Fraud Litigation after *Dura*, *Stoneridge* and *Tellabs*: Swimming Upstream?

N. Peter Rasmussen, J.D.
CCH Senior Writer-Analyst

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Introduction

As stock prices tumble across the board, investors may seek to recover their losses in class action litigation against issuers and other parties. However, recent decisions from the federal circuit courts suggest that significant obstacles now hinder the road to recovery.

In order to recover, plaintiffs must plead and prove, among other elements, that the defendants acted with fraudulent intent (scienter) and that their actions caused the plaintiffs' financial losses. As to scienter, courts have long recognized that it is not sufficient merely to claim that individual defendants were senior officers of a company. However, recent circuit court cases have reached different conclusions on the question of whether an inference may be drawn that senior management must be aware of matters involving the company's "core operations," including any fraudulent conduct, and whether "collective scienter" may be actionable in the absence of a sufficient inference of scienter attributable to a particular individual.

Plaintiffs must also show that the alleged unlawful conduct caused their financial losses. The question of loss causation becomes more challenging in a rapidly declining market, as investors can find it difficult to attribute stock price declines to company-specific fraud rather than general market conditions. Pleading loss causation has become more complex in the aftermath of the U.S. Supreme Court's 2005 decision in *Dura Pharmaceuticals, Inc. v. Broudo* (2005 CCH Dec. ¶93,218 [IP access user]).

In that case, the high court held that the claim of an inflated stock price at the time of purchase was insufficient, without more, to show loss causation. The Court found that the complaint, which failed to allege that the company's share price fell significantly after the truth became known, did not adequately show loss causation. Following *Dura*, pleading loss causation often has evolved into "mini-trials" at very early stages in the proceedings, and plaintiffs are expected to present expert testimony that specifically links the alleged fraud to the financial losses.

Even those plaintiffs able to survive the pleading hurdles at the outset of litigation will face the issue of the collectability of judgments. In many instances of significant financial fraud, issuers lack the resources to compensate harmed investors, and plaintiffs have turned to third-party defendants such as vendors, financial institutions and gatekeepers. The Supreme Court significantly narrowed the scope of actions against third-party defendants, however, in its *Stoneridge* decision on scheme liability. See *Stoneridge Investment Partners, LLC v.*

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Scientific-Atlanta, Inc. (US Sup. Ct. 2008), 2007-08 CCH Dec. ¶94,556 [IP access user].

Scienter Issues

In 2007, the Supreme Court ruled in *Tellabs v. Makor Issues & Rights, Ltd., Inc.* (2007 CCH Dec. ¶94,335 [IP access user]) that fraud claims will survive only if a reasonable person would deem the inference of scienter "cogent" and at least as compelling as any opposing inference one could draw from the facts alleged. The Court also held that the allegations must also be considered collectively. A federal judge must not scrutinize each allegation in isolation, according to the court, but must assess all of the allegations "holistically." Courts must determine whether the allegations, taken collectively, raise an inference of scienter that is at least as strong as any opposing inference.

Courts have long recognized that an actionable inference of scienter may not be drawn merely from the fact that individual defendants were senior officers of a company. However, recent circuit court cases issued in light of *Tellabs* have reached different conclusions on the question of whether an inference may be drawn that senior management must be aware of matters involving the company's "core operations," including any fraudulent conduct, and whether "collective scienter" may be actionable in the absence of a sufficient inference of scienter attributable to a particular individual.

Core Operations Inference

The Ninth Circuit has addressed this issue in two recent and somewhat contradictory decisions. In *Berson v. Applied Signal Technology, Inc.*, issued in June 2008 (2008 CCH Dec. ¶94,743 [IP access user]), a Ninth Circuit panel found that the plaintiffs pleaded with sufficient particularity that the contractor's alleged practice of counting work suspended to government "stop-work orders" as "backlog" could be actionable. Because the named CEO and CFO were directly responsible for Applied Signal's day-to-day operations, the court observed that "it is hard to believe that they would not have known about stop-work orders that allegedly halted tens of millions of dollars of the company's work," and that these facts were prominent enough that it would be absurd to suggest that top management was unaware of them.

