Fordham Journal of Corporate & Financial Law

Volume 18 | Issue 1 Article 7

2012

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Cover Page Footnote

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VOLUME XVIII 2012 NUMBER 1

FORDHAM

JOURNAL OF
CORPORATE & FINANCIAL LAW

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ABSTRACT

Since the Supreme Court's landmark holding in *Basic, Inc. v. Levinson*, courts have incorporated the efficient capital markets hypothesis as an analytical tool in securities fraud cases. Nevertheless, recent turmoil in the financial markets and a growing chorus of scholarship challenging traditional notions of market efficiency have caused some courts to reconsider the role of the efficient capital markets hypothesis in securities fraud litigation. This Note analyzes a question that has split the circuits and marks the intersection of market efficiency and securities fraud: how quickly must an equity security depreciate in price following the publication of a corrective disclosure for a plaintiff to plead and prove loss causation? Part I introduces the efficient capital markets hypothesis, securities fraud actions, and the ways in which courts have traditionally employed concepts of market efficiency into their analyses. Part II analyzes the circuit split regarding the speed with which the market must incorporate information into price for a plaintiff to properly plead and prove loss causation. Finally, Part III argues that courts should resist the temptation to draw bright-line rules in the context of loss causation and should engage each case on its facts by analyzing the efficiency of the relevant market during each event giving rise to the fraud and economic loss.

* J.D., Fordham University School of Law, 2012; B.A., Boston College, 2008.

INTRODUCTION

> There is an old joke, widely told among economists, about an economist strolling down the street with a companion when they come upon a $100 bill [laying] on the ground. As the companion reaches down to pick it up, the economist says "Don't bother—if it were a real $100 bill, someone would have already picked it up."[1]

This joke is representative of a widely endorsed economic theory—the efficient capital markets hypothesis ("ECMH")—taken to its logical extreme.[2] Developed in its contemporary form by the Chicago School of Economics, the ECMH posits that in "efficient" markets, the prices of securities accurately reflect all publicly available information.[3] Over the

1. ANDREW W. LO & CRAIG MACKINLAY, A NON-RANDOM WALK DOWN WALL STREET § 1.2 (1999).

2. *See id.*; *see also* Michael C. Jensen, *Some Anomalous Evidence Regarding Market Efficiency*, 6 J. FIN. ECON. 95, 95 (1978).

3. This Note found the following sources helpful in navigating the rich and vast body of scholarship regarding the ECMH. *See* Eugene F. Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. FIN. 383 (1970); *see also* JUSTIN FOX, THE MYTH OF THE RATIONAL MARKET: A HISTORY OF RISK, REWARD, AND DELUSION ON WALL STREET (2009); Jonathan R. Macey & Geoffrey P. Miller, *Good Finance, Bad Economics: An Analysis of the Fraud-On-The-Market Theory*, 42 STAN. L. REV. 1059 (1987); Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549 (1984); Daniel R. Fischel, *Use of Modern Finance Theory in Securities Fraud Cases Involving Actively Traded Securities*, 38 BUS. LAW. 1 (1982); Jensen, *supra* note 2.

course of the last four decades, the ECMH has had a monumental influence on securities litigation, particularly in the context of Rule 10b-5 securities fraud.[4] This Note examines a question that has split the circuits: how quickly must an equity security depreciate in price following the release of a corrective disclosure for a plaintiff to prove the element of loss causation? Part I provides a brief explanation of the ECMH, Rule 10b-5, and the ways in which at least three elements of Rule 10b-5 have been shaped by judicial endorsement of the ECMH. Part II examines the circuit split regarding this issue and discusses recent case law addressing the rapid incorporation of information into securities prices. Part III takes the position that courts should adopt a fact-specific rule with respect to loss causation and resist the temptation to apply any bright-line rule based on the ECMH.

I. ECONOMIC AND LEGAL BACKGROUND

A. THE EFFICIENT CAPITAL MARKETS HYPOTHESIS

The contemporary version of the ECMH,[5] and the version that has had the clearest impact on legal analyses in the Rule 10b-5 context,[6] was first articulated by University of Chicago Booth School of Business economist Eugene F. Fama.[7] In his 1970 work entitled *Efficient Capital Markets: A Review of Theory and Empirical Work*, Fama outlined a framework of market efficiency in the context of three categories[8]: weak

4. *See* Donald C. Langevoort, *Theories, Assumptions, and Securities Regulation: Market Efficiency Revisited*, 140 U. PA. L. REV. 851, 851 (1992); *see also* Jill E. Fisch, *Picking A Winner*, 20 J. CORP. L. 451, 463 (1995) (reviewing ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW (1993)).

5. The notion of efficient pricing and efficient markets far predates Fama. Scholars including Adam Smith, Jules Regnault, Louis Bachelier, and perhaps even Thomas Aquinas and Aristotle have commented on market price efficiency. *See* FOX, *supra* note 3, at xiii.

6. *See* Langevoort, *supra* note 4, at 852 n.7.

7. *See Faculty Directory: Eugene F. Fama*, CHICAGO BOOTH, http://www.chicagobooth.edu/faculty/bio.aspx?person_id=12824813568 (last visited Nov. 11, 2012).

8. Strictly speaking, Fama's work did not categorize markets but rather relied on empirical data to define characteristics of a particular market with respect to information. In terms of methodology, Fama utilized conditional expected returns described notationally as

$$E(\tilde{p}_{j,t+1}|\Phi_t) = [1 + E(\tilde{r}_{j,t+1}|\Phi_t)]p_{jt},$$

form, semi-strong form, and strong form.[9] In weak form markets, prices of securities[10] reflect only historical price data of that security.[11] Accordingly, an investor trading in a weak form market who possesses any information more recent than historical price data with respect to a security could turn a profit by trading on the basis of the recent information.[12] In semi-strong markets, prices of securities accurately reflect all publicly available information.[13] In a semi-strong form market, contrary to a weak form market, an investor who possesses publicly available information would not be able to turn a profit by trading on the basis of that information because the market would have already incorporated that information into the prices of securities.[14] Finally, in a strong form market, all information—including information that is available only to groups with "monopolistic access," such as corporate insiders and designated market makers—is reflected in the prices of securities.[15] Accordingly, even corporate insiders who seek to trade on the basis of material non-public information would be unable to turn a profit because the market would have already priced in such information.[16] Despite Fama's neatly divided categories of market efficiency, it is important to realize that the data behind the ECMH

Conditional on relevant information, the expected return (i.e. expected price at time *t+1*) is a function of the information available to the market – or risk. The expected return of the price of security *j* at time *t+1* is a function of the current (at time *t*) price of the security and the expected one period percentage return given some set of relevant information. On a market-wide scale, such prices will approach equilibrium and cancel out irrational outliers. It is also important to note that Fama listed three characteristics sufficient, although not necessary, to achieve a (semi-strong form) efficient market. Such factors include: (1) zero transaction costs associated with trading securities; (2) freely available information accessible by all market participants; and (3) unanimous agreement on the part of market participants with respect to the current implications of information on future prices. *See* Fama, *supra* note 3, at 387.

9. *See id.* at 384.

10. The term "securities" in this Note refers to equity securities, and more specifically, to common stock. It does not refer to debt securities or convertible debt/equity hybrid instruments.

11. *See* Fama, *supra* note 3, at 388.

12. *Id.*

13. *Id.*

14. *Id.*

15. *See id.* at 388, 415.

16. *See id.* at 388.

predates the ECMH itself, at least in its contemporary form.[17] Put another way, Fama did not suggest that there are three types of markets, which always behave in accordance with certain abstract economic principles.[18] Rather, Fama argued that there are three general types of market behavior, which can be seen in any market at any given time.[19]

Of Fama's three categories, the semi-strong form is most widely endorsed by economists,[20] traders,[21] jurists,[22] and securities regulators.[23] In fact, less than a decade after Fama's landmark work, Michael Jensen, a famous financial economist in his own right, boldly stated that "there is no other proposition in economics which has more solid empirical evidence supporting it than the Efficient [Capital] Market Hypothesis."[24] From Jensen's comment to the present day, the ECMH "began its

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17. *See id.* at 383 ("Though we proceed from theory to empirical work, to keep the proper historical perspective we should note to a large extent that the empirical work in this area preceded the development of the theory."); *see also* Gilson & Kraakman, *supra* note 3, at 552 ("[L]egal users of the ECMH literature have been, by and large, confronted with a body of empirical evidence in search of a causative theory.").

18. *See* Fama, *supra* note 3, at 387 ("[A] frictionless market in which all information is freely available and investors agree on its implications is, of course, not descriptive of markets met in practice.").

19. *See id.*

20. *See, e.g.*, Jensen, *supra* note 2, at 95; Fama, *supra* note 3, at 383, 387; Eugene F. Fama et al., *The Adjustment of Stock Prices to New Information*, 10 Int'l Econ. Rev. 1 (1969) [hereinafter Fama, *Adjustment of Stock Prices*], *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=321524## ("There is an impressive body of empirical evidence which indicates that successive price changes in individual common stocks are very nearly independent. [Economic papers and research] show rigorously that independence of successive price changes is *consistent* with an 'efficient' market, i.e., a market that adjusts rapidly to new information.").

21. The belief that stock prices reflect all available information at any given time led, at least in part, to the belief that investors, even professional investors, could not outperform the market with any consistency. Such belief gave rise to index fund-investment strategies, which provide investors with an opportunity to invest in funds that seek merely to simulate, rather than outperform, the market as a whole. *See* BURTON G. MALKIEL, A RANDOM WALK DOWN WALL STREET: THE BEST INVESTMENT ADVICE FOR THE NEW CENTURY (1999).

22. *See, e.g.*, Langevoort, *supra* note 4, at 851; Thomas Lee Hazen, *Rational Investments, Speculation, or Gambling?: Derivative Securities and Financial Futures and Their Effect on the Underlying Capital Markets*, 86 NW. U. L. REV. 987, 987 (1992); Gilson & Kraakman, *supra* note 3, at 549.

23. *See, e.g.*, Langevoort, *supra* note 4, at 851; Donald C. Langevoort, *The SEC as a Bureaucracy: Public Choice, Institutional Rhetoric, and the Process of Policy Formulation*, 47 WASH. & LEE L. REV. 527, 537–38 (1990).

