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Abstract

This Article evaluates the issues remaining open after the recent Supreme Court decision in Dura Pharmaceuticals, Inc. v. Broudo, concerning causation in Rule 10b-5 fraud-on-the-market actions. Analytically, for a positive misstatement to cause an investor to suffer a loss, (1) the misstatement must inflate the market price of a security, (2) the investor must purchase the security at the inflated price, and (3) the investor must not resell the security sufficiently quickly that the price at the time of sale is still inflated. The lower courts have been left the task of designing a comprehensive set of rules concerning what the plaintiff must plead and prove, and the acceptable forms of evidence, concerning each of these critical elements. Dura simply narrowly holds that a plaintiff cannot establish causation merely by pleading and proving that the misstatement inflated price. One important matter on which the Court expresses no opinion is whether loss causation can ever be established where the price at the time suit is brought (or, if earlier, the time of sale) is higher than the purchase price. The Article concludes that a blanket rule against actions where the price has increased would be inappropriate because there are situations where the price has increased but each of the three critical elements can still be reasonably easily and definitively established. Where one or more of these elements cannot be reasonably easily and definitively established, however, a price increase is a negative piece of evidence and under some specified circumstances a bright line rule barring actions might be appropriate. The other important matter on which the Court expresses no opinion is whether the plaintiff must plead and prove a price drop immediately following the unambiguous public announcement of the truth. Again, the Article concludes that a blanket rule requiring such a showing is inappropriate. Other ways of demonstrating that the misstatement inflated price are sufficiently reliable that they should be allowed under at least some circumstances. The absence of a price drop after the announcement, however, makes it less clear when the inflation dissipated, which is relevant to whether the plaintiff bought at an inflated price and did not sell at one. Some plaintiffs can show these other elements reasonably easily and definitively in other ways, for example plaintiffs who purchase the security immediately after the misstatement is made and still hold it at the time of the public announcement of its falsity. For ones who cannot, it may be appropriate to ban actions where there is no post announcement price drop. This problem is less critical for class actions because at least minimum losses to the class as a whole can be established without concern as to when the inflation dissipated.

Keywords: Dura Pharmaceuticals Inc. v. Broudo, inflated price, fraud-on-the-market, rule 10b-5, causation

JEL Classifications: K22, K42

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Understanding Dura

By Merritt B. Fox[*]

On April 19, 2005, the Supreme Court announced its unanimous opinion in *Dura Pharmaceuticals, Inc. v. Broudo,*[1] concerning what a plaintiff must show to establish causation in a Rule 10b-5 fraud-on-the-market suit for damages. The opinion had been awaited with considerable anticipation, being described at the time of oral argument in the *Financial Times,* for example, as the "most important securities case in a decade."[2] After the opinion was handed down, a representative of the plaintiffs' bar lauded it as a "unanimous ruling protecting investors' ability to sue."[3] A representative of the defendant's bar equally enthusiastically hailed it as "a significant victory for public companies and others named as defendants in securities fraud cases."[4]

This Article seeks to ascertain the opinion's real significance. It addresses three basic questions. First, what issues have been definitively decided by the Court and what issues remain open to be decided by the lower courts. Second, to what extent is the reasoning used by the Court reaching its decision useful in determining how these open issues should be resolved. Third, how, from a policy point of view, should these open issues be resolved. As background for these three inquiries, the Article begins with a brief discussion of how, as a general matter, to understand

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

[2] Patti Waldmeir, *Supreme Court to Rule on 'Most Important Securities Case in a Decade,'* FINANCIAL TIMES, January 10, 2005, at 5.

[3] Press release of Lerach Stoia Geller Rudman & Robbins LLP issued April 19, 2005.

[4] Latham & Watkins, *Supreme Court In Dura Pharmaceuticals Unanimously Endorses "Loss Causation" Requirement in Fraud-on-the-Market Cases*, Client Alert 455, April 28, 2005, at 6, *available at* http://www.lw.com/resource/Publications/_pdf/pub1258_1.pdf.

causation in fraud-on-the-market cases generally. There is also a short history of the *Dura* litigation itself.

I. UNDERSTANDING CAUSATION IN FRAUD-ON-THE-MARKET CASES

This article is a sequel to an article that I wrote prior to the Court's decision, published earlier this year in *The Business Lawyer*.[5] The approach to understanding causation in fraud-on-the-market actions developed in the earlier article is useful as well to this post-decision evaluation. The Court's grant of *certiorari* in *Dura* was an opportunity to clear up some highly confusing lower court case law. This confusion had arisen, I argued in the earlier article, because the lower courts had tried to analyze causation in fraud-on-the-market cases using the twin concepts of "transaction causation" and "loss causation." These concepts had been originally developed in connection with causation determinations in cases based on traditional reliance. Traditional reliance-based cases, unlike fraud-on-the-market cases, involve the plaintiff establishing that defendant's misstatement *induced* the plaintiff to enter into what has turned out to be a losing transaction. In such cases, transaction causation was satisfied by the very showing of traditional reliance, i.e., that the plaintiff would not have purchased but for the misstatement.[6] Loss causation in these cases involved, in turn, an additional showing that the purchased security declined in value from what was paid (or was sold at a loss) and that the decline or loss was in some way reasonably related to the falsity of the statement that induced the purchase.[7] The function of the loss causation requirement, like the function of proximate cause in actions for negligence, was to prevent the wrongdoer from being responsible for all the consequences for

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[5] Merritt B. Fox, *Demystifying Causation in Fraud-on-the-Market-Actions*, 60 BUS. LAW. 507 (2005) [hereinafter *Demystifying Causation*].
[6] *See, e.g., Emergent Capital Inv. Mgmt. v. Stonepath Group, Inc.*, 343 F.3d 189, 197 (2d Cir. 2003).
[7] Fox, *Demystifying Causation*, *supra* note 5, at 507. The concepts of transaction causation and loss causation within the context of traditional reliance-based actions is further discussed in my earlier article. *Id.* at 511–13.

which his action was a "but for" cause, i.e., all the losses, however unrelated to the misstatement, that the plaintiff might suffer over time as a result of purchasing this security.

Fraud-on-the-market actions such as *Dura* are very different from traditional reliance-based actions. The plaintiff in a traditional reliance-based action is typically a purchaser involved in either a face-to-face transaction in shares of a non-publicly traded issuer or an IPO. These are the only situations where plaintiffs are likely to be able to show traditional reliance. In such situations, there is no reason to assume that the price is an efficient one. In contrast, plaintiffs in fraud-on-the-market actions such as *Dura* are purchasers in active public secondary markets, where prices can be assumed to be efficient. Fraud-on-the-market actions involve a fundamentally different kind of causal connection between the defendant's misstatement and the plaintiff's injury. The defendant's misstatement injures the plaintiff not because it caused her to make a purchase that later, *ex post*, turned out to be a losing transaction, but because, *ex ante*, it caused her to pay a purchase price that is higher than it would have been but for the misstatement. The purchase is one that she might well have made even if the defendant had not made the misstatement. This causal connection between the misstatement and an injury in the form of its effect on price at the time the plaintiff enters into the transaction was recognized by the Court when it originally approved fraud-on-the-market actions in *Basic v. Levinson*[8] more than fifteen years ago.

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[8] *Basic Inc. v. Levinson,* 485 U.S. 224, 243 (1988) (stating that the fraud-on-the-market theory, based on the idea that a material misstatement will affect the plaintiff's purchase price, provides the plaintiff with an alternative way to demonstrate "the requisite causal connection between a defendant's misrepresentation and a plaintiff's injury."). The rule in *Basic* applies both to suits by secondary market purchasers in cases of falsely positive statements, and to suits by secondary market sellers in cases of falsely negative statements. This Article assumes throughout a suit by a purchaser based on a falsely positive statement. Everything I have to say here about causation requirement in positive misstatement cases would, with the appropriate reversals, apply equally to a suit by a seller based on a falsely negative statement.

The fraud-on-the-market theory's *ex ante* focus on the price at the time of purchase is, for transactions occurring in efficient markets, what is called for by the modern, efficiency-oriented economic thinking that has been the driving force behind the evolution of securities regulation over the last two decades. Efficiency-oriented thinking considers problems from an *ex ante* perspective because its concern is with the law's effect on the structure of incentives of the various actors involved at the time the plaintiff enters into the transaction. Thus it is these actors' expectations at the time of the transaction that matters. Other than the inflation in price due to the misstatement, the efficient market hypothesis ("EMH") guarantees that the purchase price is a fair one because the other factors affecting price in the future are as likely to increase price as decrease it.[9] Thus the injury is the inflation in price at the time of purchase.

The twin concepts of transaction causation and loss causation are reasonably serviceable in helping to determine when causation is, and is not, present in an action for fraud based on traditional reliance. These twin concepts simply do not make sense in an action for fraud based on the fraud-on-the-market theory, however, because of the difference between the two kinds of actions in terms of the causal connections between misstatement and injury. The transaction causation requirement makes no sense in a fraud-on-the-market action since the plaintiff is not required to show that she would not have purchased if the defendant had not made its misstatement. Indeed, often she would have. The typical plaintiff is a member of a class

[9] Stated more precisely, the EMH holds that future returns from holding a security will be priced in an unbiased way given all publicly available information. RICHARD A. BREALEY, STEWART C. MYERS, & FRANKLIN ALLEN, PRINCIPLES OF CORPORATE FINANCE 333-341 (8th ed. 2006). Combined with the capital asset pricing model ("CAPM"), *see Id.* at 188-192, the efficient market hypothesis provides that other factors are as likely to add as to subtract from what would be the price predicted on the basis of the return on a completely safe asset, such as U.S. government bonds, plus a premium reflecting the expected return on an investment in the market as a whole and the systematic riskiness of the issuer's shares. Thus, while the EMH does not stand for the proposition that there will be no long-term growth in share prices on average over time, it says that the ordinary investor cannot on average make profits by trying to pick particular, unusually attractive stocks based on publicly available information.

predominantly consisting of portfolio investors who have made impersonal purchases of shares in the secondary market on the NYSE or NASDAQ and may well not have been aware of the misstatement. Alternatively, the plaintiff may have been an index investor. Even if the plaintiff had been aware of the misstatement and was investing speculatively, the misstatement is unlikely to have been decisive in the decision to purchase, since the misstatement, while making the stock appear more attractive than it really was, would also have made it commensurately more expensive.