However, three months later in *South Ferry LP, #2 v. Killinger* (2008 CCH Dec. ¶94,833 [IP access user]), the same court severely narrowed *Berson*. In distinguishing its earlier opinion, the court specifically noted that the defendants in Berson knew of the adverse conditions two weeks after they made their statements. However, despite the fact that the awareness came after the statements

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were made, the Ninth Circuit relegated *Berson* to that "exceedingly rare category of cases in which the core operations inference, without more, is sufficient under the PLSRA."

In *South Ferry*, the Ninth Circuit held that allegations relying on the core-operations inference are "among the allegations that may be considered in a complete PSLRA analysis." But the court cautioned:

> A question remains, however, about reliance on the core-operations inference when it is the only basis for scienter in the complaint. Where a complaint relies on allegations that management had an important role in the company but does not contain additional detailed allegations about the defendants' actual exposure to information, it will usually fall short of the PSLRA standard.

According to the Ninth Circuit panel, the core operations pleadings could be relevant in three circumstances, when: (1) the allegations are used in conjunction with other allegations that together raise an inference of scienter that is "cogent and compelling," thus strong in light of other explanations; (2) the allegations alone are "particular and suggest that defendants had actual access to the disputed information"; or (3) the allegations, although lacking additional particular allegations, are based on a relevant fact so prominent that it is "absurd" to suggest that management was without knowledge of the matter.

An obvious difficulty with the panel's holding is the notion of "absurdity." As *Tellabs* requires courts to weigh and evaluate competing inferences qualitatively and quantitatively, a standard of absurdity" seems ambiguous and difficult to apply.

In its review on remand of the *Tellabs* case (2007-08 CCH Dec. ¶94,560 [IP access user]), the Seventh Circuit seemed to embrace the core operations inference. According to Judge Posner, it was "extremely unlikely" that the allegedly false statements "were the result of merely careless mistakes at the management level based on false information fed it from below, rather than of an intent to deceive or a reckless indifference." The reason for such a conclusion, said Judge Posner, was that the products in question were Tellabs's most important and self-described "flagship" products. Because of the products' importance to the company, Judge Posner wrote:

> That no member of the company's senior management who was involved in authorizing or making public statements about the demand for the 5500 and 6500 knew that they were false is very hard to credit, and no plausible story has yet been told by the defendants that might dispel our incredulity.

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The Eleventh Circuit rejected the core operations presumption in *Mizzaro v. Home Depot, Inc.* (2008 CCH Dec. ¶94,876 [IP access user]) in October 2008. The court stated that “we indulge at least some skepticism about allegations that hinge entirely on a theory that senior management ‘must have known’ everything that was happening in a company as large as Home Depot” and that the complaint “must at least allege some facts showing how knowledge of the fraud would or should have percolated up to senior management.”

The Eighth Circuit expressed doubts about the viability of a core operations inference in an October 2008 decision, *Elam v. Neidorff* (2008 CCH Dec. ¶94,879 [IP access user]). The plaintiffs argued that the company “must have known about the additional $9.7 million in medical costs in April and June of 2006, when the allegedly false statements were made, because Centene touts its ability to predict medical costs.” The court found the complaint inadequate without squarely addressing the core operations question. “We need not determine whether the core operations approach can be utilized to plead scienter,” stated the court. The panel reasoned:

> [E]ven if the proper factual allegations could warrant its application, plaintiffs have not made such a showing …. [I]n order to attribute knowledge of the additional medical costs to Centene’s officers at the time of the April or June statements on this basis, we would at least require a showing that this information was known within the company at that time.

