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Litigation | Securities Litigation & Enforcement | December 18, 2014

Ninth Circuit Court of Appeals Raises Pleading Standard for Securities Fraud Actions

By Bruce A. Ericson

Since the Supreme Court's Dura Pharmaceuticals *decision in 2005, courts of appeals have split as to what a party must do to plead loss causation—an element of a claim under SEC Rule 10b-5. Some courts have held that a party need only satisfy the notice pleading standard in Federal Rule of Civil Procedure 8. Other courts have held that a party must plead loss causation "with particularity" to satisfy Federal Rule of Civil Procedure 9(b). The Ninth Circuit has now joined the latter group, holding that loss causation—and indeed all elements of a 10b-5 claim—must satisfy the more exacting Rule 9(b) standard.* Oregon Public Employees Retirement Fund v. Apollo Group Inc.*, No. 12–16624, 2014 WL 7139634 (9th Cir. Dec. 16, 2014).*

Background

Dura Pharmaceuticals, Inc. v. Broudo, 544 U.S. 336 (2005) is the leading opinion on loss causation. But it expressly left undecided the standard governing the pleading of loss causation, assuming instead for purposes of that decision that "a short and plain statement" (Fed. R. Civ. P. 8) would suffice. *Dura*, 544 U.S. at 346.

Since 2005, federal courts have struggled to answer the question that *Dura* left open. The Fifth Circuit concluded that Rule 8 applies. The Fourth and Seventh Circuits concluded that Rule 9(b) applies. The First Circuit—and, until now, the Ninth Circuit—ducked the issue. And the Second Circuit developed a two-part standard of its own grounded in neither rule.

The *Oregon Public Employees* Decision

Now the Ninth Circuit has cast its lot with the Fourth and Seventh Circuits, holding that the higher Rule 9(b) standard applies to allegations of loss causation and indeed to all elements of a 10b-5 claim. In so ruling, the court gave three reasons. First, 10b-5 is derived from common-law fraud, and Rule 9(b) has been held to cover all elements of a common-law fraud claim. Second, the text of Rule 9(b) itself suggests this result.

The rule requires a claimant to "state with particularity the circumstances constituting fraud or mistake." Loss causation is part of the "circumstances." Third, this approach creates a consistent standard for all elements of a 10b-5 claim, "rather than the piecemeal standard adopted by some courts." 2014 WL 7139634, at *4.

Consequences of the Decision

Motions to dismiss play a key role in securities fraud litigation. NERA Economic Consulting, in its review of securities class actions developments in 2013, noted that such motions are filed in over 90 percent of all cases. Often such motions are not merely the main event, but the only event: if the defendants do not win the motion, often they pull out their checkbooks and settle. Thus, anything affecting the odds of success on such motions is of keen interest both to defendants and to plaintiffs. Choice of a pleading standard thus looms far larger than it would in other kinds of litigation, where the motion to dismiss may just be the first act in a much longer drama.

In addition, courts increasingly question whether some alleged frauds really have hurt anyone. Many things move markets; the link between an alleged corrective disclosure and a stock-price movement is not always clear. This concern may have animated the Supreme Court's decision in *Halliburton Co. v. Erica P. John Fund, Inc.*, 134 S. Ct. 2398 (2014) to allow evidence rebutting the fraud-on-the-market presumption underpinning most class certification motions. To be sure, *Halliburton* rose in a different context: the element was reliance, not loss causation, and the motion was for class certification, not to dismiss. Nonetheless, *Halliburton* and cases since *Halliburton* suggest some increased judicial receptivity to early-stage challenges to the linkage between the alleged fraud and the alleged harm. If so, the rule in *Oregon Public Employees*, by raising pleading standards, will assist defendants in mounting such challenges.

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