

18.8 Securities—Causation

The plaintiff [*name*] must prove by a preponderance of the evidence that the alleged material misrepresentations or omissions were the cause of [his] [her] [*other pronoun*] economic injury. To establish economic injury or loss, the plaintiff must prove that the alleged misrepresentation[s] or omission[s] artificially inflated the price of the security. To establish causation, the plaintiff [*name*] must prove that the alleged misrepresentation[s] or omission[s] played a substantial part in causing the injury or loss the plaintiff [*name*] suffered. The plaintiff [*name*] need not prove that the alleged misrepresentation[s] or omission[s] [was] [were] the sole cause of the economic injuries.

Comment

The Private Securities Litigation Reform Act of 1995 ("PSLRA") imposed the requirement that a private plaintiff prove that the defendant's fraud caused an economic loss. 15 U.S.C. § 78u-4(b)(4). This element of causation has been referred to as "loss causation," *i.e.*, a causal connection between the material misrepresentation and the loss." *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 342 (2005); *see also In re Genius Brands Int'l, Inc. Sec. Litig.*, 97 F.4th 1171, 1183 (9th Cir. 2024) ("[I]n the end, loss causation is simply a variant of proximate cause, [and] the ultimate issue is whether the defendant's misstatement, as opposed to some other fact, foreseeably caused the plaintiff's loss."). In *Dura*, the Supreme Court held that the PSLRA "makes clear Congress' intent to permit private securities fraud actions for recovery where, but only where, plaintiffs adequately allege and prove the traditional elements of causation and loss." 544 U.S. at 346. The Supreme Court reversed the Court of Appeals' ruling that a plaintiff may establish loss causation if the plaintiff merely shows that the price paid on the date of purchase was inflated because of the defendant's misrepresentation. *Id.* at 338. The Supreme Court held that a plaintiff's mere purchase of stock at an inflated price is not sufficient to establish loss causation for a number of reasons, such as that at the moment of purchase the plaintiff has suffered no loss because the inflated price paid is offset by the value of the shares he or she acquired, which at that instant possess equivalent market value. *Id.* at 342-43. Also, the purchaser could later sell those shares at a profit. Conversely, if the price drops, the cause of the decline could be attributable to a host of factors other than that the stock price previously had been inflated as a result of the defendant's misrepresentation or omission. *Id.* at 343. The Court held that under the plaintiff's theory of liability, the complaint failed adequately to allege causation because it did not allege that the defendant corporation's share price fell significantly after the truth became known, did not specify the relevant economic loss, and did not describe the causal connection between that loss and the misrepresentation. *Id.* at 346-48.

Still, the Ninth Circuit has held that "loss causation begins with the allegation that the defendant's misstatements (or other fraudulent conduct) artificially *inflated* the price at which the plaintiff purchased [the] share." *In re BofI Holding, Inc. Sec. Litig.*, 977 F.3d 781, 789 (9th Cir. 2020). In *Genius Brands*, the court emphasized that initial price inflation and initial price

increase are not the same and that while a price increase following the fraudulent conduct is one way to demonstrate that the price is higher than it would have been, it is not the only way. 97 F.4th at 1185. Indeed, as the court noted, inflation can be shown by plausibly alleging that the price remained stable but would have gone down if the misstatement had not been made. *Id.* Similarly, where the price dropped, a plaintiff can allege that the drop would have been more significant had the misstatement not been made. *Id.* In either case, the court explained, “the plaintiff would plausibly allege that the stock’s price was higher ‘than it would have been had the false statements not been made,’ even though the misstatements did not increase the stock’s price.” *Id.* (quoting *BofI Holding*, 977 F.3d at 789).

