Securities Regulation Daily Wrap Up, TOP STORY—U.S.: High Court is asked to address standards for pleading loss causation, (Nov. 29, 2016)

Securities Regulation Daily Wrap Up

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By Rodney F. Tonkovic, J.D.

A petition for certiorari has been filed asking the Supreme Court to look into the prerequisites for pleading loss causation. The petitioner takes issue with the Eleventh Circuit's rules for pleading loss causation and notes a circuit split regarding pleading loss causation based on the disclosure of a government investigation or based on reports analyzing information that is already in the public domain (*Norfolk County Retirement System v. Health Management Associates, Inc.* , November 21, 2016).

According to the complaint, Health Management Associates, Inc., an operator of health care facilities, engaged in a scheme to overbill Medicare for hospital services. The company then invented innocent explanations for the consequent boost in its financial position and stock price. The petitioners tied HMA's share price decline to two corrective disclosures: the announcement of a government investigation into HMA's hospital admission practices and an analyst report describing a wrongful termination lawsuit filed by a whistleblowing former HMA employee who had informed his superiors of serious compliance issues involving Medicare billing practices.

Dismissed on loss causation grounds. The district court found that the investors were unable to show loss causation because the fall in the share price was due to the disclosure of possible fraud and not the fraudulent conduct itself. In other words, an investigation alone, without disclosure of actual wrongdoing, cannot qualify as a corrective disclosure, and the analyst report simply repackaged information that was already available to the public.

A divided Eleventh Circuit panel affirmed, holding that the revelation of the government investigation did not qualify as a corrective disclosure because it did not show any wrongdoing. And, the whistleblower case was not proof of fraud, because the mere filing of a civil suit is not proof of liability and the analyst report describing the case contained only information that had already been assimilated by the market. This lack of new information, the panel said, was fatal to the investors' claim.

Pleading loss causation. The petition asserts that the Eleventh Circuit decision rested on two erroneous legal rules: that a finding of actual wrongdoing is a legal prerequisite to an investor pleading loss causation based on the announcement of a government investigation into the defendant's fraudulent practices and that an investor who invokes a fraud-on-the-market presumption of reliance is barred from pleading loss causation based on a corrective disclosure that analyzes information already in the public domain but not widely known to the market. Both rules warrant the Court's review, the petition says.

According to the petitioners, the Eleventh Circuit's loss causation pleading rules implicate entrenched circuit splits. In the Fifth and Ninth Circuits, as well as among district courts in the Second Circuit, an investor may plead loss causation based on the disclosure of an investigation whether or not it produces a finding of wrongdoing. Next, the Fifth and Ninth Circuits hold that analyst reports may support loss causation at the pleading stage if it is plausible that the market has not yet absorbed the source information.

The petition argues further that the Eleventh Circuit's rules are contrary to Supreme Court precedent. Regarding the government-investigation rule, plaintiffs are improperly required to prove their case at the pleading stage. Also, citing *Halliburton,* the petition asserts that, contrary to the Eleventh Circuit's analyst-report rule, even in an efficient market not every piece of information is immediately incorporated into the share price.

The petition is No. 16-685.

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Companies: Norfolk County Retirement System; Health Management Associates, Inc.

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