24. Jensen, *supra* note 2, at 95; *see* Langevoort, *supra* note 4, at 853 n.8.

remarkable transition from theory to doctrine"[25] and embedded itself in policies underlying securities laws, regulations, and jurisprudence.[26] In 1988, after some years in the federal circuit courts,[27] the Supreme Court famously adopted the ECMH in the landmark decision of *Basic, Inc. v. Levinson*.[28]

B. SECTION 10(b) SECURITIES FRAUD

In the midst of the Great Depression, Congress, passed the Securities Act of 1933[29] (the "Securities Act") and the Securities Exchange Act of 1934 (the "Exchange Act" and, together with the Securities Act, the "Securities Laws")[30] in an effort to prevent future instances of rampant fraud and manipulation.[31] These landmark pieces of legislation were based on two overarching principles: disclosure of information and prevention of fraud.[32]

Following a period of unbridled abuse in the securities markets, Congress, as a matter of public policy, decided that the best and least intrusive way[33] to ensure market integrity was to provide investors with

25. Langevoort, *supra* note 4, at 853.

26. *Id.* at 851.

27. *See, e.g.*, Peil v. Speiser, 806 F.2d 1154, 1160–61 (3d Cir. 1986); Blackie v. Barrack, 524 F.2d 891, 905 (9th Cir. 1975).

28. 485 U.S. 224 (1988).

29. Securities Act of 1933, Pub. L. No. 73–38, 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a-77aa (2006)).

30. Securities Exchange Act of 1934, Pub. L. No. 111–72, 48 Stat. 881 (codified as amended at 15 U.S.C. §§ 78a–78pp (2006).

31. *See* H.R. REP. NO. 73–85 (1933) ("During the post-war decade some 50 billions of new securities were floated in the United States. Fully half or $25,000,000,000 worth of securities floated during this period have been proved to be worthless. . . . The flotation of such a mass of essentially fraudulent securities was made possible because of the complete abandonment by many underwriters and dealers in securities of those standards of fair, honest, and prudent dealing that should be basic to the encouragement of investment in any enterprise."); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 727–28 (1975).

32. *See* Frank H. Easterbrook & Daniel R. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 VA. L. REV. 669, 669 (1984).

33. The Securities Act and the Exchange Act expressly do not involve merit review of securities at the federal level. Certain state securities laws and regulations, known colloquially as "Blue Sky Laws," do involve the review of the merits and characteristics of securities by state regulators. *See, e.g.*, Basic Inc. v. Levinson, 485 U.S. 223, 232 (1988) ("[T]he [Supreme] Court repeatedly has described the 'fundamental purpose' of

information about the various companies whose securities were issued to, and traded by, the public.[34] Accordingly, the Securities Act, which governs capital formation in the primary market,[35] requires companies that wish to issue securities to the public to file a registration statement[36] containing detailed information about both the securities and the company at large with the United States Securities and Exchange Commission (the "SEC"). This registration statement is in turn made available to the public.[37] Similarly, the Exchange Act, which governs, *inter alia*, securities that trade in secondary markets,[38] requires reporting

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the [Securities Laws] as implementing a 'philosophy of full disclosure.'" (quoting Santa Fe Indus. Inc. v. Green 430 U.S. 462, 477–78 (1977))); JAMES D. COX ET AL., SECURITIES REGULATION: CASES AND MATERIALS 3 (6th ed. 2009) ("Disclosure is the remedy the Securities Act embraces for this malady. . . . Sunlight is said to be the best of disinfectants: electric light the most efficient policeman." (quoting LOUIS D. BRANDEIS, OTHER PEOPLE'S MONEY 62 (1914))).

34. S. REP. NO. 73–729, at 5 (1934) (noting that one of the "principal problems with which the [Exchange Act] deals" is "the secrecy surrounding the financial condition of corporations which invite the public to purchase their securities"); *see Blue Chip Stamps*, 421 U.S. at 728 (noting that a primary purpose of the Securities Act and the Exchange Act was to ensure disclosure to investors); Easterbrook & Fischel, *supra* note 32, at 684 (commenting on the importance of disclosure, both at the time of issuance and at regular intervals thereafter, as a key goal of the Securities Laws).

35. The primary market refers to the sale of securities from an issuer to an investor. If the sale of securities refers to the first such sale for the company issuing the securities, then the sale is referred to as an initial public offering or an IPO. *See* 1 THOMAS LEE HAZEN, THE LAW OF SECURITIES REGULATION §§ 2.0, 2.2 (6th ed. 2009).

36. There are various exceptions to the registration process required by the Securities Act. *See, e.g.*, Regulation D, 17 C.F.R. §§ 230.501–.508 (2006) (providing three exemptions from registration based on the amount of the issuance and the net worth of the investors); Regulation A, 17 C.F.R. §§ 230.251–.263 (2006) (providing exemption from registration for small offerings, totaling no more than $5 million in the aggregate, upon the submission of the minimal disclosure requirements of Form 1-A).

37. 15 U.S.C. §§ 77f (requiring the filing of a registration statement and payment of a registration fee); 77g (requiring registration to contain information specified by section 77aa); 77aa (requiring issuers to disclose various facts regarding the company, its operations, and control persons). Prior to the passage of the Exchange Act in 1934, the Federal Trade Commission was the governmental agency charged with regulating the securities industry. The SEC was created by Section 4 of the Exchange Act, and has been the primary regulator of the securities industry from 1934 to the present day. 15 U.S.C. § 78d (2006).

38. The secondary market refers to the sale of securities that have already been issued. Purchase and sale in the secondary market is referred to as secondary trading. Secondary trading can take place in a face-to-face transaction or in an impersonal securities market such as the New York Stock Exchange. *See generally* COX ET AL., *supra* note 33, at 2–3.

companies[39] to make disclosures at regular intervals following initial issuance.[40] Taken together, these reporting requirements demonstrate Congress' unequivocal position that the disclosure of information to the marketplace best equips investors to make sound, rational investment decisions.[41] As SEC Commissioner Troy A. Paredes recently stated, the securities laws are principally based on a policy of "transparency, achieved through disclosure."[42]

In addition to various disclosure requirements, Congress included a number of antifraud provisions in both the Securities Act and the Exchange Act.[43] These antifraud provisions give teeth to the Securities Laws by providing investors with redress[44] against companies that fail to

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39. Reporting companies include all companies with a class of securities registered under Section 12 of the Exchange Act, all companies that have executed a primary offering to the public by means of a registration statement as required by 15 U.S.C. § 77f, and any company with 500 or more shareholders and $10 million or more in total assets. These reporting companies are often referred to as "public companies." *See* COX ET AL., *supra* note 33, at 7–8.

40. 15 U.S.C. §§ 78*l*, 78m (2006). Secondary trading refers to the purchase and sale of securities that have already been issued.

41. S. REP. NO. 73–729, at 1–5 (1934).

42. Troy A. Paredes, Commissioner, SEC, Keynote Address at the Fordham University School of Law: A.A. Sommer, Jr. Lecture on Corporate, Securities and Financial Law (Oct. 27, 2011), http://www.sec.gov/news/speech/2011/spch102711tap.htm.

43. *See, e.g.*, Securities Act of 1933 § 11, 15 U.S.C. § 77k (2006) (providing for civil liability in the case of material misrepresentations and/or omissions in registration statements); § 12(a)(2), 15 U.S.C. § 77*l*(a)(2) (providing for civil liability in the form of excision of the purchase price in the case of the offer or sale of a security by means of a prospectus or oral statement containing a material misstatement or omission); § 17, 15 U.S.C. § 77q (authorizing SEC enforcement actions for violations of the Securities Act, including, *inter alia*, violations of the anti-fraud provisions); Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j (making it unlawful to use or employ any manipulative device or contrivance in connection with the purchase or sale of a security); § 21A, 15 U.S.C. § 77u-1 (providing for civil penalties in instances of insider trading).

44. *See* Kardon v. Nat'l Gypsum Co., 69 F. Supp. 512 (E.D. Pa. 1946) (recognizing an implied private right of action under Rule 10b-5); *see also* Superintendent of Ins. Of the State of New York v. Bankers Life & Cas. Co., 404 U.S. 6, 13 n.9 (1971) ("It is now established that a private right of action is implied under s[ection] 10(b)" of the Exchange Act.). Additionally, the antifraud provisions create rights of action for securities regulators – chiefly the SEC and, in the criminal context, the Department of Justice – as well. *See, e.g.*, Securities Act of 1933 § 17, 15 U.S.C. § 77q (authorizing SEC enforcement actions for violations of the Securities Act); § 20, 15 U.S.C. § 77t(b) (authorizing the SEC to seek injunctions in order to prevent ongoing violations of the

comply with, *inter alia*, disclosure requirements.[45] Of these antifraud provisions, the most widely used are Exchange Act section 10(b)[46]—the "catchall provision"[47]—and Rule 10b-5,[48] promulgated thereunder, which provide investors with a private cause of action[49] against companies engaging in manipulative or deceptive practices.[50] To succeed on a Rule 10b-5 claim, a private plaintiff need plead and prove[51]: (1) a material misrepresentation or omission; (2) scienter;[52] (3) connection with a purchase or sale of a security;[53] (4) reliance; (5) economic loss;[54] and (6) loss causation.[55]

Securities Act); Securities Exchange Act of 1934 § 21, 15 U.S.C. § 78u (authorizing the SEC to investigate apparent violations of the Exchange Act and any rules promulgated thereunder); § 32(a), 15 U.S.C. § 78ff (criminalizing false statements made in periodic filings required by the Exchange Act).

45. *See, e.g., Kardon*, 69 F. Supp. at 512; *Bankers Life*, 404 U.S. at 13 n.9.

46. 15 U.S.C. § 78j(b) (2006).

47. Chiarella v. United States, 445 U.S. 222, 234–35 (1980) ("Section 10(b) is aptly described as a catchall provision.").

48. 17 C.F.R. § 240.10b-5 (2012).