The loss causation requirement makes no sense either in the context of a fraud-on-the-market action because the injury – that the plaintiff paid too much – flows *directly* from the misstatement. Requiring the defendant to compensate for such an injury presents no danger of providing compensation for risks unrelated to the misrepresentation because nothing that happens to price after the purchase date matters to the calculation. Thus there is no need for some intervening proximate cause requirement to prevent the defendant from compensating a loss for which its misconduct is a "but for" cause, but which is unrelated in the sense that it did not increase the risk that the plaintiff would suffer the loss.

Abandoning the transaction causation/loss causation framework would have permitted the Court, I suggested in my earlier article, to avoid the confusion exhibited by the lower courts as they struggled to redefine the twin concepts to make them fit the fraud-on-the-market context. By casting this rhetorical baggage aside, the Court could have used the *Dura* case self-consciously to develop standards concerning what an *ex ante* analysis suggests are the two main concerns relating to causation in fraud-on-the-market actions. One main concern involves identifying those situations where a misstatement actually did inflate the purchase price and hence create an injury. Rules are needed concerning what the plaintiff must plead and prove, and the acceptable forms of evidence, concerning this question. The other main concern involves how to prevent damages from being paid to the subset of investors who suffer injury by purchasing shares at a price inflated by the misstatement but who recoup this injury by reselling sufficiently quickly that the price at the time of sale is still equally inflated. Thus rules are also needed concerning who, at the pleading stage and at trial, has the burden of proof on the question of when the market realized the true situation, thereby dissipating the inflation price, and what are the acceptable forms of evidence of the occurrence of such realization.

The design of each of these sets of rules has an impact on the extent to which we achieve two important public policy aims. One aim relates to the desirability of enhancing share price accuracy, in particular by deterring corporate misstatements. The other relates to the desirability of limiting the variety of transaction costs associated with civil litigation, including, but not limited to, the costs associated with strike suits. These two aims are in part conflicting. Good design involves both minimizing these conflicts to the extent possible and then choosing the appropriate place in the inevitable remaining degree of tradeoff between the two aims.

As discussed in more detail below, the Court in its opinion in *Dura* did not abandon the bifurcated transaction causation/loss causation framework for fraud-on-the-market actions and so it was not able to address these two main issues in a fully self-conscious way. Rather, as the lower courts had been doing in various differing ways, the Supreme Court redefined the twin concepts to try to make them fit fraud-on-the-market actions. The Court allowed plaintiffs to satisfy the transaction causation requirement by use of *Basic's* "presum[ption] that the price reflects a material misrepresentation,"[10] in other words a presumption that the price is inflated by the misrepresentation. This is a very different standard than the "but for the misstatement, the

[10] 125 S.Ct. at 1631.

plaintiff would not have purchased" loss causation standard used in traditional reliance-based cases. As for loss causation, the Court ruled that a mere showing that the price has been inflated by the misstatement is not sufficient.[11] The Court was not specific concerning what kind of additional showing would be sufficient.

Although the Court retained the transaction causation/loss causation framework, the approach developed in my earlier article still provides a useful way to conduct the post-decision evaluation being undertaken here. Whatever the legal rhetoric, rules relating to causation are best evaluated in terms of the two main concerns discussed above: how well, and at what cost, the rules (1) identify those situations where plaintiffs have purchased shares at a price that has genuinely been inflated by a misrepresentation, and (2) avoid payment of damages to the subset of such plaintiffs who recoup their injury by reselling sufficiently quickly that the price is still equally inflated.

II. THE HISTORY OF THE *DURA* LITIGATION

Dura involved a class action by plaintiffs who were open market purchasers of defendant Dura Pharmaceutical shares. They alleged that they had been damaged as a result of Dura falsely claiming progress on an asthma medication delivery device that the FDA ultimately found not approvable. The alleged misstatements were made in a series of press releases issued from April 15, 1997 through January 1998. On February 24, 1998, Dura publicly announced that it expected lower-than-forecast earnings, which it attributed to slow sales of one of its current products, Ceclor CD. Dura's share price dropped sharply and the plaintiffs so alleged. In November 1998, Dura publicly announced the FDA finding that the asthma medication device was not approvable.

[11] *Id*.

The plaintiffs did not allege that the November announcement was followed by a price drop.[12] The class consisted of all purchasers of Dura Pharmaceutical shares between April 15, 1997, when the firm reported strong progress selling Ceclor CD as well as the completion of "patient dosing" (a step in the tests needed as part of the FDA approval process for the asthma medication delivery device) and February 24, 1998, the date of the lower-than-forecast earnings announcement.

The district court dismissed the complaint in *Dura* for failure to state a claim, deciding that because the complaint did not allege any relationship between the negative FDA finding and the February price drop, the plaintiff failed to plead "loss causation."[13] The Ninth Circuit reversed, requiring only a "pleading that the price at the time of purchase was overstated and sufficient indication of the cause."[14] The Supreme Court granted *certiorari* on whether, contrary to the Ninth Circuit's position, a plaintiff in a fraud-on-the-market suit such as *Dura* must demonstrate loss causation by pleading and proving a causal connection between the misstatement and a subsequent decline in price.[15] Defendants, in support of their position that such a demonstration was required, cited opinions from other circuits.[16] They were joined in their *certiorari* petition by an amicus brief from the Solicitor General and the Securities and Exchange Commission.

The Supreme Court reversed the Ninth Circuit's judgment. The Court held that a plaintiff cannot establish causation simply by alleging, and subsequently establishing, that the price of the

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[12]The price in fact fell 21%, from $12 3/8 to $9 3/4. Brief for the United States as Amicus Curiae Supporting Petitioners at 2-3.
[13] *In re* Dura Pharms., Inc. Secs. Litig., Civil No. 99CV0151-L (NLLS), 2000 U.S. Dist. LEXIS 15258 (S.D. Cal. July 11, 2000).
[14] *Broudo v. Dura Pharm. Inc.*, 339 F.3d 933, 938 (9th Cir. 2003), *rev'd*, 125 S.Ct. 1627 (2005).
[15] 124 S.Ct. 2904 (2004).
[16] *See, e.g., Semerenko v. Cendant Corp.*, 223 F.3d 165, 185 (3d Cir. 2000); *Robbins v. Koger Properties, Inc.*, 116 F.3d 1441, 1148 (11th Cir. 1997).

security on the date of purchase was inflated because of a misstatement made by the issuer.[17] Since the complaint only alleged that the asthma delivery device misrepresentations resulted in the plaintiffs paying artificially inflated prices for Dura securities and that they suffered damages, the Court concluded that the complaint was legally insufficient and remanded the case.[18]

III. ISSUES REMAINING OPEN

The Court's holding in *Dura* is extremely narrow. It settles only one issue: We now know that a plaintiff who merely alleges, and subsequently establishes, that a positive, materially false misstatement in violation of Rule 10b-5 inflated the price she paid for a security has not done enough to establish causation in a fraud-on-the-market action for damages. The pleadings must provide in addition some indication of the loss and the causal connection the plaintiff has in mind.[19] And proof at trial must provide evidence that the inflated purchase price proximately caused an economic loss.[20] The Court, however, does not specify what kinds of allegations and proofs would be sufficient to meet these standards. Specifically, there are two large open questions. One concerns what constitutes a "loss," specifically whether a plaintiff would ever be allowed to establish that a misstatement caused a loss in a situation where the price at the time suit is brought (or, if earlier, the time of sale) is higher than the purchase price. The second concerns what, for purposes of pleading, would, beyond the allegation that the misstatement inflated the purchase price, constitute a sufficient "indication of the loss and the causal connection" and what, for purposes of proof at trial, would constitute the kind of evidence sufficient to establish that there had been an inflation in price that proximately caused an economic loss. In particular, is it

[17] 125 S.Ct. at 1629.
[18] *Id.* at 1634–35.
[19] *Id.* at 1634.
[20] *Id.* at 1633.

necessary for the plaintiff to plead and prove a price drop immediately following the public announcement of the truth? Or can the pleadings or proof at trial consist of some other kind of indication that the purchase price had been inflated by the misstatement and that the market had later realized the true situation dissipating this inflation?

A. Sale Price Above Purchase Price

Consider the situation where the price at the time of sale (or, if earlier, the time suit is brought) is higher than the price at the time of purchase, but not as high as it would have been had not a misstatement-caused inflation in price dissipated in the interim. In other words, other news in the interim that was relevant to the issuer's future but unrelated to the subject matter of the misstatement was, on balance, sufficiently positive that it pushed the price up more than it had been pushed down by the dissipation of the inflation.