One observation by the Eighth Circuit panel merits closer examination. In refusing to recognize the core operations inference, the court stated that “the Fifth and Ninth Circuits have rejected it,” and cited the *In re Read-Rite Corp. Securities Litigation* (2003 CCH Dec. ¶92,446 [IP access user]) decision in support of that proposition. This is significant because the Eighth Circuit did not address the *South Ferry* decision above, entered more than a month earlier, in which the Ninth Circuit stated that *Tellabs* “suggests that perhaps *Silicon Graphics* (1999-2000 CCH Dec. ¶90,610 [IP access user]), *Vantive* (2001-02 CCH Dec. ¶91,720 [IP access user]) and *Read-Rite* are too demanding and focused too narrowly in dismissing vague, ambiguous, or general allegations outright.” Although the Ninth Circuit in *South Ferry* found the pleadings insufficient, that panel clearly used a different analytical frame than that applied by the *Read-Rite* court.

Collective Scienter

Corporations can only act through their agents, their officers and directors. An important issue addressed by several circuit courts with different results recently has been the question of whether a corporation can be found to have acted with the requisite scienter if no individual officer or director possessed that level of intent. Under a “collective scienter” approach, courts consider the state of mind

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and conduct of individual actors collectively, and that in the aggregate can constitute corporate scienter even if insufficient to show scienter in any individual instance.

In a 2004 decision, *Southland Securities Corp. v. Inspire Insurance Solutions, Inc.* (2004 CCH Dec. ¶92,803 [IP access user]), the Fifth Circuit rejected this notion. According to the court:

> A defendant corporation is deemed to have the requisite scienter for fraud only if the individual corporate officer making the statement has the requisite level of scienter, i.e., knows that the statement is false, or is at least deliberately reckless as to its falsity, at the time he or she makes the statement. This is consistent with the general common law rule that where, as in fraud, an essentially subjective state of mind is an element of a cause of action also involving some sort of conduct, such as a misrepresentation, the required state of mind must actually exist in the individual making (or being a cause of the making of) the misrepresentation, and may not simply be imputed to that individual on general principles of agency.

In 2005, in *City of Monroe Employees Retirement System v. Bridgestone Corp.* (2004-05 CCH Dec. ¶93,097 [IP access user]), the Sixth Circuit took the opposite view. The court found specifically that the officer in question did not act with scienter, but found that sufficient intent could be imputed to the corporate defendant. The court recognized that "[a]t first glance, it might seem incongruous to reach this conclusion after relying in part on Ono's knowledge of the claims settlements as a basis for Bridgestone's scienter on that claim," but concluded that:

> [W]hile an individual officer's knowledge may be attributed to the corporation, liability for the corporation's act does not, absent independent evidence, generally flow from the corporation to the corporate officer.

In 2008, the Second Circuit reached a mixed result on the question in *Teamsters Local 445 Freight Division Pension Fund v. Dynex Capital Inc.* In this case (2008 CCH Dec. ¶94,763 [IP access user]), the panel concluded that the lack of individual scienter did not necessarily preclude a similar finding against the corporate entity, but in this instance, the plaintiffs failed to show the requisite fraudulent intent by other means. As the court stated:

> Although there are circumstances in which a plaintiff may plead the requisite scienter against a corporate defendant without successfully pleading scienter against a specifically named individual defendant, the plaintiff here has failed to do so.

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In this case, the district court held that the fraud complaint against the defendant, a financial services company, for misrepresentations concerning its underwriting guidelines for bonds collateralized by pools of mobile home installment sales contracts was sufficient to survive a motion to dismiss. Although the complaint failed to establish a strong inference of scienter against individual officers, the allegations that the company systematically disregarded various indicia of borrowers' creditworthiness in order to quickly consummate large volumes of loans, and ignored signs that the bond collateral was defective after the loans were originated, sufficed to infer scienter on the part of the corporation itself, held the court.

Subsequently the district court declined to reconsider its finding on collective scienter, but certified the question for interlocutory appeal. Judge Baer wrote:

> [The defendants] have not demonstrated that I overlooked controlling authority in denying Dynex's motion to dismiss. However, defendants have demonstrated that the permissibility of pleading corporate or collective scienter within this Circuit constitutes 'a controlling question of law' as to which there is substantial ground for difference of opinion on the issue.