49. *See Kardon*, 69 F. Supp. 512 (holding that there is an implied private cause of action under Section 10(b) and SEC Rule 10b-5); *see also Bankers Life*, 404 U.S. at 13 n.9 ("It is now established that a private right of action is implied under [§] 10(b).").

50. 15 U.S.C. §78j(b).

51. This Note frequently uses terms such as "establish," "demonstrate," or "plead and prove." Unless otherwise specifically indicated, all such arguments refer to standards that must be met to succeed on the merits, not merely to survive a motion to dismiss.

52. Scienter is a term borrowed from common law fraud that refers to an individual's state of mind. *See* BLACK'S LAW DICTIONARY 1463 (9th ed. 2009); *see also* Rolf v. Blyth, Eastman Dillon & Co., 570 F.2d 38, 45 (2d Cir. 1978) (noting the common law origin of the term scienter as a state of mind requirement). To satisfy the element of scienter in a Rule 10b-5 securities fraud case, a plaintiff needs to plead and prove that the individual who has omitted material information or who has made a material misstatement either intended to do so or should have known that her actions would result in such materially misleading information reaching the marketplace. It is important to note that the Private Securities Litigation Reform Act of 1995 raised the pleading standard with respect to, *inter alia*, scienter in Rule 10b-5 securities fraud actions by requiring plaintiffs to "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." 15 U.S.C. § 78u-4(b)(2) (2006). The Supreme Court interpreted this language in *Tellabs, Inc. v. Makor Issues & Rights, Ltd.* to require a complaint to provide an inference of intent that is as "cogent and at least as compelling as any opposing inference." 551 U.S. 308, 314 (2007).

53. The element of connection to a purchase or sale stands for the proposition that no person may recover damages via Rule 10b-5 without having actually purchased or sold a security. *See* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 745–46

C. ELEMENTS OF RULE 10b-5 IN AN EFFICIENT CAPITAL MARKET

1. Materiality

In the context of securities fraud, materiality refers to the objective import of a particular piece of information from a reasonable investor's perspective.[56] The Supreme Court first defined the concept of materiality in the context of an alleged factual omission from proxy materials in *TSC Industries, Inc. v. Northway*.[57] In *TSC Industries*, Justice Marshall, writing for a unanimous Court, framed the concept of materiality in terms of whether there exists "a substantial likelihood that the disclosure of the omitted fact would have been viewed by a reasonable investor as having significantly altered the total mix of information made available."[58] A dozen years later, in the landmark decision *Basic, Inc. v. Levinson*,[59] the Supreme Court "expressly adopt[ed] the *TSC Industries* standard of materiality for the § 10(b) and Rule 10b-5 context."[60] A determination of materiality requires a highly

(1975) ("[I]t would be insufficient for a plaintiff to prove that he had failed to purchase or sell stock by reason of a defendant's violation of Rule 10b-5." (citing Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir. 1952))); *see also* HAZEN, *supra* note 35, § 12.7[3][B]. Accordingly, a complaint alleging that the plaintiff would have purchased or sold a security but for the defendant's material misrepresentation or omission will not survive a motion to dismiss. *See* Cohen v. Stratosphere Corp., 115 F.3d 695, 702 (9th Cir. 1997) (affirming the dismissal of a 10b-5 claim because the plaintiff lacked standing due to the lack of a purchase or sale).

54. The element of economic loss stands for the proposition that an investor must suffer an actual monetary loss in order to bring a securities fraud action that will survive a motion to dismiss. *See, e.g.*, McFeeley v. Florig, 966 F. Supp. 378, 384 (E.D. Pa. 1997); King v. Sharp, 63 F.R.D. 60, 63–64 (N.D. Tex. 1974).

55. *See In re* Omnicom Grp., Inc. Sec. Litig., 597 F.3d 501, 509 (2d Cir. 2010) (citing Dura Pharm., Inc. v. Broudo, 544 U.S. 336, 341–42 (2005)).

56. *See, e.g.*, TSC Indus., Inc. v. Northway, 426 U.S. 438, 449 (1976); Basic Inc. v. Levinson, 485 U.S. 224, 231–32 (1988).

57. *TSC Indus.,* 426 U.S. at 449.

58. *Id.* at 449. Justice Stevens did not participate in the disposition of the case.

59. 485 U.S. 224 (1988).

60. *Id.* at 231-32 (1988). It is worth noting that *Basic*, likely the most important modern securities fraud case handed down by the Supreme Court, was a plurality opinion.

fact-specific inquiry to evaluate the objective import of the particular statement in the context of all other available information.[61]

Facially, neither *TSC Industries* nor *Basic* requires any inquiry into market efficiency to determine if a statement or omission is material.[62] Rather, each case embraces the disclosure mandates embedded in the Securities Laws and requires companies to undertake an *ex ante* analysis of the import of a piece of information from a reasonable investor's perspective.[63] Some courts, however, undertake an *ex post* analysis of materiality by asking the simpler, empirical question—did the information in question cause a significant change in the price of the security?[64] As discussed in more detail below,[65] this approach runs afoul in two principal ways. First, it provides courts with the benefit of hindsight, while affording reporting companies no such luxury.[66] Second, it conflates the element of materiality with reliance and loss causation, rather than analyzing each element of Rule 10b-5 separately.[67]

2. Reliance

The element of reliance establishes a causal link between the defendant's material misstatement and the plaintiff's decision to buy or sell.[68] The most obvious way to establish reliance is for the plaintiff to plead and prove that they read the defendant's material misstatement

61. *See, e.g.*, *Basic*, 485 U.S. at 236 (1988) (stating that materiality is "an inherently fact-specific finding"); *In re* WorldCom, Inc. Sec. Litig., 346 F. Supp. 2d 628, 658 (S.D.N.Y. 2004) (commenting on the "fact-intensive inquiry that accompanies any analysis of materiality").

62. *Basic*, 485 U.S. at 231–32; *TSC Indus.*, 426 U.S. at 449.

63. *Basic*, 485 U.S. at 231; TSC Indus., 426 U.S. at 449.

64. *See, e.g.*, Oran v. Stafford, 226 F.3d 275 (3d Cir. 2000); *In re* Burlington Coat Factory Sec. Litig., 114 F.3d 1410 (3d Cir. 1997); *see also* Fischel, *supra* note 3, at 4.

65. *See infra* notes 200–25 and accompanying text.

66. *See, e.g.*, Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (2006); Regulation FD, 17 C.F.R. § 243.100(a) (2010) (requiring public disclosure of previously material nonpublic information that has been leaked to a third party without regard for the effect of the information on the company's stock price); *see also* HAZEN, *supra* note 38, § 12.19.

67. *See* Fischel, *supra* note 3, at 4. *But see* Semerenko v. Cendant Corp., 223 F.3d 165, 180 (3d Cir. 2000) (citing 2 THOMAS LEE HAZEN, THE LAW OF SECURITIES REGULATION § 13.5B (3d ed. 1995)) ("The reliance requirement is a corollary of materiality.").

68. Ross v. Bank S., N.A., 885 F.2d 723, 728 (11th Cir. 1989) (citing Lipton v. Documentation, Inc., 734 F.2d 740 (11th Cir. 1984)).

and consequently decided to purchase or sell on the basis of that incorrect or misleading information.[69] Reliance of this type is referred to as direct reliance.[70]

In addition to direct reliance, the Supreme Court has adopted two theories of so-called presumptive reliance.[71] In *Affiliated Ute Citizens of Utah v. United States*,[72] the Supreme Court held that reliance may be presumed when a defendant omitted a material fact.[73] Because it would be extremely difficult, if not impossible, for a plaintiff to prove that they relied on the absence of certain information, the Court in *Affiliated Ute* held that "[a]ll that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important" in deciding whether to buy or sell.[74]

In *Basic*, the Supreme Court again extended the reliance element of Rule 10b-5 and held that reliance may be presumed when a plaintiff purchased or sold a security in an "impersonal, efficient market" following the misstatement or omission of a material fact.[75] Known as the fraud-on-the-market theory ("FOTM"), the holding in *Basic* incorporated the ECMH into Rule 10b-5 jurisprudence.[76] In so doing, the Court reasoned that an investor who transacts in a security in an efficient market does so in reliance on the price of that security, which, in turn, reflects all available information, including any material misstatements or omissions, about that security.[77]

The more foundational question with respect to the FOTM, of whether the market is efficient, is often dispensed with quickly by the

69. *See, e.g.*, *Basic*, 485 U.S. at 241–42; Peil v. Speiser, 806 F.2d 1154, 1160–61 (3d Cir. 1986); Blackie v. Barrack, 524 F.2d 891, 905–06 (9th Cir. 1975).

70. *See, e.g.*, *Basic*, 485 U.S. at 242; *Peil*, 806 F.2d at 1160–61.

71. It should be noted that the circuits are currently split on a third possible presumption of reliance known as the fraud-created-the-market theory. That theory presumes that investors rely not on the price of securities but rather on the integrity of the market itself. *See, e.g.*, Matt Silverman, Note, *Fraud Created the Market: Presuming Reliance in Rule 10b-5 Primary Securities Market Fraud Litigation*, 79 FORDHAM L. REV. 1787 (2011); Julie A. Herzog, *Fraud Created the Market: An Unwise and Unwarranted Extension of Section 10(b) and Rule 10b-5*, 63 GEO. WASH. L. REV. 359 (1995).

72. 406 U.S. 128 (1972).

73. *Id.* at153–54.

74. *Id.*

75. *Basic*, 485 U.S. at 246, 248.

76. *See Basic*, 485 U.S. at 242; *see also Peil*, 806 F.2d at 1160–61.

77. *See Basic*, 485 U.S. at 242 (citing *Peil*, 806 F.2d at 1160–61).

courts.[78] In large, liquid trading environments, such as the New York Stock Exchange, market efficiency is presumed.[79] In over-the-counter markets,[80] courts generally consider expert testimony and look to factors such as (1) weekly trading volume; (2) the number of securities analysts following the company in question; (3) the number of market makers with respect to the security in question; (4) the company's eligibility to file a Form S-3 Registration Statement;[81] and (5) "empirical facts showing a cause and effect relationship between unexpected corporate events or financial releases and an immediate response in stock price."[82]

It is important to note that a defendant may rebut both the *Affiliated Ute* and *Basic* presumptions of reliance by showing that the plaintiff did not actively rely on the material misstatement or omission.[83] As a practical matter, because the overwhelming majority of securities fraud class actions settle, and such rebuttal would occur at trial, rebutting an alleged presumption of reliance hardly ever occurs.[84]

3. Loss Causation

The element of loss causation refers to "the causal connection between the material misrepresentation and the loss."[85] In securities fraud, as in common law fraud,[86] it is insufficient to demonstrate mere

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78. Silverman, *supra* note 71, at 1787.