In one sense of the word, the plaintiff has suffered no loss. She sold, or at time of suit would have been able to sell, the share for more than she paid for it. In such a situation, application of the loss causation rule developed in the context of a traditional reliance-based action would bar recovery. This rule required that the purchased security decline in value from what was paid (or was sold at a loss) and that the decline or loss is in some way reasonably related to the falsity of the statement that induced the purchase.[21] This also appears to be the

[21] *See, e.g., Emergent Capital Inv. Mgmt. v. Stonepath Group, Inc.*, 343 F.3d 189, 197 (2d Cir. 2003). The loss causation rule in traditional reliance-based actions and a rationale for its *ex post* perspective for assessing whether a loss has occurred are discussed in more detail in my earlier article. Fox, *Demystifying Causation, supra* note 5, at 511–13.

position urged upon the Court by the defendants in *Dura*, even though *Dura* was a fraud-on-the-market suit, not a traditional reliance-based suit.[22]

In another sense of the word, however, the plaintiff *has* suffered a loss. Assuming that she does not sell before full market realization of the true situation, the defendant's misstatement has made her worse off in an amount equal to its inflation of purchase price. But for the misstatement, she would have paid exactly that much less for the share, yet her return over her period of ownership (however long, and from whatever mix of dividends, distributions and sales proceeds that she receives) would have been just as great.[23] Interestingly, the U.S. government, while arguing in its amicus briefs in *Dura* that the Ninth Circuit ruling in *Dura* should be reversed, took the position that the plaintiff in the situation being considered here has suffered a loss.[24]

The Court explicitly reserved decision on this matter. It did so by first noting that when a share purchaser who claims that his purchase price has been inflated by a misrepresentation later sells at a price below his purchase price, the lower price may be the result of factors unrelated to the misrepresentation, rather than from the dissipation of an inflated price. The Court then went

[22] The question that the defendants successfully sought to have the Court certify was whether a plaintiff in a fraud-on-the-market suit must demonstrate loss causation by pleading and proving a causal connection between the misstatement and a subsequent decline in price. Petition for Writ of Certiorari, *Dura Pharm., Inc. v. Broudo*, No. 03-932, 2003 WL 23146437 (Dec. 24, 2003). *See also,* John C. Coffee, *Loss Causation After 'Dura': Something for Everybody,* NEW YORK LAW JOURNAL (May 20, 2005) at 5.

[23] This statement is somewhat of an over-simplification since it assumes that the misstatement does not enable management to operate the firm in a different way. It is quite possible that the misstatement allows managers more slack and so they run the firm less profitably, or permits managers to obtain more compensation, both actions that would reduce future returns to the plaintiff. Or the misstatement could allow the firm to obtain financing on more favorable terms, thus possibly increasing the value of the firm. Each of these possibilities, however, raises issues of corporate and securities law that differ from the cause of action under study here.

[24] In their briefs, the government makes statements such as "the inflation attributable to the untruth... could also be removed through an increase in price that is smaller than it otherwise would have been," Brief for the United States as Amicus Curiae Supporting Petitioners, *Dura Pharmaceuticals, Inc. et al., v. Michael Broudo, et al* (In the Supreme Court of the United States, No. 03-932) (hereinafter "Amicus Brief for the United States) at 7, and "a price decline may not be a necessary condition for loss causation, however, because the inflation attributable to the fraud could be reduced or eliminated even if there were a net increase in price." Amicus Brief for the United States, *Dura Pharmaceuticals, Inc. et al., v. Michael Broudo, et al* (In the Supreme Court of the United States, No. 03-932) (hereinafter "Cert. Pet. Amicus Brief for the United States") at 13.

on to observe that unrelated factors can also push the sale price above the purchase price, stating: "The same is true in respect of a claim that a share's higher price is lower than it would otherwise have been – a claim we do not consider here."[25]

B. Sufficient Pleadings and Proofs at Trial That the Misstatement Caused a Loss

What constitute sufficient pleadings, and proofs at trial, that defendant's misstatement inflated the purchase price in a way that resulted in a loss to the plaintiff? To see the matters left open by the Court in this regard and the variety of considerations relevant to the task of future courts in shaping definitive rules with regard to these open matters, it is helpful to consider four different situations. In each, a plaintiff purchaser in a fraud-on-the-market action claims that she was injured by a defendant issuer's misstatement. At some point after the purchase, there is an unambiguous public announcement by the issuer that the misstatement was false. For simplicity, assume that suit is brought immediately after the announcement (as soon as the market has had a chance to reflect any reaction to the announcement of the truth).[26] Two other assumptions will be made in this initial discussion of the four situations, which will be dropped in subsequent discussion. One initial assumption is that the plaintiff purchases her shares immediately after the misstatement (as soon as the market has had a chance to reflect any reaction to the original misstatement). The other, to avoid confusion with the other large open question discussed just above, is that in each of the four situations, the purchase price is greater than the share price at the time the suit is brought (and, if the plaintiff sold before the suit was brought, the price at the time of sale as well).

[25] 125 S.Ct. at 1632.

[26] This assumption is made for expositional convenience to avoid needing to describe separately the state of affairs where the plaintiff sells after the public announcement but before the suit is brought from the state of affairs where the plaintiff still holds the shares at the time suit is brought. Any differences in the results between these two states of affairs is not important for points I am making in this discussion.

Ultimately, when the discussion of the remaining open issues in this Part III is complete, the implications of four potentially critical variables will have been considered: was there a significant price drop after the public announcement of the falsity of the misstatement; did the plaintiff continue to hold her shares until after the public announcement; did the plaintiff purchase the shares immediately after the misstatement was made or later; and was the sale price lower or higher than the purchase price. The implications of the fact that most fraud-on-the-market actions are class actions will also be considered.

1. The First Situation: Price Drops Immediately After the Public Announcement of the Truth While Plaintiff Still Holds Shares

In the first situation, the plaintiff still holds the shares at the time suit is brought. She alleges, and proves at trial, that immediately after the announcement of the falsity of the misrepresentation, the price dropped significantly.

There is little doubt that this plaintiff satisfies the Court's requirements under *Dura* concerning causation. The drop in price after the announcement strongly indicates that the misstatement, when made, inflated price. It would simultaneously indicate, consistent with the efficient market hypothesis, that after the announcement, the market realized the true situation, thereby dissipating the inflation in price. The misstatement caused the plaintiff to pay more than she would have otherwise and, because she held her shares until the inflation had dissipated, she did not recoup her injury through a sale at a similarly inflated price. Thus she suffered a loss as a result of the misstatement.[27] Given these considerations, the plaintiff's allegation of the price drop immediately after the announcement of the falsity of the misstatement would certainly satisfy the

[27] I assume throughout this article that the impact on the underlying fundamental value of the issuer's shares of the facts asserted by the misstatement, if these facts were true, would remain constant. See V.C. *infra* for further discussion of this assumption.

Court's requirement that the plaintiff allege "some indication of the loss and causal connection." Proof of this price drop at trial would be a strong indication both that the misrepresentation inflated the purchase price and that the inflation later dissipated before the plaintiff sold, thereby proximately causing a loss.[28]

The question is whether something other than a share price drop immediately following the announcement would satisfy the Court's requirements and, if so, under what circumstances? Some of the circuit court opinions cited by the defendants in *Dura* appear to suggest that nothing else would do,[29] but, as is elaborated just below in the discussion of the second and third situations, there are respectable arguments for allowing submission of a broader range of evidence on the matter and the Court has left this question open.

2. The Second Situation: Price Does Not Drop Immediately After the Public Announcement of the Truth While Plaintiff Still Holds Shares

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[28] Modern corporate finance teaches us that calculations of price drops or increases of this sort should, when possible, be done on an adjusted basis using the market model to take account of the influence of other factors that are simultaneously moving share prices in the market generally. RONALD J. GILSON & BERNARD S. BLACK, THE LAW AND FINANCE OF CORPORATE ACQUISITIONS 194-95 (2d. ed. 1995). While the courts and securities litigants increasingly recognize that price drops and increases should be calculated in this fashion, the practice is far from universal. All of the inferences in the Article that I suggest can be derived from price drops or increases are stronger when they are calculated on a market adjusted basis. Where the plaintiff submits only an unadjusted price change as evidence supporting his claim that the misstatement inflated his purchase price, it is appropriate for the defendant to be able to introduce market adjusted data. If the defendant's data convincingly show that there has been no price change on a market adjusted basis, the inferences suggested here that can be drawn from a price change would be unwarranted. Where the plaintiff does submit to a market adjusted price change as evidence supporting his claim that the misstatement inflated his purchase price, it is also appropriate that the defendant be allowed to introduce any evidence that some other firm-specific event occurred simultaneously that can explain the price movement. The inferences in this Article that I suggest can be derived from price drops or increases assume that the defendant presents no persuasive evidence of this kind. If in fact the defendant does introduce evidence that some other firm-specific event unrelated to the misstatement or its correction explains the price change, then again the inferences suggested here would be unwarranted.

[29] *Semerenko v. Cendant Corp.*, 223 F.3d 165, 185 (3d Cir. 2000); *Robbins v. Koger Properties, Inc.*, 116 F.3d 1441, 1148 (11th Cir. 1997). Each of these cases calls for pleading and proving that there was a causal connection between the misstatement and a subsequent decline in price. It is not clear whether these courts maintain that to establish the causal connection, the decline in price needs to be subsequent to the public announcement of the truth or only subsequent to the original misstatement.

In this second situation, unlike the first, there is no significant price drop immediately after the announcement of the falsity of the misstatement. There is a price drop, however, prior to the announcement. Like the first situation, the plaintiff still holds the shares at the time suit is brought.

In this second situation, the plaintiff should again easily be able to allege and prove that the market realized the true situation. This is because the issuer made an unambiguous public announcement that the earlier misstatement was false. The efficient market hypothesis tells us, therefore, that to the extent, if any, that the misstatement inflated the purchase price, the price after the public announcement was no longer inflated by the misstatement. Thus, to the extent, if any, that the misstatement caused the plaintiff to pay more than she otherwise would have, she did not recoup her injury through a sale at a similarly inflated price. As a consequence, if the misstatement did inflate the purchase price, it caused the plaintiff to suffer a loss.

