

1 *Defendants-Appellees,*

2 GARY G. LYNCH,

3 *Defendant.*
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6 David Kessler (Andrew L. Zivitz, Kimberly A. Justice,
7 Richard A. Russo, Jr., Joshua A. Materese, *on the brief*)
8 Kessler Topaz Meltzer & Check, LLP, Radnor, PA, *for*
9 *Plaintiff-Appellant Fjarde AP-Fonden.*

10 JAVIER BLEICHMAR (Jonathan M. Plasse, Joseph A. Fonti,
11 Wilson M. Meeks, *on the brief*), Labaton Sucharow LLP,
12 New York, NY, *for Movant-Appellant State Boston*
13 *Retirement System.*

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15 ROBERT F. WISE, JR. (Charles S. Duggan, Andrew Ditchfield,
16 *on the brief*), Davis Polk & Wardwell LLP, New York, NY,
17 *for Defendants-Appellees.*

18 **UPON DUE CONSIDERATION**, it is hereby **ORDERED, ADJUDGED, and DECREED**
19 that the order of the District Court is **AFFIRMED**.

20 State-Boston Retirement System and Fjarde AP-Fonden bring this putative securities fraud
21 class action on behalf of themselves and other similarly situated investors (“Plaintiffs”), against
22 Morgan Stanley, and six of its officers and former officers: John J. Mack, Zoe Cruz, David Sidwell,
23 Thomas Colm Kelleher, and Thomas Daula (“Defendants”), pursuant to Sections 10(b), 15 U.S.C.
24 § 78j(b), and 20(a), 15 U.S.C. § 78t(a), of the Securities and Exchange Act of 1934 (the “Exchange
25 Act”). In orders dated April 4, 2011 and January 18, 2013, the United States District Court for the
26 Southern District of New York (Batts, *J.*) granted Defendants’ motions to dismiss. Plaintiffs timely
27 appealed. We assume the parties’ familiarity with the underlying facts, the procedural history, and
28 the issues presented for review. For the reasons stated here and in an opinion issued simultaneously

1 with this summary order, we affirm.¹

2 * * *

3 We review a district court’s judgment granting a motion to dismiss pursuant to Federal Rule
4 of Civil Procedure 12(b)(6) *de novo*, accepting all factual allegations in the complaint as true.
5 *Absolute Activist Value Master Fund Ltd. v. Ficeto*, 677 F.3d 60, 65 (2d Cir. 2012). “To survive a
6 motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to state a
7 claim to relief that is plausible on its face.” *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (internal
8 quotation marks omitted). In making this determination, we consider “public disclosure documents
9 required by law to be, and that have been, filed with the SEC.” *Rothman v. Gregor*, 220 F.3d 81,
10 88 (2d Cir. 2000). We may also consider “well-publicized stock prices.” *Ganino v. Citizens Utils.*
11 *Co.*, 228 F.3d 154, 166 n.8 (2d Cir. 2000)

12 Section 10(b) of the Securities Exchange Act of 1934, makes it unlawful to “use or employ,
13 in connection with the purchase or sale of any security . . . any manipulative or deceptive device or
14 contrivance in contravention of [the] rules and regulations” that the SEC prescribes. 15 U.S.C. § 78j.
15 SEC Rule 10b-5, which implements Section 10(b), prohibits “mak[ing] any untrue statement of a
16 material fact or [omitting] to state a material fact necessary in order to make the statements made,
17 in light of the circumstances under which they were made, not misleading.” 17 C.F.R. § 240.10b-
18 5(b). To state a claim for securities fraud under Section 10(b) and Rule 10b-5, a plaintiff must allege
19 that each defendant “(1) made misstatements or omissions of material fact, (2) with scienter, (3) in
20 connection with the purchase or sale of securities, (4) upon which the plaintiff relied, and (5) that

¹ We decide Plaintiffs’ claim that the Defendants violated Section 10(b) by omitting to disclose known trends required to be disclosed pursuant to Item 303 in a separate opinion issued simultaneously with this summary order. The remaining claims are resolved by this summary order.

1 the plaintiff's reliance was the proximate cause of its injury." *ATSI Commc'ns, Inc. v. Shaar Fund,*
2 *Ltd.*, 493 F.3d 87, 105 (2d Cir. 2007) (citing *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 172 (2d
3 Cir. 2005)).