79. *See* Cammer v. Bloom, 711 F. Supp. 1264, 1277 (D.N.J. 1989).

80. *See* HAZEN, *supra* note 35, § 1.1.

81. COX ET AL., *supra* note 33, at 184–86 (explaining that form S-3 provides certain established issuers the opportunity to register classes of securities in a simpler, streamlined manner by allowing for, *inter alia*, the integration of previous filings into an issuer's registration statement).

82. *Cammer*, 711 F. Supp. at 1286–87.

83. *See Basic*, 485 U.S. at 245; Affiliated Ute Citizens v. United States, 406 U.S. 128, 153–54 (1972); *see also* Jeffrey L. Oldham, Comment, *Taking "Efficient Markets" Out of the Fraud-on-the-Market Doctrine After the Private Securities Litigation Act*, 97 NW. U. L. REV. 995, 997 (2003); Silverman, *supra* note 71, at 1800 nn.116–18.

84. *See In re* Oxford Health Plans, Inc. Sec. Litig., 182 F.R.D. 42, 47 n.5 (S.D.N.Y. 1998) ("An overwhelming percentage of securities class actions are settled . . . .") (citing Joseph A. Grundfest & Michael A. Perino, *Ten Things We Know and Ten Things We Don't Know About the Private Securities Litigation Reform Act of 1995*, 1015 PLI/Corp. 1015, 1027 (1997)); *see also* Oldham, *supra* note 83, at 1005; Silverman, *supra* note 71, at 1800 n.117.

85. Dura Pharm., Inc. v. Broudo, 544 U.S. 336, 342 (2005).

86. *See In re* Cendant Corp. Sec. Litig., 76 F. Supp. 2d 531, 534 (D.N.J. 1999) (stating that Rule 10b-5 fraud, "although statutory in origin, sounds in the common law of fraud and deceit and retains, in modified form, the common law elements of duty,

correlation between the defendant's misstatement and the plaintiff's economic loss.[87] Rather, to avoid Rule 10b-5 from being used as a form of "investors' insurance,"[88] the plaintiff must prove that the defendant's material misstatement was in a "reasonably direct, or proximate, way responsible" for the plaintiff's economic loss.[89] Take, for instance, the following example. On Monday, ABC Company makes a material misstatement. On Tuesday, Investor X purchases securities of ABC Company relying on that material misstatement, either directly or via the reliance presumptions set forth in *Affiliated Ute* or *Basic*. On Wednesday, ABC Company releases a statement correcting the material misstatement it made on Monday (referred to as a corrective disclosure). After the corrective disclosure is released, the price of ABC Company's securities declines significantly and Investor X, who sold her securities thereafter, suffers an economic loss. For Investor X to properly plead and prove loss causation in this hypothetical situation, she would need to demonstrate that the fraud, revealed to the market by means of a corrective disclosure, caused her price of the securities to depreciate and, therefore, caused their economic loss.[90] In the rare instance of trial, plaintiffs generally attempt to prove loss causation via expert testimony, in which the plaintiff's expert presents statistical data, usually in the form of an event study,[91] that seeks to establish a causal link between the corrective disclosure and the economic loss.[92] Generally speaking, defendants also utilize expert testimony to attempt to rebut or discredit

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breach, causation, and damages) (citing Huddleston v. Herman & MacLean, 640 F.2d 534, 547 (5th Cir. 1981)).

87. *See Dura*, 544 U.S. at 342.

88. *Id.* at 345 (citing *Basic*, 485 U.S. at 252 (White, J., concurring in part and dissenting in part)) ("[A]llowing recovery in the face of affirmative evidence of nonreliance would effectively convert Rule 10b-5 into a scheme of investor's insurance.").

89. *In re* Sahlen & Assocs., Inc. Sec. Litig., 773 F. Supp. 342, 359 (S.D. Fla. 1991); *see* HAZEN, *supra* note 35, § 12.11.

90. *See Dura*, 544 U.S. at 342.

91. An event study is a form of statistical regression analysis that seeks to determine the causal link between two events. *See* Michael J. Kaufman & John M. Wunderlich, *Regressing: The Troubling Dispositive Role of Event Studies in Securities Fraud Litigation*, 15 STAN. J.L. BUS. & FIN. 183, 195 (2009).

92. *See id.*

the evidence presented by the plaintiff's expert, resulting in a so-called "battle of the experts."[93]

II. THE CIRCUIT SPLIT

It is clear that to succeed on the merits in a Rule 10b-5 claim, a plaintiff must demonstrate that the defendant's previous material misstatements, revealed to the market by means of a corrective disclosure, caused the plaintiff's economic loss.[94] Since *Dura*, this has been established as black-letter law.[95] One point that is not clear, however, is how quickly the price of a security must depreciate after the release of a corrective disclosure. This question has split those circuits that have provided an opinion into two camps. The Second, Third, and Eleventh Circuits require a security to depreciate "immediately" following the release of a corrective disclosure. Conversely, the Fifth, Sixth, and Ninth Circuits draw no bright-line rules and engage each case on its facts. On March 7, 2011, the Supreme Court declined to resolve this split of authority.[96]

A. IMMEDIATE DEPRECIATION REQUIRED

The Second Circuit, Third Circuit, and Eleventh Circuit all require an immediate depreciation in the price of a security following the release of a corrective disclosure. Absent such a showing, a complaint alleging Rule 10b-5 securities fraud will not survive a motion to dismiss.[97] Although each case turns on its own facts, it is important to note that in each case discussed below, the plaintiffs pled reliance based

93. *See id.*; *see also* Martis Alex & Michael W. Stocker, *Role of the Event Study in Loss Causation Analysis*, 242 N.Y. L.J. 36 (2009).

94. *Dura*, 544 U.S. at 336.

95. *Cf.* Find What Investor Grp. v. FindWhat.com, 658 F.3d 1282, 1316–17 (11th Cir. 2011) (holding that defendants can be liable under Rule 10b-5 for failure to take affirmative steps to limit the period during which a security is trading at an inflated price); *see also* Lyle Roberts, *Repeating Falsehoods*, THE 10B-5 DAILY (Oct. 7, 2011, 10:10 PM), http://www.the10b-5daily.com/archives/001154.html.

96. *In re* Apollo Grp., Inc. Sec. Litig., No. 08-16971, 2010 WL 5927988 (9th Cir. June 23, 2010), *cert. denied*, 131 S. Ct. 1602 (2011).

97. *See, e.g.*, *In re* Omnicom Grp., Inc. Sec. Litig., 597 F.3d 501, 509 (2d Cir. 2010); Thompson v. RelationServe Media, Inc., 610 F.3d 628 (11th Cir. 2010); Oran v. Stafford, 226 F.3d 275 (3d Cir. 2000).

on FOTM.[98] Accordingly, at the time of transaction, the relevant district courts presumed that the plaintiffs purchased securities in an efficient market.

The Third Circuit, in *Oran v. Stafford*, was the first to consider and opine on how fast an efficient market incorporates information.[99] In *Oran*, the plaintiff class alleged that American Home Products Corp. ("AHP"), a major pharmaceutical company, made material misstatements and omissions about the safety of two weight-loss drugs—Pondimin and Redux—that doctors often prescribed in tandem and colloquially referred to as "fen-phen."[100] According to the plaintiffs allegations, AHP learned about heart valve abnormalities in fen-phen patients as early as February 1994 and, although AHP looked into the matter internally, failed to disclose any such information to its investors.[101] On July 8, 1997, AHP, the Food and Drug Administration (the "FDA"), and others issued a joint press release that disclosed reports of heart valve abnormalities in a population of fen-phen patients, emphasized the seriousness of these reports, and noted that there was no conclusive evidence of a causal relationship between fen-phen and heart valve abnormalities.[102] AHP's stock price did not decline.[103] Two months later, on September 12, 1997, the FDA showed AHP data indicating that 92 of 291 fen-phen patients developed heart valve abnormalities.[104] On September 15, 1997, the next business day, AHP pulled fen-phen from the market and issued a press release projecting lost profits of $0.14 per share for fiscal year 1997 and fiscal year

98. *See, e.g.*, Complaint, Oran v. Stafford, 34 F. Supp. 2d 906 (D.N.J. 1999) (No. 97-4513); Complaint at 110, *In re* Omnicom Grp., Inc. Sec. Litig., 233 F.R.D. 400 (S.D.N.Y. 2006) (No. 02-CV-4483); *Thompson*, 610 F.3d at 680 (Tjoflat, J., concurring in part and dissenting in part) ("I will read [the plaintiff's] Rule 10b-5 claim broadly to invoke the fraud-on-the-market doctrine.").

99. 226 F.3d 275 (3d Cir. 2000). It is important to note that *Oran* was decided five years before *Dura*—the seminal Supreme Court case regarding loss causation. In this regard, one could argue that *Oran* is not relevant to the issue at hand both because it predates *Dura* and because it does not comment on the issue of loss causation but rather engages in a post hoc analysis of materiality. As argued below, the Third Circuit's approach in *Oran* improperly frames the concept of loss causation in the context of materiality, which should be analyzed separately in the context of Rule 10b-5 litigation.

100. *Id.* at 279.

101. *Id.*

102. *Id.* at 280.