On appeal, the Second Circuit, despite its recognition that a lack of individual scienter is not conclusive at the pleading stage, used language in the opinion that seems to suggest otherwise, at least with regard to proving the claim as compared to pleading it and surviving an initial motion to dismiss. The court stated that in order to recover, "someone whose scienter is imputable to the corporate defendants and who was responsible for the statements made was at least reckless toward the alleged falsity of those statements."

Accordingly, it is important to distinguish between what must be pleaded to raise a sufficient inference and what must be proven in order to recover. To prevail and recover, "a plaintiff must prove that an agent of the corporation committed a culpable act with the requisite scienter, and that the act (and accompanying mental state) are attributable to the corporation." The court in this case found that the inferences raised in the complaint were not "at least as compelling as the competing inference and that "the statements either were not misleading or were the result of merely careless mistakes at the management level based on false information fed it from below."

Finally, the Ninth Circuit recently indicated in *Glazer Capital Management LP v. Magistri* (*In re Invision Technologies Inc. Securities Glazer Litigation*) that a fraud plaintiff must plead facts showing that the particular individual who made allegedly actionable misstatements acted with scienter in order to recover against a corporate defendant (2008-09 CCH Dec. ¶95,008 [IP access user]).

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In *Glazer*, decided in late November 2008, the Ninth Circuit did not quite rule out any situation in which there could be a finding of corporate scienter absent actionable individual intent, but it indicated that this would require highly unusual circumstances in which "a company's public statements were so important and so dramatically false that they would create a strong inference that at least some corporate officials knew of the falsity upon publication."

The case arose from a merger between Invision, a maker of explosive detection systems, and General Electric. In the merger agreement, attached as an exhibit to Invision's Form 10-K, the company warranted to GE that it was "in compliance in all material respects with all laws" in general, and with the books and records and anti-bribery provisions of the Exchange Act in particular. Subsequently, the company disclosed violations of the Foreign Corrupt Practices Act.

The court expressed skepticism about collective scienter in this factual situation, stating that if "the doctrine of collective scienter excuses Glazer from pleading individual scienter with respect to these legal warranties, then it is difficult to imagine what statements would not qualify for an exception to individualized scienter pleadings."

The panel then found that the CEO, who signed the merger agreement, lacked the requisite intent because the pleadings did not indicate any knowledge of the FCPA violations at the time of the merger agreement. The payments in question were not "the type of transaction of which it would be 'hard to believe' senior officials were unaware," the court noted. Absent other particularized indications of fraud, the fact that the officers signed Sarbanes-Oxley certifications and could profit from the merger were insufficient to show individual scienter.

A collective scienter inference in the absence of actionable individual intent can be criticized for effectively divorcing the culpable conduct from the culpable state of mind. Although the various circuit courts that have addressed collective scienter or the core operations inference after the *Tellabs* decision have reached different and often contradictory results, the opinions seem to be trending away from finding these inferences sufficient. Given the conflicts between and sometimes within the circuits, the fact-intensive nature of these questions, and the introduction of potentially ambiguous standards such as "absurdity" into the mix, the balkanization of fraud litigation and circuit-specific pleading appears likely.

Loss Causation Pleading

The *Dura* decision on loss causation has had a far greater impact on securities litigation practice than has *Tellabs*. In some circuits, the *Tellabs* actually lowered the pleading standard. For example, the Sixth Circuit recently recognized in *Frank v. Dana Corp.* (2008-09 CCH Dec. ¶95,013 [IP access user]) that the law

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in that circuit, that plaintiffs are entitled "only to the most plausible of competing inferences," was no longer valid after *Tellabs*. That court had adopted a more stringent standard in its 2001 *Helwig v. Vencor, Inc.* decision (2001 CCH Dec. ¶91,445 [IP access user]). Because *Tellabs* required that "where two equally compelling inferences can be drawn, one demonstrating scienter and the other supporting a nonculpable explanation ... the complaint should be permitted to move forward," the court concluded that *Helwig* was no longer good law.

