging-corrective-disclosures-in-press-releases/ (arguing that viewing "corrective disclosures in a vacuum can precipitate a rush to judgment by potential class action plaintiffs or their lawyers . . . to launch a securities fraud class action").

[173] *See Acticon*, 692 F.3d at 40–41.

[174] *See* Ashcroft v. Iqbal, 556 U.S. 662, 678 (2009) (quoting Bell Atlantic Corp. v. Twombly, 550 U.S. 554, 570 (2007)) ("To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible [i.e. not "probable"] on its face.'").

Congress designed the PSLRA to prevent.[175] Additionally, most 10b-5 cases that pass the pleading stage are likely to settle,[176] since, beyond that point, it is probably more cost-effective for the defendant to pay out—even if it has done nothing wrong—rather than engage in what would likely be an expensive discovery process.

V. CONCLUSION

Ultimately, the Second Circuit's decision causes a lot of uncertainty. The five federal district court cases that addressed this issue have all interpreted *Dura* and the relevant securities fraud statutes in a similar way, bringing some clarity. With its holding, the Second Circuit has created confusion in this area of the law, and has given future defendants one less arrow in their quiver with which to defeat these claims before proceeding to the costly stage of discovery. Moving forward, the Supreme Court should clarify a few of the main issues from *Acticon* soon—specifically, whether Federal Rule of Civil Procedure 8 or 9 applies to economic loss and loss causation, and, more importantly, whether a plaintiff is or is not precluded as a matter of law from pleading economic loss or loss causation when her stock price becomes commensurate to her purchase price following a corrective disclosure. Until then, future defendants within the Second Circuit will have to live with a decision that, legally and logically, seems to contravene both the principles of the federal securities laws and past Supreme Court jurisprudence.

[175] *See* Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 313 (2007) (noting that the PSLRA was designed to be "a check against abusive litigation in private securities fraud actions").

[176] *See* Thomas F. Gillespie III, *Dura Pharmaceuticals, Inc. v. Broudo*: *A Missed Opportunity to Right the Wrongs in the PSLRA and Rebalance the Private Rule 10b-5 Litigation Playing Field*, 3 J. BUS. & TECH. L. 161, 174 (2008), *available at* https://docs.google.com/viewer?a=v&q=cache:8qzGRSCUuUMJ:www.law.umaryland.edu/academics/journals/jbtl/issues/3_1/3_1_161_Gillespie.pdf+&hl=en&gl=us&pid=bl&srcid=ADGEESiZ-CLpseVDzbGPkZ3J0WLAXDAihMeUtnGSwpH_MdSHDLJa5OowRd8dxUFo59fDX6lpQqH33RXJcbyaiZ6G_NtB5S2DdiL6HrbwpPBvqGKbCSQJ6J6VFbzcvrfwLxapNuH7Q-bj&sig=AHIEtbS3KIMzZwNUBjdrBUpEiah5N0ayww (remarking that the pleading stage of 10b-5 cases is so important because "so few, if any, Rule 10b-5 cases go to trial").