4 Securities fraud claims are subject to heightened pleading requirements. A complaint
5 alleging securities fraud must satisfy Rule 9(b), *Ganino*, 228 F.3d at 168, which requires that "the
6 circumstances constituting fraud" be "state[d] with particularity," Fed. R. Civ. P. 9(b). A securities
7 fraud complaint based on misstatements must "(1) specify the statements that the plaintiff contends
8 were fraudulent, (2) identify the speaker, (3) state where and when the statements were made, and
9 (4) explain why the statements were fraudulent." *Novak v. Kasaks*, 216 F.3d 300, 306 (2d Cir. 2000)
10 (internal quotation marks omitted). Allegations that are conclusory or unsupported by factual
11 assertions are insufficient. *See Luce v. Edelstein*, 802 F.2d 49, 54 (2d Cir. 1986).

12 The gravamen of Plaintiffs' complaint is that Defendants made numerous material
13 misstatements and omissions from June 20, 2007 through November 19, 2007 to conceal Morgan
14 Stanley's exposure and losses associated with a subprime mortgage trade (the "proprietary trade,"
15 which included both a "long" and "short" position). Plaintiffs' second amended complaint identifies
16 two categories of alleged misrepresentations and omissions made by Defendants:
17 (1) misrepresentations and omissions regarding Morgan Stanley's exposure to subprime-related
18 assets (the "exposure claim") and (2) misrepresentations regarding Morgan Stanley's subprime
19 related losses (the "valuation claim"). We affirm the district court's dismissal of both claims.

20 **I. Exposure Claim**

21 We first conclude that the district court properly dismissed the exposure claim to the extent
22 it was based on alleged misrepresentations because Plaintiffs did not adequately plead any material

1 misrepresentation.² Plaintiffs have identified four supposed material misstatements made by Morgan
2 Stanley officers. The district court correctly held that none of the statements are actionable under
3 Section 10(b). The complaint fails to “demonstrate with specificity why and how” the statements
4 are misleading. *See Rombach v. Chang*, 355 F.3d 164, 170-74 (2d Cir. 2004). In particular, to the
5 extent that Defendants used “cautionary language” we must “analyze the allegedly fraudulent
6 materials in their entirety to determine whether a reasonable investor would have been misled.”
7 *Halperin v. eBanker USA.com, Inc.*, 295 F.3d 352, 357 (2d Cir. 2002).

8 *First*, Plaintiffs allege that Sidwell’s June 20, 2007 statement on an earnings call — to the
9 effect that “concerns early in the quarter [ending May 31, 2007] about whether issues in the sub-
10 prime market were going to spread [had] dissipated” — was a material misrepresentation. J.A. 498.

11 Read in context, it is clear that this statement did not fraudulently convey that the firm faced no
12 subprime risk. Sidwell’s statement was related to the affect of the subprime market on Morgan
13 Stanley’s broader market outlook, not the trading risk Morgan Stanley faced from the subprime
14 market itself. Moreover, the complaint itself reveals that Sidwell explained that there were ongoing
15 risks and weaknesses from the residential mortgage market. He specifically noted there was a
16 “weakness in U.S. residential mortgage markets,” J.A. 318, and that there was a 24 percent decline
17 in credit products revenues due to “volatility in the mortgage markets,” J.A. 315. Thus the district
18 court correctly concluded that this was not a material misstatement.

19 *Second*, Plaintiffs allege that Sidwell’s June 20, 2007 statement on an earnings call that
20 Morgan Stanley “really did benefit” from conditions in the subprime market and “certainly did not

² The opinion issued simultaneously with this summary order concludes, as to the claim that Defendants violated Rule 10b-5 by failing to disclose known trends or uncertainties in its 10-Q filings (as required by Item 303), that the district court properly dismissed this claim on the ground that scienter was not adequately alleged.

1 lose money in this business” in the second quarter, was a material misrepresentation. J.A. 498-99.
2 The district court correctly concluded that this was a true statement regarding past performance.
3 Sidwell said nothing about future exposure to subprime, but asserted instead that as of the second
4 quarter of 2007 Morgan Stanley did not lose money and in fact did benefit from the subprime
5 market. Even assuming that this statement did imply — as Plaintiffs argue — that Morgan Stanley
6 did not face significant future subprime liability, it still would not be actionable because the
7 allegations only show that, at that time, Morgan Stanley had subprime trading risk, not that it had
8 accrued losses. In sum, Plaintiffs have not plausibly pled how or why this statement was false.