103. *Id.*

104. *Id.*

1998.[105] AHP's stock price dropped $3^{11/16}$ points, to 73¼.[106] The next day, despite a *Wall Street Journal* article warning about possible class action suits, AHP's stock gained slightly.[107] On September 17, 1997, both the *Wall Street Journal* and the *New York Times* published articles indicating that AHP knew of abnormalities since at least March of 1997, and likely faced substantial liability.[108] Subsequently, AHP's stock price dropped $4^{1/4}$ points.[109] Plaintiffs brought suit alleging Rule 10b-5 securities fraud.[110] The District of New Jersey dismissed the suit, holding that the July 8, 1997 press release fully disclosed the risks to the market and, therefore, because there was no appreciable decline in AHP's stock price immediately thereafter, the alleged misstatement was immaterial as a matter of law.[111]

In an opinion by then-Judge Alito, the Third Circuit affirmed.[112] Echoing the views of the District Court, Judge Alito analyzed the issue not in terms of loss causation, but rather in terms of materiality in an efficient market.[113] Endorsing the ECMH as orthodoxy, Judge Alito stated that in an efficient market such as the New York Stock Exchange, where AHP traded its shares, material information is *immediately* incorporated into stock prices.[114] As such, "when a stock is traded in an efficient market, the materiality of disclosed information may be measured *post hoc* by looking to the movement, in the period immediately following disclosure, of the price of the firm's stock."[115] Therefore, because AHP's stock price did not immediately depreciate following the July 8, 1997 disclosure—in fact, as then-Judge Alito

105. *Id.*
106. *Id.*
107. *Id.*
108. *Id.*
109. *Id.*
110. *Id.* at 281.
111. *Id.*
112. *Id.* at 275.
113. *Id.* at 281–87.
114. *Id.* at 282 ("In *Burlington*, however, this Court fashioned a special rule for measuring materiality in the context of an efficient securities market. This rule was shaped by the basic economic insight that in an open and developed securities market like the New York Stock Exchange, the price of a company's stock is determined by all available information regarding the company and its business. In such an efficient market, 'information important to reasonable investors . . . is immediately incorporated into the stock price.'" (quoting *In re* Burlington Coat Factory Sec. Litig., 114 F.3d 1410, 1417 (3d Cir. 1997) (emphasis added))).
115. *Id.* at 282.

pointed out, AHP's share price rose by $3.00 during the four days following the July 8 press release—the misstatements and omissions alleged were immaterial as a matter of law.[116]

A decade after *Oran*, the Second Circuit took a position in *In re Omnicom Group, Inc. Securities Litigation*.[117] According to the plaintiff class, Omnicom Group—a global advertising firm—entered into a transaction with Pegasus Partners II, L.P.—a private equity firm—in the first quarter of 2001.[118] The entire purpose of the transaction was to transfer Omnicom Group's interests in multiple internet companies, the values of which were depreciating rapidly in the wake of the dotcom bubble.[119] At the time of the transaction, multiple news sources commented on the transaction and, similar to the plaintiff class, suggested "that it was an attempt to move the internet companies, whose value was deteriorating, off Omnicom's books."[120] In spite of this coverage, Omnicom Group's stock did not exhibit a statistically significant drop in price.[121] Over a year later, on June 5, 2002, Omnicom Group filed a Form 8-K disclosing that an outside director who sat on the audit committee resigned from the Board.[122] Over the course of the next several days, multiple news sources commented on the director's departure.[123] On June 12, 2002, the *Wall Street Journal* published the most negative article to date, noting disagreement with the internet companies transaction, aggressive accounting habits, possible cash flow concerns, an increase in borrowing, and off-balance sheet earn out obligations.[124] Later that day, Omnicom held a conference call during which it concomitantly tried to reassure its investors, while admitting that the director in question did resign for the reasons

116. *Id.* at 282–83.
117. 597 F.3d 501 (2d Cir. 2010).
118. *Id.* at 504.
119. *Id.* at 505 n.1, 504–05; *see also* Complaint at 27, *In re* Omnicom Group, Inc. Sec. Litig., 233 F.R.D. 400 (S.D.N.Y. 2006) (No. 02-CV-4483) ("As a result of the serious, other than temporary impairment that had been sustained by its e-services investments, Omnicom was required to write-down these investments in accordance with GAAP. But rather than taking these write-downs and suffering the inevitable blow to its earnings that resulted from its losing investments, Omnicom perpetrated a scheme to move these losses off its books and maintain the façade of continued growth.").
120. *In re Omnicom*, 597 F.3d at 505.
121. *Id.*
122. *Id.*
123. *Id.*
124. *Id.*

suggested in the *Wall Street Journal* article.[125] In the two days following the article, Omnicom's stock price dropped more than 25% relative to trading prices and activity in the market and the industry.[126] Notwithstanding the steep drop in price, on June 13, 2002, a Lehman Brothers analyst stated in a report that the previous day's *Wall Street Journal* article "did not bring up any substantial 'new' issues."[127] Following extensive discovery, the Southern District of New York granted Omnicom's motion for summary judgment, holding that, in light of the timing of the disclosures relative to the drop in Omnicom Group's stock price, there existed no issue of material fact and, accordingly, the plaintiff could not prove loss causation.[128]

On appeal, the Second Circuit affirmed.[129] Framing the issue in terms of loss causation, rather than following the Third Circuit's *post hoc* materiality analysis, the Second Circuit stated that the June 6, 2002 *Wall Street Journal* article did not properly constitute a corrective disclosure because "a negative journalistic characterization of previously disclosed facts does not constitute . . . anything but the journalists' opinions."[130] Therefore, because the article contained no new "hard fact[s]" and merely commented on facts that were already known to the market for over a year, there was no causal connection between the article and the drop in price.[131] Moreover, because the market was aware of the alleged material misrepresentations for more than a year and because such "numerous public reports . . . were 'promptly digested' by the market," the plaintiffs' theory of loss causation was untenable as a matter of law.[132]

Strictly interpreted, the Second Circuit's opinion in *Omnicom* does not require an immediate drop in price.[133] Rather, *Omnicom* stands for the narrow proposition that a plaintiff cannot establish loss causation

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125. *Id.* at 507.
126. *Id.* at 508.
127. *Id.* at 507.
128. *Id.* at 505 ("Several news articles at or near the time reported the Seneca transaction and suggested that it was an attempt to move the internet companies, whose value was deteriorating off Omnicom's books. Indeed, observers expressed these views well into 2002. However, Onmicom's stock never experienced any statistically significant drop in value at or near the time of these news reports.").
129. *Id.* at 514.
130. *Id.* at 512.
131. *Id.*
132. *Id.* at 513.
133. *Id.* at 504.

when a security depreciates over a year after a material misstatement is made in a market that "promptly digests" such information.[134] However, two years earlier in *Teamsters Local 445 Freight Division Pension Fund v. Bombardier, Inc.*,[135] the same court, in the context of analyzing market efficiency at the class certification stage, stated that "[e]vidence that unexpected corporate events or financial releases cause an immediate response in the price of a security has been considered . . . 'the essence of an efficient market and the foundation for the fraud on the market theory.'"[136] The *Teamsters* opinion thus made clear that the Second Circuit treats markets as inherently efficient, and, when read in conjunction with *Omnicom*, suggests that corrective disclosures will result in immediate price depreciation.[137] In turn, immediate price depreciation seems to be required to establish loss causation in a Rule 10b-5 action in the Second Circuit.[138]

The most ardent judicial supporter of the immediate price drop requirement is Judge Tjoflat of the Eleventh Circuit.[139] In his partially-concurring and partially-dissenting opinion in *Thompson v. RelationServe Media, Inc.*,[140] Judge Tjoflat[141] argued that a plaintiff

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134. *Id.* at 511.

135. 546 F.3d 196 (2d Cir. 2008).

136. *Id.* at 207 (quoting Cammer v. Bloom, 711 F. Supp. 1264 (D.N.J. 1989)).

137. Brief for Former SEC Commissioners and Law Professors as Amici Curiae in Support of Petitioners' Petition, Apollo Grp., Inc. v. Policemen's Annuity & Benefit Fund of Chi., 131 S. Ct. 1602 (2001) (No. 10-649), 2010 WL 5172861 at *6 n.5 ("Other circuits that follow the [immediate price depreciation approach] include the Second Circuit . . . .").

138. Recent case law in the Southern District of New York suggests an even more stringent position with respect to loss causation. *See In re* China N. E. Petroleum Holdings Ltd. Sec. Litig., 819 F. Supp. 2d 351 (S.D.N.Y. 2011) ("A plaintiff who forgoes a chance to sell at a profit following a corrective disclosure cannot logically ascribe a later loss to devaluation caused by the disclosure."); *see also* Lyle Roberts, *Around the Web*, THE 10b-5 DAILY (Oct. 21, 2011, 6:01 PM), http://www.the10b-5daily.com/archives/2011_10.html.

139. *See* Thompson v. RelationServe Media, Inc., 610 F.3d 628, 639–700 (11th Cir. 2010) (Tjoflat, J., concurring in part and dissenting in part).

140. 610 F.3d 628, 689–90 (Tjoflat, J., concurring in part and dissenting in part).

141. It should be noted that this is, at least, Judge Tjoflat's second major extra-opinion comment with respect to market efficiency in the context of Rule 10b-5 litigation. In a widely cited concurrence in *Ross v. Bank South, N.A.*, 885 F.2d 723 (11th Cir. 1989), Judge Tjoflat argued in favor of an "economic unmarketability" standard for plaintiffs seeking to plead reliance via the fraud-created-the-market theory. *Id.* at 736 (Tjoflat, J., concurring). The commonality between Judge Tjoflat's opinions

cannot properly demonstrate loss causation when a corrective disclosure is made to the market well before the drop in price. Judge Tjoflat, however, goes a step further and states that such arguments are "legally frivolous because [they] advance[] an untenable theory of loss causation."[142] While Judge Tjoflat's dissent does not carry the force of law, his argument goes so far as to suggest that Federal Rule of Civil Procedure 11 sanctions are appropriate in cases where a decline in price does not immediately follow the corrective disclosure.[143]

B. IMMEDIATE DEPRECIATION NOT REQUIRED

In sharp contrast to the Second, Third, and Eleventh Circuits, the Ninth Circuit has endorsed a fact-specific rule with respect to loss causation and does not draw any bright-line rules based on the ECMH.[144] In *In re Apollo Group, Inc. Securities Litigation*, the plaintiff class alleged that the for-profit education provider, Apollo Group, made material misstatements about a Department of Education ("DOE") investigation regarding its student recruiting policies which ultimately resulted in its stock depreciating.[145] In August 2003, DOE began investigating Apollo about potential violations of student recruiting standards mandated by the Higher Education Act.[146] Such violations, if true, threatened Apollo's eligibility for Title IV funding.[147] On February 5, 2004, DOE provided Apollo with a report indicating that Apollo had violated applicable student recruiting standards.[148] On September 7, 2004, Apollo announced it reached a settlement with DOE for $9.8

in *Thompson* and *Ross* seems to be strict adherence to the ECMH, in both the primary and secondary markets.