Did the misstatement in fact inflate the purchase price, however? The fact that there was no negative price reaction after the announcement is unhelpful to the plaintiff's claim, but it does not rule out the possibility that the misstatement inflated the purchase price. This is because the misstatement might initially have inflated the share price but the market may have realized the true situation prior to the public announcement of the truth. Complete market realization of the true situation in this context means that the price is no longer any higher than it would have been if the misstatement had never been made. Prior to an unambiguous public announcement, the operation of one or more phenomena may lead to a complete market realization of the truth. One way is a series of earlier, smaller disclosures by the issuer or others that gradually leads market participants whose actions set price to conclude that the misstatement was false. Another is that the price is pushed back to the level it would have been but for the misstatement as a result of trading by insiders or others based on non-public information or rumors concerning the true state of affairs. Another would be a growing quiet awareness on the part of certain highly sophisticated market participants – arbitrageurs and sell side analysts – that previously publicly-available facts, which for a time had gone unnoticed or seemed unimportant, were in fact inconsistent with the misstatements. Yet another is that the higher earnings or sales in the future that one would have predicted based on the misstatement do not materialize when they should.

The Court's requirements concerning how a plaintiff establishes that a misstatement caused a loss are phrased in terms of what more, beyond an inflation in the purchase price, needs to be pled and proved. The Supreme Court's decision to phrase its requirements in these terms was presumably due to the way, in turn, that the Ninth Circuit opinion in *Dura* phrased its holding. Unfortunately, phrasing its requirements in these terms is likely to lead to new confusion. In the very common situation where the plaintiff still holds the shares after the public announcement of the falsity of the misstatement, the "something more" is the public announcement. As just discussed, where the plaintiff already has clearly established that the misstatement inflated the purchase price, the public announcement is surely enough additional evidence to establish that the plaintiff suffered a loss. Indeed, the only coherent story that the Court tells as to how an inflated purchase price might not lead to a loss is where the investor resells at the still inflated price.[30] The efficient market hypothesis rules out any continuing inflation in price once there has been an unambiguous public announcement of the falsity of the misstatement.

There is thus an irony in the Court's phrasing of its loss causation requirements in terms of what more needs to be established beyond the inflation in purchase price. For a plaintiff who

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[30] *See infra* Section IV.B.

still holds shares at the time of the public announcement, if anything is going to be difficult to establish, it is that the purchase price was inflated, not the "something more." I suspect that in cases such as this second situation, where there is no significant share price drop immediately following the public announcement, the issue of whether the misstatement inflated the purchase price is in fact the one troubling the Court as well. The Court is probably concerned that in many of these cases, there was in fact no loss. The misstatement, although arguably facially material, did not inflate the purchase price and unrelated factors caused the share price drop observed prior to the public announcement.[31]

In some cases resembling this second situation, therefore, the misstatement inflated the purchase price and caused the plaintiff a loss, and in others it did not. That gives rise to a question that will have to be addressed by future courts. Where there is no significant price drop after the public announcement of the truth, what alternative kinds of evidence, if any, will the plaintiff be allowed to introduce in order to establish that the misstatement inflated the purchase price?

The strongest alternative evidence would be a showing that the misstatement itself, when initially made, was immediately followed by a significant price increase. This kind of evidence should be at least as acceptable as a significant price drop at the time of the public announcement of the falsity of the misstatement because it is at least as good a market confirmation of the importance of the misstatement. The problem, however, is that of all the misstatements that do in fact inflate the purchase prices of issuers' shares, probably most are made to avoid disappointing expectations rather than to increase expectations, which means they will not be followed by an immediate significant price increase.

[31] *See infra* Section IV.B.

Thus it is important whether other, less definitive kinds of evidence of purchase price inflation are also acceptable. If less definitive evidence is allowed, it would need to relate to a combination of showings. First, the plaintiff would need to establish that the misstatement was self-evidently important in the sense that if it were considered reliable, it would significantly affect investors' expectations concerning the issuer's future returns. The importance of the statement in this sense is something that could be established, for example, by testimony of analysts or industry experts. Such testimony would tend to be more persuasive if it was empirically supported by studies showing the effect of similar announcements on the share prices of other firms. Second, the plaintiff would need to establish that the misstatement was in fact believed by the participants in the market whose actions set prices. One indication of the extent to which it was believed would be the reactions of analysts or the financial media at the time the misstatement was made. Finally, the plaintiff would have to explain how a claim that the misstatement inflated the purchase price could be consistent with the absence of a price decline immediately after the later public announcement of its falsity. Such an explanation would presumably require the testimony of financial economists or securities market professionals able to point to grounds for believing that by one or more of the other routes discussed above the market was realizing the true situation prior to the public announcement. The more persuasive the first two showings – the self-evident importance of the misstatement and its acceptance as true by the market – the less complete this third showing – the explanation of how the market realized the true situation prior to the public announcement – needs to be for the overall case to be convincing.

Nothing in the Court's opinion in *Dura* rules out use of these other kinds of evidence. Since market realization of the true situation by routes other than a public announcement is not uncommon, allowing submission of these other kinds of evidence will permit actions to succeed in the many cases where the purchase price genuinely was inflated but where there was no negative price reaction immediately after the announcement. On the other hand, because these other kinds of evidence are less reliable than a price drop immediately after the announcement or a price increase immediately after the misstatement, allowing them will also permit more actions to succeed where in fact the misstatement did not inflate the purchase price.

3. The Third Situation: Price Does Not Drop Immediately After Public Announcement of the Truth and Plaintiff Has Sold Shares Earlier

In this third situation, like in the second, there is a price drop prior to the announcement of the falsity of the misstatement but there is no significant price drop immediately after the announcement. Unlike in the second situation, however, the plaintiff sells before the announcement. In this third situation, to prove that the misstatement caused a loss, the plaintiff must both show that the misstatement inflated the purchase price and that his sale occurred after at least partial market realization of the true situation. To establish that the misstatement inflated price, the plaintiff would need to make the same showings with regard to the self-evident importance of the misstatement and its acceptance by the market as true as would the plaintiff in the second situation. The third showing relating to how the market realized the true situation prior to the public announcement of the misstatement's falsity takes on new importance, however. This is because the plaintiff will not only need defensively to explain why the lack of market reaction to the announcement of the falsity of the misstatement does not undermine the plaintiff's other evidence showing the misstatement's importance and acceptance as true, but also must affirmatively show that the realization of the true situation occurred prior to his sale of the shares.

This difference is significant. At least where share price continued to fall after the plaintiff's sale, any weakness in the plaintiff's showing that the decline prior to his sale was due to market realization of the true situation cannot, unlike in the second situation, be compensated for by the strength of his showings relating to the misstatement's self-evident importance and acceptance as true. The plaintiff needs to establish that market realization of the true situation occurred prior to his sale in order to show that he did not recoup his injury through resale at an inflated price. The lack of a significant price drop after the announcement of the falsity of the misstatement despite a strong showing of the self-evident importance of the misstatement and its market acceptance as true may be just as easily explained as the result of a market realization of the true situation after the plaintiff's sale as before. Thus, while again nothing in the Court's *Dura* opinion rules out the acceptability of the kinds of evidence that the plaintiff in this third situation would need to introduce, a presentation of the same evidence by the plaintiff in the third situation would be less reliable as to whether the misstatement really caused the plaintiff economic disadvantage than if the same evidence were introduced by the plaintiff in the second situation. This lower level of reliability provides a rationale for a bright line rule prohibiting a finding of loss causation in cases resembling this third situation but not prohibiting such a finding in cases resembling the second situation. The existence of a rationale does not necessarily mean, however, that such a bright line rule should be adopted. Again, there is the familiar tradeoff involved in adopting such a rule. On the one hand, it prevents the introduction of evidence that is less reliable, and thus it will block actions that otherwise would have succeeded where in fact the misstatement did not cause the plaintiff economic disadvantage. On the other hand, it will also block actions that otherwise would have succeeded where in fact the misstatement did cause the plaintiff economic disadvantage.

4. The Fourth Situation: Price Drops Immediately After the Public Announcement of the Truth But the Plaintiff Sells Earlier

In this situation, like in the first, there is a price drop immediately after the public announcement of the falsity of the misstatement. Unlike in the first situation, but like the third, the plaintiff sells before the announcement. The plaintiff in this situation cannot claim a loss based on the portion of inflation in his purchase price indicated by the price drop at the time of the public announcement. This is because he sold before market realization of this portion of the inflation. Thus the price he received still reflected it, thereby allowing him to recoup this portion of his injury. To prove that the misstatement caused him any loss, the plaintiff must both show that the misstatement inflated his purchase price by more than was indicated by the price drop after the public announcement and that his sale was after market realization of the facts relating to this additional inflation.

This plaintiff's proof problems are therefore essentially identical to the plaintiff in the third situation. He cannot use the price drop after the public announcement to establish that his purchase price was inflated in a way that caused him a loss. He needs to show the existence of some additional inflation that is not indicated by a post-announcement price drop and he needs to show that market realization of the true situation with regard to this additional inflation occurred prior to his sale. As a consequence, future courts face the same range of possible rules concerning what evidence to admit with regard to this fourth situation as they do with regard to the third. Whatever set of rules they choose to deal with one situation should be applied to the other as well.

5. Changing the Four Situations to Reflect a Later Purchase

The four situations assume that plaintiff purchases his or her shares immediately after the misstatement (as soon as the market has had a chance to reflect any reaction). What if the plaintiff purchases after that point, but before the public announcement of the truth? A later purchase may alter the analysis because, to the extent, if any, that the market realized the truth by the time of the purchase, the inflation in the purchase price would be commensurately dissipated, along with the potential loss.