9 *Third*, Plaintiffs allege that Kelleher’s September 19, 2007 statement that Morgan Stanley
10 “remain[ed] exposed to risk exposures through a number of instruments [including] CDOs” was
11 false and misleading because it gave investors the impression that Morgan Stanley was only
12 marginally exposed to the subprime market. J.A. 506-07. This statement was a purely factual
13 recitation of some of the risks Morgan Stanley still faced — and it accurately and truthfully included
14 CDO risk. Kelleher made clear that the risk was *not* minimal as he noted that Morgan Stanley was
15 a “major market player” in the market with remaining exposure to “subprime[] CDOs” and that the
16 company “may continue to see challenging market conditions in the months ahead.” J.A. 1788. On
17 the facts alleged, it is not plausible that this statement was a material misrepresentation.

18 *Fourth*, Plaintiffs allege that Kelleher’s October 24, 2007 statement that he “[did] not see
19 further write-downs to [Morgan Stanley’s] carrying values over the near term” was false and
20 misleading. J.A. 516. Plaintiffs failed to argue that this statement was a basis for their fraud claim
21 in the district court and, in any event, the complaint does not provide the context necessary to show
22 specifically why this statement was false or misleading. We therefore affirm the dismissal of this
23 claim.

1 **II. Valuation Claim**

2 Plaintiffs allege in their valuation claim that Morgan Stanley failed properly to write down
3 the true extent of the losses sustained by the long position and that when the true losses came to
4 light, the company’s stock price declined. We affirm the dismissal of the valuation claim because
5 Plaintiffs failed to plead loss causation.

6 Loss causation requires plaintiffs to plead that the alleged “misstatement or omission is the
7 ‘proximate cause’ of an investment loss.” *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 173 (2d
8 Cir. 2005). In *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336 (2005), the Supreme Court held
9 that “an inflated purchase price will not itself constitute or proximately cause the relevant economic
10 loss.” *Id.* at 342. Even if a purchaser later sells at a lower price after a corrective disclosure is made,
11 “that lower price may reflect, not the earlier misrepresentation, but changed economic
12 circumstances, changed investor expectations, new industry-specific or firm-specific facts,
13 conditions, or other events, which taken separately or together account for some or all of that lower
14 price.” *Id.* at 342-43. Thus to establish loss causation, “a plaintiff must allege . . . that the subject
15 of the fraudulent statement or omission was the cause of the actual loss suffered,” *Suez Equity*
16 *Investors, L.P. v. Toronto–Dominion Bank*, 250 F.3d 87, 95 (2d Cir. 2001), i.e., that the
17 misstatement or omission concealed something from the market that, when disclosed, negatively
18 affected the value of the security. *See Lentell*, 396 F.3d at 173. To allege a corrective disclosure,
19 a plaintiff must allege that the disclosure “reveal[ed] to the market the falsity of the prior
20 [statement].” *Id.* at 175 n.4.

21 Plaintiffs here allege that various analysts made corrective disclosures including predictions
22 that Morgan Stanley would report significant fourth quarter write-downs as a result of the decline

1 in the values of subprime CDOs. These analyst predictions were followed by a drop in Morgan
2 Stanley’s stock price. But the analyst reports did not disclose any “underlying circumstance that
3 [was] concealed or misstated.” *Id.* at 173. The analysts did not report that the losses were due to
4 fraudulently concealed losses that actually occurred in the third quarter. Instead, the reports state
5 simply that the write-downs were forthcoming. This, of course, could have been a result of the
6 continued decline in the subprime market during the fourth quarter. Although Plaintiffs need not
7 rule out all competing theories for the decline in stock price, their allegations must “show that [their]
8 loss was caused by the alleged misstatements as opposed to intervening events.” *Id.* at 174 (internal
9 quotation marks omitted). Plaintiffs’ allegations failed plausibly to allege that Morgan Stanley’s
10 drop in stock price was not caused by the intervening market deterioration throughout the financial
11 services industry. For this reason, we affirm the dismissal of Plaintiffs’ valuation claim for failure
12 to plead loss causation.

13 We have reviewed Plaintiffs’ remaining arguments and find them to be without merit. For
14 the reasons stated here and the opinion issued simultaneously with this summary order, the
15 judgment of the district court is **AFFIRMED**.

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17 FOR THE COURT:
18 Catherine O’Hagan Wolfe, Clerk
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