The Ninth Circuit has stated that “[t]ypically, ‘to satisfy the loss causation requirement, the plaintiff must show that the revelation of that misrepresentation or omission was a substantial factor in causing a decline in the security’s price, thus creating an actual economic loss for the plaintiff.’” *Nuveen Mun. High Income Opportunity Fund v. City of Alameda*, 730 F.3d 1111, 1119 (9th Cir. 2013) (quoting *McCabe v. Ernst & Young, LLP*, 494 F.3d 418, 425-26 (3d Cir. 2007)). While “an outright admission of fraud” is not required, “a mere ‘risk’ or ‘potential’ for fraud is insufficient to establish loss causation.” *Loos v. Immersion Corp.*, 762 F.3d 880, 888-89 (9th Cir. 2014) (quoting *Metzler Inv. GMBH v. Corinthian Colls., Inc.*, 540 F.3d 1049, 1064 (9th Cir. 2008)) (holding that the revelation of an investigation, on its own, amounts only to notice of the potential disclosure of fraudulent conduct and thus does not satisfy the causation element of § 10(b) and Rule 10b-5 claims). However, “[d]isclosure of the fraud is not a sine qua non of loss causation, which may be shown even where the alleged fraud is not necessarily revealed prior to the economic loss.” *Nuveen*, 730 F.3d at 1120. Accordingly, “a plaintiff can satisfy loss causation by showing that ‘the defendant misrepresented or omitted the very facts that were a substantial factor in causing the plaintiff’s economic loss.’” *Id.* (quoting *McCabe*, 494 F.3d at 425). For example, in *Livid Holdings Ltd. v. Salomon Smith Barney, Inc.*, 416 F.3d 940, 949 (9th Cir. 2005), the Ninth Circuit held that loss causation was sufficiently alleged when the plaintiff alleged that the very facts concealed by the defendants—facts concerning the company’s dire financial situation—resulted in its going bankrupt, which caused the plaintiff to lose the entire value of its investment in the company. *See also id.* at 949 n.2 (concluding that *Dura* did not require the plaintiff to allege corrective disclosure because the plaintiff alleged a “private sale of privately traded stock and . . . not only asserted that it purchased the security at issue at an artificially inflated price, but pled that the [d]efendants’ misrepresentation was causally related to the loss it sustained”); *Wochos v. Tesla Motors, Inc.*, 985 F.3d 1180, 1198 (9th Cir. 2021) (upholding dismissal with prejudice when a modest stock price drop quickly rebounded because “[t]o adequately plead loss causation . . . a plaintiff must allege that the ‘share price fell significantly after the truth became known’” (quoting *In re Oracle Corp. Sec. Litig.*, 627 F.3d 376, 392 (9th Cir. 2010))). “To establish loss causation in a fraud-on-the-market case, the plaintiff must show that after purchasing her shares and before selling, the following occurred: (1) ‘the truth became known,’ and (2) the revelation caused the fraud-induced inflation in the stock’s price to be reduced or eliminated.” *In re BofI Holding, Inc. Sec. Litig.*, 977 F.3d at 789 (quoting *Dura*

Pharms., Inc., 544 U.S. at 347). A plaintiff may prove that “the truth became known” by identifying one or more “corrective disclosures.” *Id.* at 790. “A corrective disclosure occurs when ‘information correcting the misstatement or omission that is the basis for the action is disseminated to the market.’” *Id.* (quoting 15 U.S.C. § 78u-4(e)(1)); *see also Grigsby v. BofI Holding, Inc.*, 979 F.3d 1198 (9th Cir. 2020) (holding that a news article with information from a FOIA request can be corrective disclosure, but an internet article with publicly available information from a whistleblower was not a corrective disclosure). The Ninth Circuit offered guidance on what constitutes a corrective disclosure in *In re BofI Holding, Inc. Securities Litigation*, 977 F.3d at 790, explaining that “a corrective disclosure need not consist of an admission of fraud by the defendant or a formal finding of fraud by a government agency”; rather, it may “come from any source, including knowledgeable third parties such as whistleblowers, analysts, or investigative reporters.” *Id.* A corrective disclosure also “need not reveal the full scope of the defendant’s fraud in one fell swoop; the true facts concealed by the defendant’s misstatements may be revealed over time through a series of partial disclosures.” *Id.* A corrective disclosure “need not precisely mirror the earlier misrepresentation,” as it “is enough if the disclosure reveals new facts that, taken as true, render some aspect of the defendant’s prior statements false or misleading.” *Id.* (citations omitted). Against this backdrop, the Ninth Circuit rejected the district court’s conclusion that, “to adequately plead loss causation, the shareholders had to identify an additional disclosure that confirmed the truth of [the] allegations” in the corrective disclosure. *Id.* at 792. Rather, the court noted that “short of an admission by the defendant or a formal finding of fraud—neither of which is required—any corrective disclosure will necessarily take the form of contestable allegations of wrongdoing.” *Id.* (citations omitted). Although the “plaintiff must, of course, prove that the defendant’s misstatements were false, . . . that can be done through proof other than the corrective disclosure itself.” *Id.*

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