The fact that the purchase was made later should not alter any conclusions with regard to the first situation, where the price drops after the public announcement of the falsity of the misstatement and the plaintiff is still holding her shares. Assuming that the plaintiff is not claiming an inflation in purchase price greater than what is indicated by the price drop after the public announcement, the market clearly had no realization of the true situation until the announcement and therefore not until after the plaintiff's purchase.[32] Her purchase price would have involved the full amount of the inflation caused by the misstatement. Thus the analysis made of the first situation as originally portrayed is equally applicable here and the plaintiff should easily be able to meet the Court's requirements in *Dura* concerning pleading and proving loss causation.

In the second situation, where there is no price drop after the public announcement of the truth and the plaintiff is still holding the shares, the plaintiff needs to prove that the misstatement inflated price by a showing that the misstatement was self-evidently important and was accepted by the market as true. He also needs to reconcile the claim of price inflation with the absence of a price drop after announcement through an explanation of how the market realized the true situation prior to the public announcement. It was observed earlier, in the discussion of the second situation as originally portrayed, that the more persuasive the showings of the self-evident

[32] Such a plaintiff, of course, might well claim there was additional inflation that was not reflected in the price drop after the announcement because the market partially realized the true situation prior to the announcement. This portion of the plaintiff's claim is the same as the claim made by the plaintiff in the second situation and should be treated accordingly by the courts.

importance of the misstatement and its acceptance as true by the market, the less complete the explanation of how the market realized the true situation prior to the public announcement needs to be for the overall case to be convincing. Where the plaintiff makes her purchase later, however, this explanation of how the market realized the true situation takes on independent importance. This is because the plaintiff, to establish that he suffered a loss, needs to show that the market has not already fully realized the situation when he makes his purchase. This change in the second situation, with the plaintiff purchasing later, consequently converts it to one that in this regard resembles the original portrayal of the third situation, where the plaintiff buys right after the misstatement but sells before the public announcement.[33]

Because of this resemblance, the analysis made in the original portrayal of the third situation is equally applicable to this changed version of the second situation. As a consequence, future courts face the same range of possible rules concerning what evidence to admit with regard to this changed version of the second situation, with the plaintiff purchasing later, as they do with regard to the third situation as originally portrayed. Again, whatever set of rules they choose to deal with one should be applied to the other as well.

The same can be said of changing the third and fourth situations to reflect a later purchase by the plaintiff. Whether the plaintiff purchases immediately after the misstatement (as the situations were originally portrayed) or later, the plaintiff's challenges are the same. She must demonstrate the existence of price inflation without the aid of a price drop after the

[33] In the second situation as originally portrayed, I suggested that an alternative way for the plaintiff to demonstrate that her purchase price had been inflated was to introduce evidence that there was a price increase immediately after the misstatement was made. If the plaintiff could successfully show such a price increase, this would be sufficiently convincing evidence of the misstatement inflating her purchase price that she would not need to provide an explanation of how the market realized the true situation prior to the public announcement. With the second situation changed to reflect the plaintiff purchasing later, however, the plaintiff would need to provide such an explanation, in order to show that market realization had not occurred before her purchase.

announcement, and her explanation of how the market realized the true situation takes on importance independent of that demonstration.

6. Class Actions Typically Involve a Mix of These Situations

Most fraud-on-the-market actions are class actions. The typical class is composed of all persons who purchased an issuer's shares from the time of the misstatement to the time of the public announcement of its falsity. Thus it will contain plaintiffs in several of the situations described above. These realities are something that will inevitably need to be considered by future courts as they fashion rules to deal with these situations. These class actions fall into two categories: ones in which the public announcement is followed by a significant price drop and ones in which it is not.

The analysis of class actions where there is a price drop immediately following the public announcement of the truth is very straightforward. Assuming that there is no claim of inflation in purchase price beyond what is indicated by the price drop after the public announcement, the market clearly had no realization of the true situation until the announcement and therefore not until after the purchases by all of the members of the class.[34] For any member of the class still holding the shares at the time the suit is brought, whenever they were purchased, meeting the Court's requirements in *Dura* concerning pleading and proving loss causation should be easy. For the rest of the members of the class, meeting these requirements should be impossible because they sold prior to the announcement and thus recouped all of the claimed inflation.

[34] Similar to the discussion of individual claims in Section III.A.5 *supra*, there might well be a claim that there was additional inflation that was not reflected in the price drop after the announcement because the market partially realized the true situation prior to the announcement. This portion of the claim is the same as the claim in a class action where the public announcement is not followed by an immediate significant price drop and should be treated accordingly by the courts.

The analysis of class actions where the public announcement of the truth is not followed by an immediate significant price decline raises more issues. It is important to stress, however, that for the class as a whole, the proof problems are simpler than in many of the individual claims considered in the situations above. This is because for every *share* purchased at least once between the time of the misstatement and the time of the public announcement, one or more members of the class suffer losses that in the aggregate equal the amount, if any, by which the share's price was inflated at the time of its initial purchase. If the share is purchased only once during the class period, the single purchaser suffers this full loss. If the initial purchaser sells it prior to the end of the class period and the price at the time of her sale is still inflated to one extent or another, she will recoup part or all of her injury. But the second buyer of this share, if he holds until the suit is brought, sustains whatever portion of the loss was not sustained by the first buyer. If there are three or more purchases of the share during the class period, the same process is at work. Whatever portion of the loss is not sustained by the earlier purchasers is sustained by the later ones. Fundamentally, for the class as a whole, the situation is akin to the second situation (where the plaintiff still holds her shares at the time of suit) changed, as discussed above, to reflect that some of the shares purchased during the class period were purchased at a point in time later than immediately after the misstatement.

Probably, however, some members of the class would have purchased immediately after the misstatement and others close enough to that date that if there was any inflation caused by the misstatement, its dissipation was unlikely to have already occurred. As far as the class as a whole is concerned, the shares initially purchased by these class members, even if sold by them prior to the announcement, are more akin to the second situation as initially portrayed, where the individual plaintiff purchases immediately after the misstatement is made and still holds her shares at the time the suit is brought. With regard to these shares, one or more members of the class will in aggregate suffer losses equal to the full amount by which the price was initially inflated by the misstatement. Thus the methods of proving that the class as a whole suffered at least some losses are the same as for the individual claimant in the originally portrayed second situation. One method of proof is to show there was a price increase immediately following the misstatement. If there was no such increase, the other way of showing that the class as a whole sustained at least some losses is to establish that the misstatement inflated price by a showing that the misstatement was self-evidently important and was accepted by the market as true and by reconciling the claim of price inflation with the absence of a price drop after announcement through an explanation of how the market realized the true situation prior to the public announcement. Like the second situation as originally portrayed, to prove that the class as a whole suffered at least *some* damages, the explanation of how the market realized the true situation takes on no independent significance: the more persuasive the showings of the self-evident importance of the misstatement and its acceptance as true by the market, the less complete the explanation of how the market realized the true situation prior to the public announcement needs to be for the overall case to be convincing. As long as it is established that the misstatement inflated price, for each of the shares initially purchased immediately, or soon after, the misstatement was made, one or more members of the class suffered a loss that in aggregate equals the full amount by which the misstatement initially inflated the share price.

C. Combining the Open Questions

I have discussed the two large questions left open by the Court's opinion in *Dura* separately from each other in order to make clear what is at stake with each. Under some circumstances, there is a possible interaction between the two, however. Consider each of the four situations described above as initially portrayed, except with the modification that the purchase price is less than, not greater than, the share price at the time the suit is brought (and, if the plaintiff sold before the suit was brought, than the price at the time of sale as well).

1. Revisiting the First Situation

In the first situation, where the announcement of the falsity of the misstatement is immediately followed by a significant stock price drop and the plaintiff still holds the shares at the time suit is brought, this changed assumption that the price at the time of suit is higher than the purchase price turns out to be unimportant. This is because the significant price drop after the announcement is a very strong indication that the misstatement did inflate the purchase price. The fact that the price after the announcement is still higher than the purchase price does very little to undermine this conclusion since drop after the announcement strongly suggests that the increase before the announcement was due to unrelated factors. Since the plaintiff clearly held the shares until after market realization of the true situation, the misstatement, which inflated her purchase price, unquestionably makes her economically worse off. The case is essentially as strong for providing compensation to the plaintiff in the modified version of the first situation as in the first situation as originally portrayed. Unless the ultimate rule turns out to be that under no circumstances can there be compensation without an *ex post* loss, which I have suggested would be unfortunate, the plaintiff in this modified version of the first situation, with the price at the time of suit greater than purchase price, should still meet the Court's pleading and proof requirements under *Dura* concerning causation.

2. Revisiting the Second and Third Situations

In the second and third situations, however, where there is not a significant price drop after the falsity of the misstatement is announced, the fact that the price at time the suit was brought (or, in the third situation, at the time of sale) was higher than the price at time of purchase weakens the plaintiff's claim that the misstatement inflated the price.[35] In these situations, if the misstatement had in fact inflated the price, the dissipation of the inflation would have needed to occur between the time of purchase and the time of the announcement of the truth (or, in the case of the third situation, the time of sale) and this dissipation would have exerted downward pressure on price. As for the other unrelated influences on price during this period, there is just as great a probability that they too, on a net basis, would have exerted a downward force on price as an upward one. This means that if there was any inflation to be dissipated, the combination of the dissipation of the inflation and the other unrelated influences on price were more likely to be negative than positive.[36] Thus standing alone as a single piece of evidence, the fact that the price at the time of suit or earlier sale is higher than at the time of purchase suggests that it is more likely than not that there never existed any misstatement-caused inflation in the first place. Moreover, the greater the increase in price, the greater the likelihood that there was no inflation from the misstatement.