142. *Id.* at 689.

143. *Id.*; *see also* FED. R. CIV. P. 11 (allowing the court to issue sanctions in cases where parties offer frivolous arguments).

144. *See, e.g.*, *In re* Apollo Grp., Inc. Sec. Litig., No. CV 04-2147-PHX-JAT, 2008 WL 3072731, at *2–3 (D. Ariz. 2008), *rev'd on other grounds*, No. 08-16971, 2010 WL 5927988 (9th Cir. June 23, 2010); Lormand v. US Unwired, Inc., 565 F.3d 228 (5th Cir. 2009); City of Monroe Emps. Ret. Sys. v. Bridgestone Corp., 399 F.3d 651 (6th Cir. 2005).

145. *In re* Apollo Grp., Inc. Sec. Litig., No. CV 04-2147-PHX-JAT, 2008 WL 3072731, at *1 (D. Ariz. 2008).

146. Petition for Writ of Certiorari at 5, Apollo Grp., Inc. v. Policemen's Annuity & Benefit Fund, 131 S. Ct. 1602 (2011) (No. 10-649), 2010 WL 4655891, at *5.

147. *Id.*

148. *Id.* at 6.

million.[149] Apollo's stock price did not decline.[150] One week thereafter, no fewer than four widely read newspapers published articles relating to Apollo's recruiting practices and the settlement with the DOE.[151] Once again, Apollo's stock price did not decline.[152] On September 20, 2004, a UBS analyst published a report—containing no new facts—that cast Apollo in a negative light and downgraded its buy-sell rating from "Neutral" to "Reduce."[153] The next day, Apollo's stock price dropped significantly.[154] Following a full trial in the District of Arizona, the jury returned a verdict in favor of the plaintiff class.[155] Thereafter, Apollo motioned for judgment as a matter of law notwithstanding the verdict pursuant to Federal Rule of Civil Procedure 50(b).[156] Judge Teilborg granted the motion, holding that the UBS report could not constitute a corrective disclosure because it disclosed no new facts and, since no new facts came to the market after the newspaper articles were published approximately a week beforehand, loss causation could not be established.[157]

In an unpublished memorandum opinion, the Ninth Circuit reversed.[158] Citing its previous holding in *In re Gilead Sciences Securities Litigation*, the court held that a jury could reasonably conclude that the UBS report did constitute a corrective disclosure that

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149. *In re* Apollo Grp., Inc. Sec. Litig., 2008 WL 3072731, at *1; Petition for Writ of Certiorari at 6, *Apollo Grp., Inc.*, 131 S. Ct. 1602 (2011) (No. 10-649), 2010 WL 4655891, at *7.

150. *In re* Apollo Grp., Inc. Sec. Litig., 2008 WL 3072731, at *1; Petition for Writ of Certiorari at 6–7, *Apollo Grp., Inc.*, 131 S. Ct. 1602 (2011) (No. 10-649), 2010 WL 4655891, at *8.

151. *In re* Apollo Grp., Inc. Sec. Litig., 2008 WL 3072731, at *1; Petition for Writ of Certiorari at 7, *Apollo Grp., Inc.*, 131 S. Ct. 1602 (2011) (No. 10-649), 2010 WL 4655891, at *8.

152. *In re* Apollo Grp., Inc. Sec. Litig., 2008 WL 3072731, at *1; Petition for Writ of Certiorari at 8, *Apollo Grp., Inc.*, 131 S. Ct. 1602 (2011) (No. 10-649), 2010 WL 4655891, at *8.

153. Petition for Writ of Certiorari at 9, *Apollo Grp., Inc.*, 131 S. Ct. 1602 (2011) (No. 10-649), 2010 WL 4655891, at *9.

154. *In re* Apollo Grp., Inc. Sec. Litig., 2008 WL 3072731, at *1; Petition for Writ of Certiorari at 9, *Apollo Grp., Inc.*, 131 S. Ct. 1602 (2011) (No. 10-649), 2010 WL 4655891, at *9.

155. *In re* Apollo Grp., Inc. Sec. Litig., 2008 WL 3072731, at *1–2.

156. *Id.*

157. *Id.* at *2–3.

158. *In re* Apollo Grp., Inc. Sec. Litig., No. 08-16971, 2010 WL 5927988 (9th Cir. June 23, 2010).

provided "additional or more authoritative fraud-related information that deflated the stock price."[159] In this regard, the UBS report could constitute a corrective disclosure because, although the market had all the information contained in the report, the market "failed to appreciate [the] significance"[160] or the "intensity and credibility" of the information previously disclosed.[161]

The Fifth Circuit has used a similar fact-specific rule with respect to loss causation. In *Lormand v. US Unwired, Inc.*,[162] the plaintiff class alleged that US Unwired—a digital mobile service provider and an affiliate of Sprint Wireless—made continuous material misstatements regarding its short- and medium-term business prospects.[163] Allegedly, US Unwired made positive public representations notwithstanding the fact that contract obligations with Sprint Wireless, which began in September of 2000 at the latest, proved to be "disastrous."[164] Although it did publicly disclose details of contract obligations and corresponding business plans related to Sprint Wireless, US Unwired "never accurately disclosed the known risks involved" and continued to tout its ongoing prospects.[165] Finally, on March 5, 2002, US Unwired, in its 10-K filing with the SEC, disclosed some general risks involved in its obligations to Sprint Wireless but "did not disclose the potential magnitude of those risks nor the fact that some of those risks had been realized."[166] All the while, US Unwired privately pleaded with Sprint Wireless to relieve it of obligations that left it "reeling from the damage."[167] Finally, between June 6, 2002 and August 13, 2002, multiple disclosures reached the market regarding US Unwired's unprofitable obligations.[168] US Unwired's stock price plummeted from \$4.94 to \$0.90.[169] The District Court, although it did not clearly articulate a position regarding an

159. *Id.* at *1.
160. *Id.* (citing *In re* Gilead Scis. Sec. Litig., 536 F.3d 1049, 1058 (9th Cir. 2008)).
161. *Id.* at *1 (citing Hanon v. Dataproducts Corp., 976 F.2d 497, 503 (9th Cir. 1992)).
162. 565 F.3d 228 (5th Cir. 2009).
163. *Id.* at 231.
164. *Id.* at 234.
165. *Id.*
166. *Id.*
167. *Id.* at 236.
168. *Id.* at 231–32 (noting continuous material misstatements regarding two aspects of US Unwired's business: (1) the implementation of a Sprint-backed plan to attract new "sub-prime" subscribers and (2) the overall character of US Unwired's business relationship with Sprint).
169. *Id.*

immediacy requirement in the context of loss causation, granted US Unwired's motion to dismiss and held, *inter alia*, that the plaintiff failed to adequately plead loss causation.[170]

On appeal, the Fifth Circuit held that US Unwired's shares traded in an efficient market and, therefore, US Unwired's material misstatements regarding its business prospects led to an artificially inflated stock price.[171] However, unlike in *Oran* and *Omnicom*, the Court held that "loss causation may be pleaded through a series of partial disclosures that caused the stock price deflation."[172] Accordingly, from June 6, 2002 to August 8, 2002, the "truth about the artificial inflation of US Unwired's stock leaked . . . its way into the marketplace" and "the final public disclosures completed the revelation of the truth."[173] Finally, the Court stated:

> The market could plausibly have had a delayed reaction; a delayed reaction can still satisfy the pleading requirements for "loss causation" though *proof* of causation would be more difficult when significant time elapses before the market allegedly reacts . . . . The actual timing issue is a factual question, and it is not enough to dismiss a complaint that *alleges* a specific causal link . . . under Rule 12(b)(6).[174]

In no uncertain terms, the Fifth Circuit noted that markets, even those that traditionally behave efficiently,[175] do not always immediately incorporate news into price, and such a delayed reaction can still satisfy the loss causation pleading requirement.[176]

In addition to the Fifth and Ninth Circuits, the Sixth Circuit also does not appear to require an immediate depreciation in price. In *City of*

170. *See id.* at 261 n.31, 266.
171. *Id.* at 258–59.
172. *Id.* at 261 n.31.
173. *Id.* at 259, 261.
174. *See id.* at 266 n.33 (citation omitted).
175. The Court in *Lormand* notes that during the time frame between the material misstatements and the purchases of shares by the plaintiff class, US Unwired stock traded in an efficient market. *See id.* at 259. Although this statement has the potential to confuse the reader, it is important to keep in mind that the Court's commentary regarding market efficiency in this context refers to the reliance stage of a securities fraud class action. *See id.* ("[D]efendants' material omissions . . . caused US Unwired's stock prices to artificially inflate."). The Court's discussion of loss causation, as noted, makes clear that markets can plausibly have delayed reactions. *Id.* at 266 n.33.
176. *See id.* at 266 n.33, 267–68.

Monroe Employees Retirement Systems v. Bridgestone Corp.,[177] the Sixth Circuit framed the issue of loss causation in the context of the ECMH.[178] In fact, the Sixth Circuit even quoted the Third Circuit and stated that "information important to reasonable investors . . . is immediately incorporated into stock prices."[179] Even so, the Sixth Circuit "measured the stock price reaction over a six-week period."[180] In this regard, even though the Court's language implies otherwise, the fact that it measured damages during a period post-dating the corrective disclosure strongly suggests that that Sixth Circuit, like the Fifth and Ninth Circuits, favors a fact-specific rule with respect to loss causation.