Dura has had far-reaching implications, however, particularly with regard to class certification questions. The strictest standard may be found in the Texas-based Fifth Circuit, where plaintiffs must prove by a preponderance of the evidence the existence of a sufficient and specific causal link between corrective disclosures of alleged fraudulent misstatements and stock price drops. In contrast, the San Francisco-based Ninth Circuit recently took a much more permissive view, stating that "[s]o long as the complaint alleges facts that, if taken as true, plausibly establish loss causation," the case may proceed.

In light of two decisions by Fifth Circuit panels and a recent district court decision within the circuit, it appears that the Fifth may be the place where class actions go to die, and the cause of death is likely to be loss causation.

Oscar Private Equity Investments v. Allegiance Telecom, Inc. (2007 CCH Dec. ¶94,317 [IP access user]), a 2007 Fifth Circuit decision, is the starting point. Although the court decided this case after the Supreme Court's *Dura* decision, the Fifth Circuit made virtually no mention of the *Dura* holding. In *Oscar*, the appeals panel, in an interlocutory appeal, vacated a class certification that was based on a presumption of reliance under the fraud-on-the-market theory. The appellants, a telecommunication provider's officers and directors, successfully argued that the investors did not prove loss causation between the provider's allegedly false statements and the loss to the investors from a lower stock price.

According to the majority opinion, "Essentially, we require plaintiffs to establish loss causation in order to trigger the fraud-on-the-market presumption." The panel rejected the district court's conclusion that the class certification stage was not the proper time for the defendants to rebut the lead plaintiffs' fraud-on-the-market presumption. As characterized by the appellate panel, the district court "suggested that the presumption of reliance was rebuttable, but only as related to a summary judgment motion."

The appellate court described this as "an outdated view that fails to accord this signal event of the case its due," because the separation of the merits of the claim from certification was not appropriate with regard to "a class exceeding purchasers of millions of shares in a volatile and downward-turning market over a ten-month period, claiming injury from one of several simultaneous disclosures of negative information." In effect, the Fifth Circuit reversed the burden of proof

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involved with the fraud-on-the-market presumption. Rather than requiring the defendant to rebut the presumption, plaintiffs had to prove by a preponderance of the evidence the existence of a sufficient and specific causal link. The court concluded:

> We cannot ignore the *in terrorem* power of certification, continuing to abide the practice of withholding until "trial" a merit inquiry central to the certification decision, and failing to insist upon a greater showing of loss causation to sustain certification, at least in the instance of simultaneous disclosure of multiple pieces of negative news.

In a dissenting opinion, Circuit Judge Dennis criticized what he called "a breathtaking revision" and an "an unjustified revision of securities class action procedure." He disagreed with the majority's required showing of loss causation at the class certification stage. The holding, noted Judge Dennis, dramatically expands the scope of class certification review in this circuit to effectively require a mini-trial on the merits of plaintiffs' claims at the certification stage.

In an "unpublished" September 2008 opinion, *Catogas v. Cyberonics, Inc.* (2008 CCH Dec. ¶94,832 [IP access user]), dealing with the review of a dismissal motion rather than class certification, the Fifth Circuit affirmed the dismissal of claims based on allegations concerning stock option backdating. The district court had dismissed the action on scienter grounds, but the appeals panel affirmed on loss causation without addressing whether scienter was adequately pleaded. The plaintiffs pointed to a press release that disclosed that the company's internal investigation was ongoing and that its 10-K filing would be delayed. The press release also revealed a Nasdaq staff letter informing the company that it was subject to delisting from the exchange if it did not file its Form 10-K. According to the plaintiffs, the press release was "the first time that the market learned the full ramifications of the backdating and repricing scheme," and that before the press release, "the investing public did not know and was never told that the illegal scheme could eventually lead Cyberonics' market to stop trading on the Nasdaq exchange." After this release, the company's stock price dropped by almost 25 percent.