The fact that the price went up does not, of course, rule out the possibility that there was inflation in price due to the misstatement: as discussed earlier, the other unrelated influences on price might well on a net basis have been positive and enough to more than counterbalance the downward force exerted on price from dissipation of an inflation due to the misstatement. The increase in price is simply, on a probabilistic basis, a negative piece of evidence to be weighed against whatever positive pieces of evidence the plaintiff might present in her efforts to show the self-evident importance of the misstatement and its acceptance as true by the market and to

[35] The exception to this statement is where the price rose immediately after the misstatement was made.

[36] To be more precise, this statement would need to be modified to recognize that these unrelated factors push price up or down from a path that reflects the fact that over the long run share prices on average tend to grow. *See supra* note 27. For relatively short periods of time, such as one or two quarters, however, this growth factor is likely to be small relative to the other factors at work.

explain how the market realized the true situation prior to the public announcement of its falsity. Thus one approach future courts might take is simply to consider all of these positive pieces of evidence offered by the plaintiff and, if they are persuasive enough to overcome the negative inference flowing from the fact that the price went up, find that the plaintiff established that the misstatement inflated price.

Alternatively, the lower courts might construct one of a number of possible simplifying bright line rules triggered by the price at time of suit or earlier sale being higher than the purchase price. The most extreme rule would be, for cases that otherwise resemble the second or third situations, an absolute bar on payment of damages. There exists a rationale for such a bright line rule even if the law develops in a way that permits compensation despite the lack of an *ex post* loss in cases where there is either a significant price drop immediately after the announcement of the truth (i.e. cases resembling the first situation) or a significant price rise immediately after the misstatement. Where the case has neither of these characteristics the plaintiff's case that the misstatement inflated price will have to rest on her showing of the self-evident importance of the misstatement and its acceptance as true by the market and her explanation how the market realized the true situation prior to the public announcement of its falsity. This case is inherently weakened by the fact that the price at the time suit is brought is higher than the purchase price.

A less draconian version of this approach would be an absolute bar to compensation only where the increase in price between time of purchase and time suit was brought (or earlier sale) was substantial relative to past fluctuations in price. Another approach would be to bar compensation unless the plaintiff can establish the existence of unrelated factors that could be expected to increase price by more than he claims the misstatement inflated price.

Again, the usual tradeoff is involved. The more restrictive the rule in terms of what evidence can be introduced, the more cases will be blocked where the misstatement in fact does cause the plaintiff economic disadvantage and the more cases will be blocked where in fact it does not.[37]

3. Revisiting the Fourth Situation

Again assume the price at the time of sale is greater than the purchase price. Consider, with this modification in assumptions, the fourth situation, where the share price drops significantly immediately after the announcement of the truth but where the plaintiff has sold her shares before that point. The analysis is the same as set out just above with regard to the second and third situations under the same modification in assumptions. As discussed earlier, the plaintiff in this situation cannot claim a loss based on the portion of inflation in his purchase price indicated by the price drop at the time of the public announcement.[38] To prove that the misstatement caused him any loss, the plaintiff must both show that the misstatement inflated his purchase price by more than was indicated by the price drop after the public announcement and

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[37] My colleague Professor John Coffee favors a bar of some sort to recovery where the price at the time suit is brought (or, if earlier, at time of sale) is higher than the purchase price. Note 22 supra, at 5. It is unclear, however, whether he favors a blanket bar to all such actions. He may simply favor a bright line rule barring recovery unless there is strong, definitive evidence that the purchase price was inflated in the first place. In other words, he might allow recovery in the first situation, involving a price decrease after the announcement of the truth, or where there is a price rise immediately after the original misstatement, but otherwise bar recovery where the price at time of suit (or earlier sale) is higher than the purchase price.

Coffee's reasoning really only supports the latter, narrower bar. His stated concern is with what the absence of an *ex post* loss says about the likelihood that the price was inflated in the first place, not an insistence that an investor must suffer an *ex post* loss for the investor to have been made economically worse off by a misstatement. Coffee says "Economically, there is little conceptual difference between a price decline because of the discovery of a prior misstatement and a price that does not change because positive and negative news have offset each other." *Id.* at 8. He poses the following hypothetical, however. The share price increases by $5 from time of purchase to time of suit. A plaintiff claims that a misstatement inflated the price by $10 and that the market realization of the truth has dissipated this inflation but at the same time macro-economic news has boosted price by $15. Thus, the $5 price increase is consistent with the plaintiff's claim that the misstatement made him $10 worse off. But it is also consistent with the misstatement having caused no inflation in price and macro economic news boosting price by only $5, in which case the misstatement had no effect on the plaintiff's welfare. The hypothetical, Coffee says, illustrates the danger of "'phantom losses' that have no corroboration in actual market movements." *Id.*

[38] *See supra* Section III.B.4.

that his sale was after market realization of the facts relating to this additional inflation. Thus this plaintiff's proof problems are essentially identical to the proof problems of the plaintiff under this changed assumption in the second and third situations discussed just above. If courts use some kind of bright line rule in these second or third situations, they should use the same bright line rule here.

IV. THE COURT'S REASONING IN DURA

The Court describes the Ninth Circuit holding concerning what a securities fraud plaintiff needs to establish to prove "that the defendant's fraud caused an economic loss" as simply "that 'the price' of the security '*on the date of purchase* was inflated because of the misrepresentation.'"[39] The Court rejects this holding, stating "In our view, the Ninth Circuit is wrong"[40] and concluding "normally ... in fraud-on-the-market cases ... an inflated purchase price will not itself constitute or proximately cause the relevant economic loss."[41] The Court gives a number of reasons for reaching this conclusion. These reasons, when subject to scrutiny, appear to be rather confused and so they unfortunately do not provide much helpful guidance concerning how future courts should decide the open issues delineated above.

A. An Inflated Price Results in No Loss at Time of Purchase

The Court states that "as a matter of pure logic, 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."[42] The Court is thus apparently equating the value of a share at any moment in time as equal to its market price even when that price has been distorted by a misstatement. This rather slippery use of the term "value" is apparently based on

[39] 125 S.Ct. at 1629 (emphasis in the original, citation omitted).
[40] *Id.*
[41] *Id.* at 1631.
[42] *Id.*

the idea that the plaintiff could at the moment of a security's purchase turn around and resell it at the same price as he bought it. Using "value" in this way is contrary to one of the fundamental building block concepts in modern corporate finance, where the "value" of a share means the expected dividends and other distributions, discounted to present value, that the holder or holders of the share, whoever that may be over time, will receive during the life of the issuing firm. Brealey, Myers, & Allen, *supra* note 9, at 61-65. It also ignores that the primary purpose of the securities laws, including its anti-fraud provisions, is to promote economic efficiency and fairness by trying to minimize the gap between price and value as it is understood in this corporate finance sense. The market, with its capacity to digest information possessed by many different participants relevant to predicting what the issuer's future dividends and other distributions will be, is a very powerful appraiser of value, but not when price is distorted by a material misstatement. More accurate share prices, i.e., prices that are closer to their fundamental values, enhance the efficient functioning of our economy by being better signals of where scarce capital should flow and aiding in the mechanisms that provide appropriate discipline and incentives to management. Fairness is also related to minimizing the differences between price and fundamental value. The Court's equating of value with price obscures the fact that while the plaintiff might be able instantly to turn around and sell for the same inflated price that he paid, eventually the truth will come out and eliminate the inflation. Thus someone will be left holding the bag, having paid the premium but not able to resell at the premium.

The Court's use of the term value is odd for a second reason as well. Fraud-on-the-market suits are also available to sellers who sell at a price that has been depressed due to a negative misstatement. It seems unlikely that the Court would say the depressed price that the plaintiff received in such a case equaled the value of the share she gave up because she could have instantly turned around and repurchased the share for the same deflated price. Presumably the Court would recognize that the plaintiff suffered a loss at the time of sale unless she in fact repurchased her shares at that same deflated price before the market realized the true situation. This hypothetical concerning a plaintiff seller and a negative misstatement is completely symmetrical to one involving a plaintiff purchaser and a positive misstatement, and there is no apparent rationale for treating them differently.

The Court's suggestion that a share's value equals its price is also at odds with established securities law when it comes to the calculation of damages. The standard measure of damages in Rule 10b-5 actions, including the Court's own jurisprudence on the matter, is the "out of pocket" measure, i.e., the extra amount that the plaintiff pays at the time of purchase because of the misstatement.[43] This could hardly be an appropriate measure of damages if value equals price at the time of purchase.

B. No Inevitable Link Between an Inflated Share Price and Later Economic Loss

Having dismissed the idea that a loss could occur at the time of purchase, the Court argues that there also might not be a loss later either, saying, "the logical link between the inflated share price and any later economic loss is not invariably strong."[44] In support of this second argument, the Court starts with the observation, "if, say, the purchaser sells the shares quickly before the relevant truth beings to leak out, the misrepresentation will not have led to any loss."[45] It is certainly true, as already discussed, that it would be a mistake to grant damages to such a purchaser. The reason for not granting damages, however, is not that the purchaser did not incur

[43] *Randall v. Loftsgaarden,* 478 U.S. 647, 662 (1986); *Estate Counseling Service, Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 303 F.2d 527, 532 (10th Cir. 1962); LOUIS LOSS & JOEL SELIGMAN, 10 SECURITIES REGULATION 4412–13 (3rd ed. rev. 2004). *See also*, Fox, *Demystifying Causation*, *supra* note 5, at 512–13, 520.
[44] 125 S. Ct. at 1631.
[45] *Id.*

an injury at the time of purchase as a result of defendant's wrongful misstatement; he did suffer an injury by having to pay more than he otherwise would have but for the misstatement. The reason for not granting damages is that the purchaser has received a benefit arising from the same wrong in an amount equal to the injury he suffered earlier. Indeed, a bar on the payment of damages to the extent that the plaintiff recoups his injury by sale at a still inflated price is exactly the Ninth Circuit rule on damages, one set out by Judge Sneed in his concurring opinion in *Green v. Occidental Petroleum Corp.,*[46] which is a standard textbook case on the matter. Thus any implication in the Court's opinion that the Ninth Circuit holding in *Dura* would have led to such a purchaser receiving damages is unfounded.