III. COURTS SHOULD FOLLOW THE FIFTH CIRCUIT'S DECISION IN *LORMAND*

In analyzing the question of how quickly the price of an equity security must depreciate following the release of a corrective disclosure to the market, courts should look to the Fifth Circuit's reasoning in *Lormand* and recognize that, even in the context of markets where news is most often immediately incorporated into price, sometimes markets for securities behave inefficiently. Adopting such a fact-specific rule (1) comports with contemporary economic research calling into question the ECMH; (2) properly and separately analyzes each element of Rule 10b-5; and (3) is consistent with other landmark holdings in Rule 10b-5 litigation, all of which have rejected bright-line rules in favor of fact-specific inquiries. Finally, such a rule neither extends Section 10(b) or Rule 10b-5 beyond their intended purpose, nor is it a form of investors' insurance.

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177. 399 F.3d 651 (6th Cir. 2005).

178. *Id.* at 675–76.

179. *Id.* at 676 (quoting *In re* Burlington Coat Factory Sec. Litig., 114 F.3d 1410, 1425 (3d Cir. 1997)).

180. Petition for Writ of Certiorari at 20, Apollo Grp., Inc. v. Policemen's Annuity & Benefit Fund, 131 S. Ct. 1602 (2011) (No. 10-649), 2010 WL 4655891, at *20 (citing City of Monroe Emps. Ret. Sys. v. Bridgestone Corp*.,* 399 F.3d at 651).

A. CONTEMPORARY CRITICISM OF THE EFFICIENT CAPITAL MARKETS HYPOTHESIS

Since Fama's seminal work in 1970, several scholars and commentators have called into question the accuracy of the ECMH.[181] The scholarship is extensive and challenges the ECMH in many forms: complex statistical studies identifying persistent pricing anomalies;[182] the burgeoning field of behavioral economics, particularly in the context of noise theory;[183] and historical instances of pricing bubbles in 2000 and 2008 which highlight blatant instances of incorrect valuation.[184] Even Fama himself, who maintains that the ECMH is the best analytical tool with which to analyze market movement,[185] has stated that the ECMH "[l]ike all models . . . is a faulty description of price formation."[186]

Notwithstanding vigorous arguments to the contrary, the ECMH maintains staunch supporters.[187] Michael Jensen, who famously referred

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181. *See, e.g.*, FOX, *supra* note 3; Lynn A. Stout, *The Mechanisms of Market Inefficiency: An Introduction to the New Finance*, 28 J. CORP. L. 635 (2003); Ming Deng, *Death of the Efficient Market Hypothesis* (20th Australasian Finance & Banking Conference 2007 Paper), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1006716; William K.S. Wang, *Some Arguments that the Stock Market Is Not Efficient*, 19 U.C. DAVIS L. REV. 341 (1985); Sanford J. Grossman & Joseph Stiglitz, *On the Impossibility of Informationally Efficient Markets*, 70 AM. ECON. REV. 393 (1980); Alan Kirman, *Economic Theory and the Crisis*, VOXEU (Nov. 14, 2009), http://www.voxeu.org/article/economic-theory-and-crisis; Brian Milner, *Sun Finally Sets on Notion That Markets Are Rational*, GLOBE AND MAIL (July 3, 2009, 7:40 PM), http://www.theglobeandmail.com/globe-investor/investment-ideas/sun-finally-sets-on-notion-that-markets-are-rational/article4301916/; Greg Hoffman, *Paul the Octopus Proves Buffett Was Right*, SYDNEY MORNING HERALD (July 14, 2010), *available at* http://www.smh.com.au/business/paul-the-octopus-proves-buffett-was-right-20100714-10air.html; Justin Fox, *Is the Market Rational? No, Say the Experts. But Neither Are You – So Don't Go Thinking You Can Outsmart It*, FORTUNE (Dec. 9, 2002).

182. *See, e.g.*, Wang, *supra* note 181; Grossman & Stiglitz, *supra* note 181.

183. *See, e.g.*, Langevoort, *supra* note 4, at 858–89; Stout, *supra* note 181, at 665–66.

184. *See* FOX, *supra* note 3.

185. Fama, *Adjustment of Stock Prices*, *supra* note 20, at 1.

186. *Id.*

187. *See, e.g.*, *id.*; Michael C. Jensen, *The Takeover Controversy: Analysis and Evidence*, MIDLAND CORP. FIN. J., Summer 1986, AT 6, 11; Fama, *supra* note 3, at 387; Langevoort, *supra* note 4, at 858–89.

to the ECMH as the most empirically evidenced theory in economics, has reinforced his sweeping comment by stating "there is no better documented proposition in any of the social sciences."[188] The ECMH has even garnered general support from Daniel Kanheman, a Nobel Laureate psychologist whose work has greatly influenced behavioral economics.[189] When recently asked about market efficiency, Kanheman stated that "[w]hat the market does do very well is that it cancels random errors."[190]

Notwithstanding the fervent debate, the ECMH remains sacrosanct in the legal context.[191] According to Donald Langevoort, the legal profession behaves as though "economists proved the [ECMH thirty years ago] and moved on to other topics entirely, so that all that is left is for the law to come into conformity with this intellectual orthodoxy."[192] While the purpose of this paper is neither to discredit the ECMH nor to take a side in the debate regarding its accuracy, it does seem counter-intuitive for the courts to draw strict categorical rules based on an unsettled economic theory.[193] Any further strict adherence to the ECMH in an abstract, categorical sense, contributes only to continued willful blindness on the part of the legal community.[194] Accordingly, courts should recognize, as economists and financial professionals long-since have, that securities prices sometimes do behave inefficiently[195] and, in such instances, plaintiffs should have the opportunity to prove loss causation over time in an inefficient market.[196]

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188. Jensen, *supra* note 192, at 11; *see also* Langevoort, *supra* note 4, at 853 n.8.

189. *See, e.g.*, Cass R. Sunstein, *Behavioral Analysis of Law*, 64 U. CHI. L. REV. 1175, 1175–77 (1997); Colin Camerer, Samuel Issacharoff, George Lowenstein, Ted O'Donoghue & Matthew Rabin, *Regulation for Conservatives: Behavioral Economics and the Case for "Asymmetric Paternalism*," 151 U. PA. L. REV. 1211, 1215 n.14 (2003).

190. *Power Lunch: Interview with Daniel Kanheman* (CNBC television broadcast Oct. 28, 2011), *available at* http://video.cnbc.com/gallery/?video=3000053951.

191. Langevoort, *supra* note 4, at 855.

192. *Id.*

193. *See* Cammer v. Bloom, 711 F. Supp. 1264, 1286–87 (D.N.J. 1989) ("It is not logical to draw bright-line tests . . . to assist fact finders in determining whether a stock trades in an 'open and efficient market.'").

194. *Cf.* Langevoort, *supra* note 4, at 854–55.

195. *See supra* notes 177–182 and accompanying text.

196. *See, e.g.*, *In re* Apollo Grp., Inc. Sec. Litig., No. CV 04-2147-PHX-JAT, 2008 WL 3072731, at *2–3 (D. Ariz. 2008); Lormand v. US Unwired, Inc., 565 F.3d 228 (5th Cir. 2009); City of Monroe Emps. Ret. Sys. v. Bridgestone Corp., 399 F.3d 651 (6th Cir. 2005).

B. TEMPORALLY ACCURATE AND INDIVIDUAL ANALYSIS OF EACH 10b-5 ELEMENT

At least four events must occur in every meritorious Rule 10b-5 claim: (1) ABC Company makes a material misstatement or omission at time t_1; (2) Investor X purchases securities of ABC Company based on presumed reliance[197] on ABC Company's material misstatement or omission at time t_2; (3) a corrective disclosure is released with respect to ABC Company's material misstatement or omission at time t_3; and (4) Investor X sells her ABC Company securities for a loss at time t_4.[198] Of course, each of these events occurs at a different point in time under the condition that $t_1 < t_2 < t_3 < t_4$. Depending upon which part of the country the Rule 10b-5 complaint is filed, however, this scenario will be analyzed very differently.[199]

Within the Third Circuit, the foundational question is whether the market is efficient.[200] Oftentimes, the market will be assumed efficient because the complaint will plead reliance based on the FOTM and the defendant will not rebut that presumption.[201] Assuming an efficient market, the only other relevant question is whether the market price of ABC Company's securities depreciated immediately following the release of the corrective disclosure (at time t_3).[202] If the answer is yes, then the plaintiff has established materiality and, most likely, loss

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197. Reliance could also be pled directly, i.e., Investor X actually read the material misstatement and decided to purchase based upon, *inter alia*, such information.

198. In this hypothetical situation, the transaction is structured chronologically as a purchase and sale. The hypothetical could just as easily be inverted as a sale and purchase. If the transaction in question involves a short sale, however, loss causation is a much more complex issue. *See* Wilamowsky v. Take-Two Interactive Software, Inc., No. 10-cv-7471, 2011 WL 4542754 (S.D.N.Y. Sept. 30, 2011); *see also* Lyle Roberts, *Win Big or Go Home*, THE 10B-5 DAILY (Oct. 28, 2011, 6:20 PM), http://www.the10b-5daily.com/archives/001156.html.

199. *Compare In re* Omnicom Group Inc. Sec. Litig., 597 F.3d 501, 509 (2d Cir. 2010), Thompson v. RelationServe Media, Inc., 610 F.3d 628 (11th Cir. 2010), *and* Oran v. Stafford, 226 F.3d 275 (3d Cir. 2000), *with In re* Apollo Grp., Inc. Sec. Litig., No. CV 04-2147-PHX-JAT, 2008 WL 3072731, at *2–3 (D. Ariz. 2008); Lormand v. US Unwired, Inc., 565 F.3d 228 (5th Cir. 2009); City of Monroe Emps. Ret. Sys. v. Bridgestone Corp., 399 F.3d 651 (6th Cir. 2005).

200. *See Oran*, 226 F.3d 275.

201. *See* Silverman, *supra* note 70, at 1798 (commenting on the effective necessity of presumptive reliance in the context of securities fraud class actions).