The appeals court disagreed, as it found that the press release did not "reveal anything regarding the accounting of options that had not already been disclosed to the investing public." The court said that the market had been apprised of the stock option problems through analyst reports and disclosures concerning an SEC investigation and subpoenas from the U.S. Attorney. The only new information in the press release, according to the panel, involved the delisting possibility. Because this information "did nothing to reveal previous misstatements with respect to Cyberonics' stock-option accounting," it was not relevant with regard to the loss causation question.

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The last sentence of the opinion's introductory paragraph also raises an interesting question. *Dura* did not directly address the question of whether loss causation was subject to the more stringent pleading rules for fraud under the Federal Rules of Civil Procedure. The court in *Catogas* did not answer the question, but it certainly hinted at a stricter view in stating that the "plaintiffs failed to plead loss causation with the requisite particularity.

The effect of *Oscar* can be seen in a decision handed down in November 2008 by the U.S. District Court for the Northern District of Texas. In *Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.* (2008-09 CCH Dec. ¶95,002 [IP access user]), the court refused to certify a class on loss causation grounds. The court agreed that the plaintiffs met all the requirements for certification except the *Oscar* loss causation requirement, which "imposes an exceedingly high burden on Plaintiffs at an early stage of the litigation." Because the plaintiffs failed to link the alleged corrective disclosures with prior actionable misrepresentations, the court declined to certify the class.

The Basic *Presumption*

On a related question, the Second Circuit recently held that the fraud-on-the-market reliance presumption established by the Supreme Court in *Basic Inc. v. Levinson* is not limited to statements by issuers, and could be available in an action against research analysts. "The reason is simple," stated Judge Pooler, as "the premise of *Basic* is that, in an efficient market, share prices reflect 'all publicly available information, and, hence, any material misrepresentations'. It thus does not matter, for purposes of establishing entitlement to the presumption, whether the misinformation was transmitted by an issuer, an analyst, or anyone else." *In re Salomon Analyst Metromedia Litigation* (CA-2 2008), 2008 CCH Dec. ¶94,861 [IP access user].

The court also held that in order to fall within the *Basic* presumption, it was not necessary for the plaintiffs to show that the alleged misrepresentations had a measurable effect on the stock price. Judge Pooler wrote the point of Basic is that an effect on market price is presumed based on the materiality of the information and a well-developed market's ability to readily incorporate that information into the price of securities.

It is important to note that the holding concerning the impact on the stock price was limited only to the question of the availability of the reliance presumption with regard to class certification. Under the *Dura* holding, the plaintiffs would still have to show a causal connection between the alleged misrepresentations and a decline in the stock price to establish a Rule 10b-5 violation.

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Split Between Circuits?

The answer to the question above is yes, but little response to that is expected. While the Fifth and Ninth Circuits have taken dramatically different approaches to the loss causation question, it is unlikely that the Supreme Court will re-visit the issue to resolve these unanswered questions.

In *Gilead Sciences Securities Litigation* (2008 CCH Dec. ¶94,799 [IP access user]), a Ninth Circuit panel reversed a lower court dismissal on loss causation grounds. The appellate court stated that "[p]erhaps what truly motivated the dismissal was the district court's incredulity" with regard to loss causation claims. In stark contrast to the Fifth Circuit in *Catogas*, the panel noted that "a district court ruling on a motion to dismiss is not sitting as a trier of fact." Although trial courts need not accept as true conclusory allegations, nor make unwarranted deductions or unreasonable inferences, the appellate panel held that so long as the complaint alleges facts that, if taken as true, plausibly establish loss causation, Rule 12(b)(6) dismissal is not appropriate.

Stoneridge and Collectability

A final problem faced by plaintiffs who survive the pleading hurdles in today's environment is collectability. As companies file for bankruptcy protection and banks are shuttered, the universe of potential defendants contracts has also been restricted in light of the Supreme Court's decision on scheme liability in *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.* (US Sup. Ct. 2008), 2007-08 CCH Dec. ¶94,556 [IP access user]. In that case, which involved the alleged complicity of third-party vendors in round-trip transactions, the Court held that the non-speaking third parties could not be held liable in private actions because investors did not rely on any public statements. Although a small window of opportunity may exist for plaintiffs if the market perceived the third party's deceptive acts, the scheme liability approach to recover against these third parties, who often are the only entities left standing after a major fraud, is largely foreclosed.