The Court then goes on to deal with the situation where the purchaser does not sell until after truth has come out:

> If the purchaser sells later after the truth makes its way into the market place, an initially inflated purchase price *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 ... other events.[47]

Here the Court is simply wrong. If the truth makes its way into the market, the initially inflated price *will* inevitably result in a loss. Whether it is the original purchaser of the share or some later one, some investor will be unambiguously economically disadvantaged because the misstatement inflated his purchase price. The investor who purchased the stock when its price was inflated and who is still holding it when the truth comes out will have paid more for the share than he would have but for the misstatement and will not be able to recoup this injury by selling at a similarly

[46] *Green v. Occidental Petroleum Corp.*, 541 F.2d 1335, 1341–46 (9th Cir. 1976).
[47] 125 S.Ct. at 1631–32.

inflated price. This is because efficient market hypothesis, the foundation on which the fraud-on-the-market theory is built, assures us that once the truth comes out, the price will no longer be inflated.

The rationale that the Court provides for its incorrect conclusion involves some odd form of backward reasoning. The issue the Court was purporting to address was not whether every misstatement that at some point later is followed by a price drop inevitably means that the misstatement has caused a loss. That is obviously not true: the misstatement might not have inflated price in the first place and the drop would therefore have to be the consequence of some unrelated factor, not the dissipation of inflation. The issue the Court was purporting to address was whether there is inevitably a loss where price *was* inflated by a misstatement and the truth later came out. The fact that not every price drop is evidence that price has been inflated by a misstatement is irrelevant because the proposition the Court was exploring assumed the price was inflated. While the statement clearly does not logically support the Court's conclusion that price inflation due to a misstatement followed by the truth coming out does not inevitably lead to a loss, it probably does reflect the Court's appropriate concern with the reliability of evidence used to establish that a price was inflated in the first place.

C. The Ninth Circuit Holding Lacks Precedent

The Court also criticizes the Ninth Circuit holding as lack[ing] support in precedent. [48]When past cases are examined carefully, however, there is not very much precedent relevant to what needs to be shown to establish causation in a fraud-on-the-market case. This lack of precedent going either way is hardly surprising given how new the cause of action is. The precedent which does exist is in fact fairly evenly split.

[48] 125 S.Ct. at 1632.

The Court starts by referring to what needs to be shown to establish causation in common law deceit actions.[49] The cases and commentary that it refers to, however, relate to traditional reliance-based actions, since the fraud-on-the-market theory is not a common law doctrine. As discussed in Part I, the causal link between the defendant's wrongful act and the plaintiff's injury is entirely different in a traditional reliance-based action than in a fraud-on-the-market action. Therefore the common law cases on causation provide very little meaningful guidance to the question before the Court. The Court's review of circuit court federal securities law Rule 10b-5 opinions suffers to some extent from a similar problem. Two of the four cases cited, *Emergent Capital Investment Management, LLC v. Stonepath Group, Inc.*[50] and *Bastian v. Petren Resources Corp.,*[51] are traditional reliance-based actions, not fraud-on-the-market actions.

When it comes to actual fraud-on-the-market cases, the Court cites only one case, *Robbins v. Koger Properties, Inc.,*[52] that holds that a showing that the price at the time of purchase was inflated by the misstatement is insufficient to constitute loss causation.[53] And while the Court

[49] *Id.*

[50] 343 F.3d 189 (2d Cir. 2003).

[51] 892 F.2d 680 (7th Cir. 1990).

[52] *Robbins v. Koger Properties, Inc.*, 116 F.3d 1441 (11th Cir. 1997). *Robbins,* which is not a very persuasively argued case, is discussed in more detail in my earlier article. Fox, *Demystifying Causation*, *supra* note 5, at 518–19. The Court in addition cites *Semerenko v. Cendant Corp.,* 223 F.3d. 165 (3d Cir. 2000), which is also a fraud-on-the-market case. 125 S.Ct. at 1632. In *Semerenko* the Third Circuit in *dicta* appears also to reject the inflation theory of loss causation, stating "…that an investor must also establish that the alleged misrepresentation proximately caused the decline in the security's value to satisfy the element of loss causation." 223 F.3d at 185. The *Semerenko* court's concern is that "Where the value of the security does not actually decline as a result of an alleged misrepresentation... the cost of the alleged misrepresentation is still incorporated into the value of the security and may be recovered at any time simply by reselling the security at the inflated price." *Id.* at 185. The court made this statement to suggest that earlier Third Circuit opinions that appeared to adopt the price inflation theory of loss causation might be wrong. What the Third Circuit rule is at this point was not tested by this case, however, since the court found that the complaint alleged that the stock involved "was 'buoyed' by the defendants [sic] alleged misrepresentations, and that it dropped in response to disclosure of the alleged misrepresentations..." *id.* at 186, and so the appellate court would have vacated the district court's granting of defendants' motion to dismiss under either approach.

[53] 125 S.Ct. at 1632.

refers to the "uniqueness" of the Ninth Circuit's perspective on this question,[54] it fails to note that the 8th Circuit had adopted the same rule as the Ninth.[55]

V. RESOLVING THE OPEN ISSUES

This article has identified two large questions left open by the Court's decision in *Dura.* The first is whether a plaintiff would ever be allowed to establish that a misstatement caused a loss in a situation where the price at the time suit is brought (or, if earlier, the time of sale) is higher than the purchase price. The second concerns what, for purposes of pleading, would, beyond the allegation that the misstatement inflated the purchase price, constitute a sufficient "indication of the loss and the causal connection" and what, for purposes of proof at trial, would constitute the kind of evidence sufficient to establish that there had been an inflation in price that proximately caused an economic loss.

A. Price at Time of Suit Higher than Purchase Price

There should not be a blanket rule barring damages in fraud-on-the-market suits where the price at the time suit is brought (or, if earlier, the time of sale) is higher than the purchase price. Such a rule would be a relic carried over without reason from traditional reliance-based actions, where, unlike fraud-on-the-market actions, there is some rationale for a focus on *ex post* losses.[56] In a case where the price at the time of suit is higher than the purchase price, but where it is clear that the misstatement inflated the plaintiff's purchase price and that she has not recouped her injury through a sale at an equally inflated price, the defendant's misstatement has unquestionably made her worse off in an amount equal to its inflation of purchase price. But for the misstatement,

[54] *Id.*
[55] *Knapp v. Ernst & Whinney*, 90 F.3d1431, 1438 (9th Cir. 1996); *Gebhart v. ConAgra Foods, Inc.,* 335 F.3d 824, 831 (8th Cir. 2003).
[56] The rationale for the *ex post* focus of traditional reliance-based actions is discussed in my earlier article. Fox, *Demystifying Causation*, *supra* note 5, at 511–13.

she would have paid exactly that much less for the share, and received in return the same share with the same value. A rule prohibiting compensation in such a case would result in a lack of balance in outcomes depending on whether, after the purchase, other news affecting the fortunes of the issuer is positive or negative. Investors would have to suffer the full downside risk associated with bad news. They would not be able, however, to enjoy fully the upside risks associated with good news, because any such gains would cancel out, where present, their otherwise valid cause of action for damages from a misstatement that inflated their purchase price. This lack of balance in outcomes is not only arbitrary, it is inefficient. It distorts incentives for investors who seek to profit through hard work by anticipating, ahead of the market, both good and bad news events. Such activities are socially useful because they help improve the accuracy of share prices.[57]

Where it is not clear whether a misstatement inflated an issuer share price in the first place, whether the inflation was still present when the plaintiff purchased, or whether it had dissipated prior to the plaintiff's sale, then the fact that price at the time suit is brought (or, if earlier, the time of sale) is higher than the purchase price has some probative value. At a minimum it is evidence that should be weighed against the other evidence that the plaintiff introduces with regard to these questions. Moreover, as discussed in Part III, there is a rationale for bright line rules triggered by this fact that would bar damages under some circumstances. In deciding how compelling the rationale is for adopting any such bright line rule, however, the lower courts should bear in mind that the arbitrariness and inefficiencies that would result from a blanket rule that never allows recovery when the price at time of suit (or earlier sale) is greater than the purchase price would still to some extent be present as well with more narrowly tailored

[57] This issue is explored in more detail in my earlier article. *Id.* at 521–22.

bright line rules applicable in only certain situations because such rules are bound to cut out some cases where in fact the misstatement did inflate the price.

B. Sufficient Pleadings and Proofs at Trial That the Misstatement Caused a Loss

A threshold question is whether it is necessary for the plaintiff to plead and prove a price drop immediately following the public announcement of the truth. The preceding discussion suggests that such a requirement, while it has a rationale, would be too strict and that the plaintiff should be able to introduce at least some other kinds of evidence showing that the purchase price had been inflated by the misstatement and that the market had later realized the true situation thereby dissipating this inflation. To start, an immediate significant increase in share price following a misstatement is as good evidence that the misstatement inflated price as a significant price drop following a public announcement of the falsity of the misstatement. Even if there is no price drop following the public announcement, a plaintiff who purchased right after such a misstatement was made and was still holding after the public announcement is very likely to have suffered a loss. The share price increase after the misstatement was made is a very strong indication that it inflated the plaintiff's purchase price. The public announcement while she is still holding the shares assures that the inflation has fully dissipated and that she cannot recoup her injury by a resale at the inflated price.