In addition, the Supreme Court declined to hear the case against Enron's investment bankers, *Regents of the University of California v. Merrill Lynch Pierce Fenner & Smith, Inc.* (2006-07 CCH Dec. ¶94,173 [IP access user]), in which the Fifth Circuit held that the banks may have aided and abetted Enron's deceit by making its misrepresentations more plausible, but that their conduct did not rise to primary liability under Rule 10b-5. Although it is extremely difficult to draw conclusions from a denial of certiorari without comment, the Court may be indicating that its restrictive view of private aiding and abetting liability is not limited to its facts and non-speaking parties acting in the ordinary course of business, such as the Stonebridge vendors.

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Conclusion

The landscape of securities fraud pleading has been dramatically reshaped by the decisions of the Supreme Court and various circuit courts, and by the overall market downturn. The challenges to successful fraud pleading have grown significantly, but class plaintiffs with good cases can still state sufficient claims.

The *Tellab*s decision, which had the potential to alter the plaintiffs' pleading burden considerably, appears to have largely worked as a draw between plaintiffs and defendants. The decision lowered the pleading bar in some circuits, and plaintiffs are not required to show that the inference of fraud is greater than any competing inference.

After *Tellabs*, though, many circuits have found the scienter inference raised by claims that the misstatements involved the companies' so-called core operations, without more, to be insufficient. Several panels have also found that claims of fraudulent intent by a group of individuals taken collectively, in the absence of a showing of actionable scienter by any particular defendant, do not meet the PSLRA pleading standard. These cases, while certainly problematic for plaintiffs, are not necessarily surprising, as they merely require plaintiffs to focus their pleadings on particular statements made by specific, individual defendants.

With regard to loss causation, however, the changes have been much more dramatic. Company-specific loss causation becomes more difficult when the overall market is trending downward. Pleading practice after *Dura* has also transformed the relatively routine class certification motion into a mini-trial on the merits, where plaintiffs are generally expected to show causation in detail, supported by evidence from expert witnesses. In the Fifth Circuit, plaintiffs must go even further and *prove* by a preponderance of admissible evidence, rather than merely plead, a sufficient causal connection at this early stage in the litigation.

The overall result of these changes in both scienter and loss causation pleading is to "front-load" the development of a case's factual basis and legal theory into what had been largely procedural stages of litigation. Fraud cases are becoming more complex and expensive to prosecute from the outset, and potential litigants must carefully examine their cases and their pleadings to clear these hurdles. Many of the cases may not be easily harmonized, however, and the balkanization of the law and circuit-specific pleading is a likely result of these decisions.

The assessment of a case's value must also take into account the *Stoneridge* decision. Because this decision effectively foreclosed recovery against many third-party defendants, potential plaintiffs must determine whether the resources of the company and its management available to compensate plaintiffs if they prevail justify the costs and risks of litigation. ❒

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About the Author

N. Peter Rasmussen is a Senior Writer-Analyst at Wolters Kluwer Law & Business, a leading provider of corporate and securities information. Rasmussen is a principal contributor to the industry-standard publication, *CCH Federal Securities Law Reporter*, and is also co-author of several books on federal securities law, including: *Responsibilities of Corporate Officers and Directors under Federal Securities Law*, *Guide to Internal Controls*, and *Guide to Section 16: Insider Reporting and Short-Swing Trading Liability*. In addition, he contributes regularly to the popular blog, *Jim Hamilton's World of Securities Regulation*, at http://jimhamiltonblog.blogspot.com/. Rasmussen earned a bachelor's degree from DePauw University and holds graduate degrees in law and history from the University of Illinois.

If you would like to post this white paper on your firm's intranet site, please contact Randy Kaplan at randy.kaplan@wolterskluwer.com or call 212-771-0866.

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