Limiting recovery to cases where there is either a price drop after the public announcement or an increase at time the misstatement is made has an attractive simplicity. Nevertheless, there are good arguments for allowing a plaintiff to submit less definitive kinds of evidence at least under some circumstances. Market realization of the true situation by another route in advance of an unambiguous public announcement of the falsity of a misstatement is not uncommon and so many price inflating misstatements would not be actionable if less definitive evidence were prohibited. I have discussed in Part III plausibly available kinds of evidence that could be quite persuasive as to importance of the misstatement, its acceptance as true by the market, and how the market realized the true situation prior to the public announcement. I also suggested that in the typical class action, at least a portion of the shares were purchased at time of misstatement or close enough to it that dissipation of any inflation was unlikely to have occurred. As far as damages owed to the class as a whole is concerned, these shares are like the shares of persons in the second situation discussed in Part III, who purchased right after the misstatement and still held the shares at the time suit was brought, which is after the inflation, if any, was fully dissipated. Thus, if the lawyers for the class can make a persuasive argument that there was an initial inflation of price, then clearly, in the aggregate, members of the class suffered losses as the result of the misstatement regardless of the time and rate of dissipation of the inflation between the making of the misstatement and the public announcement.

If less definitive kinds of evidence are allowed, the pleading standards need to be carefully thought through. The Court stated that ordinary pleading rules are not meant to impose a great burden upon a plaintiff but that it should not prove burdensome ... to provide a defendant with some indication of loss and the causal connection that the plaintiff has in mind.[58] Perhaps a bit more ominously for plaintiffs, it also said it would “assume, at least for argument’s sake, that neither the Rules [of Civil Procedure] nor the securities statutes impose any special further requirement” beyond the Federal Rules of Civil Procedure Rule 8(a)(2) requirement of “a short and plain statement of the claim showing that the pleader is entitled to relief.”[59] Ultimately, though, whether this standard is met depends on the contours of what needs to be proved at trial.

[58] 125 S. Ct. at 1634.
[59] *Id.*

The pleading with respect to the importance of the misstatement should be satisfied if it is facially material. In essence, the Court already accepted this idea when it blessed the fraud-on-the-market theory in *Basic.* Evidence concerning the acceptance of the misstatement as true should be available to plaintiffs without discovery and so requiring specific allegations with respect to this matter would not necessarily be very burdensome. Evidence supporting an explanation of how the market realized the true situation prior to the unambiguous public announcement may be more difficult to obtain. Moreover, as we have seen, for some plaintiffs – ones who bought right after the misstatement was made and were still holding their shares when suit is brought – and for class action lawyers showing that at least some damages are owed to the class, a persuasive showing of the importance of the misstatement and its acceptance as true by the market can substitute for a complete explanation of how the market realized the true situation. Thus, at least in these kinds of cases, a requirement of specific allegations with regard to this explanation seems unwarranted.

C. The Assumption of Constant Impact

I assume throughout this Article that the facts asserted by the misstatement would, if they had been true, have had a constant impact on the underlying fundamental value of an issuer's shares. For many kinds of misrepresentations, this assumption is a reasonably close approximation of reality. To illustrate, consider issuer A, with 5 million shares outstanding, that falsely stated that it had an extra $60 million in cash in its treasury. If the issuer had really had this $60 million in cash in the treasury at the time of the original misstatement, the fundamental value of each share would have been increased by $12. The same would be true if the issuer had really had this $60 million in the treasury at the time of the announcement of the truth.

For other kinds of misstatements, this assumption of constant impact is not a reasonable approximation of reality. To illustrate this second kind of misstatement, consider issuer B, also with 5 million shares outstanding, that falsely stated that it had an extra one million barrels of oil in storage. If the issuer had really had this one million barrels of oil at the time the misrepresentation was made and the price of oil was $60, the fundamental value of each share would again have been increased by $12. Suppose, though, that between the time of the misstatement and the time when the truth was announced, the price of oil decreased to $50 per barrel. By the time of the announcement of the truth, then, if the issuer had really had this one million barrels of oil in storage, the fundamental value of each share would have been increased by only $10. Thus the impact of the facts asserted by the misstatement on the underlying fundamental value of an issuer's shares, which remained constant in the first example, dropped by $2 in the second example.

I employ the constant impact assumption because, despite its deviation from reality with regard to this second type of misstatement, it simplifies the discussion of the most important issues related to loss causation without serious loss of generality. For some kinds of cases, the lack of reality in the assumption has no impact at all on the analysis. Consider again the misstatements by issuer A and issuer B in the context of cases resembling the first or second situations discussed in Part III, where an investor buys immediately after the misstatement and holds the shares until after the public announcement of the truth. An investor who buys a share of A pays $12 more per share than he would have but for A's misstatement, and the same is true of an investor who buys a share of B.[60] As a consequence, the misstatement caused each of the investors a $12 loss. This is because each paid $12 too much and each did not recoup any of this loss by selling at a price that was to any extent still inflated by the misstatement.

[60] In each, for purposes of expositional convenience, I am assuming that the market fully believes the misstatement at the time it is made. This assumption is not necessary for the point to hold.

Where an investor purchases later than immediately after the misstatement and/or sells before the market fully realizes the true situation, the assumption of constant impact may be more problematic, but it still has a rationale. This is because the EMH guarantees that the impact of the facts asserted by the misstatement on the underlying fundamental value of an issuer's shares at the time of the misstatement is an unbiased estimate of this impact at any point in the future as well. In other words, the value that the market would assign to each share of B at the time of the misstatement reflects both the chance that the price of oil in the future might go up and the chance that it might go down. As a consequence, it would not be unreasonable to have a rule that there is no loss in the case of an investor in our example who purchased a share of B immediately after the oil misstatement, when, if fully believed, it inflated the price by $12, and who sold shortly before the announcement of the truth, when, if the misstatement was still fully believed, it only inflated the price by $8. The value the market assigned to this nonexistent oil at the time of the investor's purchase reflected the possibilities both that the price of oil might go up, which at time of sale would have resulted in a share price inflation of more than $12, as well as might go down. Thus, it can be argued, while the misstatement is a but for cause of the $2 shortfall, it is not a proximate cause. This is because at the time the investor purchased the share, the misstatement, if the investor were to sell before market realization of the truth, was as likely to have resulted in a gain from an increase in the amount the misstatement inflates price as to have resulted in a loss from a decrease in the amount the misstatement inflates price. Under this argument, it is the decrease in the price of oil, not the issuer's misstatement, that is the legal cause of the $2 shortfall.

Dura does not decide whether an economic disadvantage at time of sale arising out of a fall in the underlying value of a falsely claimed asset, such as this $2 shortfall, should be considered a loss caused by the misstatement. Cases may arise, of course, that require resolution of this question, but beyond my observation that a reasonable argument could be made that such a shortfall should not be considered a loss, I do not pursue the issue further here. The constant impact assumption helps us keep our focus on what I believe are the two most important questions for loss causation – did the misstatement inflate price in the first place and has the inflation dissipated by time of sale – questions that are involved in every fraud-on-the-market case.

VI. CONCLUSION

This Article has evaluated the issues remaining open after the Court's decision in *Dura*. Analytically, in an action for damages based on the fraud-on-the-market theory, for a positive misstatement to cause an investor to suffer a loss, (1) the misstatement must inflate the market price of a security, (2) the investor must purchase the security at the inflated price, and (3) the investor must not resell the security sufficiently quickly that the price at the time of sale is still inflated. *Dura's* narrow holding is that a plaintiff cannot establish causation merely by pleading and proving that the misstatement inflated price. Future courts have thus been left the task of designing a comprehensive set of rules concerning what the plaintiff must plead and prove, and the acceptable forms of evidence, concerning each of these critical elements. I have tried to suggest a number of considerations that can help them do that in a way that minimizes the conflict between the two important social aims of deterring corporate misstatements and limiting the transaction costs associated with civil litigation.

One important matter on which the Court expresses no opinion is whether loss causation can ever be established where the price at the time suit is brought (or, if earlier, at the time of sale) is higher than the purchase price. This Article concludes that a blanket rule against actions where the price has increased would be inappropriate because there are situations where the price has increased but each of the three critical elements can still be reasonably easily and definitively established. Where one or more of these elements cannot be reasonably easily and definitively established, however, a price increase is a negative piece of evidence concerning whether the misstatement inflated price, and under some specified circumstances a bright line rule barring actions when price has increased might be appropriate.

The other important matter on which the Court expresses no opinion is whether the plaintiff must plead and prove a price drop immediately following the unambiguous public announcement of the truth. Again, the Article concludes that a blanket rule requiring such a showing is inappropriate. Other ways of demonstrating that the misstatement inflated price are sufficiently reliable that they should be allowed under at least some circumstances. The absence of a price drop after the announcement, however, makes it less clear when the inflation dissipated, which is relevant to whether the plaintiff both bought at a time when the price was still inflated (if it even was inflated) and sold at a time when it was no longer inflated. Some plaintiffs can show these other two elements reasonably easily and definitively, for example plaintiffs who purchase the security immediately after the misstatement is made and still hold it at the time of the public announcement of its falsity. For plaintiffs whose purchase and sale timings do not fit this profile, it may be appropriate to bar actions where there is no post announcement price drop. This problem is less critical for class actions because at least minimum losses to the class as a whole can be established without concern as to when the inflation dissipated.

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