202. *See* Fischel, *supra* note 3, at 4; *see also* Oran, 226 F.3d 275, 282; *In re* Burlington Coat Factory Sec. Litig., 114 F.3d 1410, 1425 (3d Cir. 1997).

causation.[203] If the answer is no, then the alleged material misstatement was immaterial in the first instance and the issue of loss causation is moot.[204]

Within the Second and the Eleventh Circuits, the analysis is largely the same except that the *post hoc* determination of materiality is replaced by consideration of the element loss causation.[205] Assuming an efficient market at the time of purchase (at time t_2), the only remaining question is whether the market price of ABC Company's securities depreciated immediately following the release of the corrective disclosure.[206] If the answer is yes, then the plaintiff has most likely established loss causation.[207] If the answer is no, then the plaintiff cannot demonstrate loss causation and the case will likely be dismissed.[208]

The common theme running through both these analyses is that market efficiency is only considered in the context of reliance at the time of purchase (at time t_2) and is not considered in the context of loss causation at the time of sale (at time t_3).[209] However unlikely, it is

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203. *See, e.g.*, *Oran*, 226 F.3d at 275; *Burlington*, 114 F.3d at 1410; *see also* Fischel, *supra* note 3, at 4.

204. *See, e.g.*, *Oran*, 226 F.3d at 282; *Burlington*, 114 F.3d at 1425; *see also* Fischel, *supra* note 3, at 4.

205. *See, e.g.*, *In re* Omnicom Group Inc. Sec. Litig., 597 F.3d 501, 509 (2d Cir. 2010), Thompson v. RelationServe Media, Inc., 610 F.3d 628, 680, 689 (11th Cir. 2010).

206. *See, e.g.*, *Omnicom*, 597 F.3d at 509; *Thompson*, 610 F.3d at 680, 689.

207. *See, e.g.*, *Omnicom*, 597 F.3d at 509; *Thompson*, 610 F.3d at 628.

208. *See, e.g.*, *Omnicom*, 597 F.3d at 509; *Thompson*, 610 F.3d at 628.

209. *See supra* note 96 and accompanying text; *see also*, *Omnicom*, 597 F.3d at 510–11 ("With regard to reliance, appellant's complaint invokes the presumption of reliance based on the [FOTM] . . . . [It further alleges that] the market for Omnicom's securities promptly digested current information regarding Omnicom from all publicly available sources and reflected such information in Omnicom's stock price. Having sought to establish investor reliance by the [FOTM] theory, appellant faces a difficult task . . . . In short, appellant must concede that the numerous public reports on the Seneca transaction were 'promptly digested' by the market and 'reflected . . . in Omnicom's stock price' in 2001 while seeking to recover for a stock price decline a year later in 2002") (citation omitted); *Thompson*, 610 F.3d at 691("[T]he efficient market theory–on which Jacoby relies–posits that all publicly available information is reflected in the market price of the security. As of July 14, 2005, the market knew that Media sold $340,000 worth of stock to five Indiana investors . . . . As of June 16, 2005, the market knew that Summit could act as a finder and would be paid a seven percent finder's fee . . . . And as of March 20, 2006, the market knew that Media paid Summit a total 'success fee' of $28,500 in connection with its private placement of common stock

possible that the market for a particular security exhibits semi-strong form characteristics at time t_2 but, for any one of a number of reasons posited by behavioral economists,[210] exhibits weak form characteristics at time t_3.[211] Notwithstanding this possibility, a complaint alleging such facts in the Second, Third, and, possibly, Eleventh Circuits would be more vulnerable to dismissal as a matter of law.[212]

To avoid such a result, courts should examine each element of Rule 10b-5 securities fraud separately and in chronological order. The first element to examine is materiality.[213] The court must assess whether there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by a reasonable investor as having significantly altered the total mix of information made available."[214] Logically absent from this definition is any mention of market efficiency. Reporting companies maintain a duty to disclose material information to their investors regardless of the efficiency characteristics exhibited by the market for their securities.[215] Accordingly, courts, like reporting companies, should analyze the materiality of information at time t_1, the

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. . . . Accordingly, the market had absorbed this information well before the May 23 amendment. If not, those shares were not being traded in an 'impersonal, well-developed' and efficient market, as required for the application of the fraud-on-the-market doctrine"); *Oran*, 226 F.3d at 282 ("[W]hen a stock is traded in an efficient market, the materiality of disclosed information may be measured post hoc by looking to the movement, in the period immediately following the disclosure, of the price of the firm's stock. Because in an efficient market 'the concept of materiality translates into information that alters the price of the firm's stock,' if a company's disclosure of information has no effect on stock prices, 'it follows that the information disclosed . . . was immaterial as a matter of law.'" (quoting *Burlington*, 114 F.3d at 1425); *see also* Fischel, *supra* note 3, at 4.

210. *See, e.g.*, Langevoort, *supra* note 4, at 858–89; Stout, *supra* note 186, at 665–66.

211. *See supra* notes 3, 83 and accompanying text.

212. *See, e.g.*, *Oran*, 226 F.3d at 282; *Burlington*, 114 F.3d at 1419; *Omnicom*, 597 F.3d at 512–13; *Thompson*, 610 F.3d at 689–90 (Tjoflat, J., dissenting).

213. Given a separate analysis of each element of Rule 10b-5, the element of materiality logically must be the first inquiry. *See generally* Dura Pharm., Inc. v. Broudo, 544 U.S. 336, 341 (2005) (listing a material misrepresentation as the first element of Rule 10b-5 securities fraud).

214. TSC Indus., Inc. v. Northway, 426 U.S. 438, 449 (1976).

215. *See* 17 C.F.R. §§ 229, 230, 239–40, 249 (2012); *see also* HAZEN, *supra* note 38, §§ 3.9[8], 12.9[10], 12.19; COX ET AL., *supra* note 36, at 630–49.

time when a misstatement or omission is disclosed to the market.[216] In so doing, courts would be faithfully following the rule handed down in *TSC Industries* and undertaking the same analysis required of reporting companies. In adhering to such a rule, certain information that is correlated to significant price movement at time t_3 may be deemed immaterial at time t_1. Such a result is both litigant-neutral and logically sound. Just as an inefficient market cannot render material information immaterial, neither can an efficient market render immaterial information material.

The next step is analyzing reliance.[217] Assuming the plaintiff pleads reliance based on the FOTM, the court should question whether at the time of purchase (at time t_2), the market for ABC Company's securities exhibited semi-strong form efficiency characteristics.[218] If so, then reliance has been demonstrated and the analysis should proceed. If not, then the court need further analyze when the market incorporated the material misstatement into the price of ABC Company's securities (at time t_2).[219] In the context of a class action, such an analysis will likely reduce the size of the class because, rather than indiscriminately beginning the class period at time t_2, the class period would begin at the time that the market for ABC Company's securities actually incorporated the misstatement into the price (at time $t_{2'}$).[220] Such an approach, in addition to being truth-seeking, would provide the courts with a tool to precisely define plaintiff classes, rather than using an over-inclusive standard.

Finally, the court must analyze loss causation.[221] The operative question, as outlined in *Dura*, is whether the revelation of the fraud to

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216. *See TSC Indus.*, 426 U.S. at 449; *see also* Regulation FD, 17 C.F.R. § 243.100(a) (2010) (requiring reporting companies to remedy the inadvertent disclosure of material non-public information by prompt public disclosure); Form 8-K, *available at* http://www.sec.gov/about/forms/form8-k.pdf.

217. The element of "connection to a purchase or sale" is effectively analyzed at this step as well.

218. A consideration of whether the market exhibited semi-strong market characteristics is appropriate because, in such markets, the prices of securities reflect all publicly available information about such securities. *See supra* notes 10–29 and accompanying text.

219. This fact pattern assumes that $t_2 < t_{2'} < t_3$.

220. *Cf.* Petition for Writ of Certiorari, Apollo Grp., Inc. v. Policemen's Annuity & Benefit Fund, 131 S. Ct. 1602 (2011) (No. 10-649), 2010 WL 4655891 at *31–32.

221. Given a separate analysis of each element of Rule 10b-5, the element of loss causation logically will be the last inquiry, not including a calculation of damages. *See,*

the marketplace caused the relevant economic loss.[222] As such, courts should question whether the market for ABC Company's securities exhibited semi-strong form efficiency characteristics at the time of the corrective disclosure (at time t_3).[223] If so, then all that remains is for the court to measure damages based on the depreciation in price of ABC Company's securities from time of purchase (at time t_2)[224] to time of sale (at time t_4).[225] If not, then the court need further analyze when the market began to price the corrective disclosure into ABC Company's securities.

The question logically turns to how courts should determine if a market exhibits semi-strong form characteristics. Perhaps the most common judicial analytical framework was outlined in *Cammer v. Bloom*.[226] In *Cammer*, the Court set out five characteristics common to an efficient market: (1) weekly trading volume; (2) the number of securities analysts following the company in question; (3) the number of market makers with respect to the security in question; (4) the company's eligibility to file a Form S-3 Registration Statement; and (5) "empirical facts showing a cause and effect relationship between unexpected corporate events or financial releases and an immediate response in stock price."[227] In addition, other courts have considered factors such as market capitalization; bid-ask spreads on the company's securities; the company's outstanding float; and the percentage of equity securities owned by company insiders.[228] These factors, albeit important

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e.g., Dura Pharm., Inc. v. Broudo, 544 U.S. 336, 342 (2005) (listing loss causation as an element of Rule 10b-5 securities fraud).

222. *Id.* at 341–42.

223. *See supra* note 209–11 and accompanying text.

224. Of course, if the market did not price in the material misstatement at time t_2, then damages should be measured from time $t_{2'}$, i.e., the time that the market priced in the material misstatement, to time t_4. Such a scenario is reserved for situations in which the market for ABC Company securities exhibits weak form characteristics at least between times t_1 and $t_{2'}$.

225. *See* HAZEN, *supra* note 38, § 12.12; COX ET AL., *supra* note 36, at 716–19.

226. 711 F. Supp. 1264 (D.N.J. 1989).

227. *Id.* at 1286–87.

228. *See In re* Healthsouth Corp. Sec. Litig., 261 F.R.D. 616, 632 (N.D. Ala. 2009) (citing Unger v. Amedisys Inc., 401 F.3d 316, 323 (5th Cir. 2005).

proxies for market efficiency, should ultimately give way to a battle of the experts,[229] as it beyond the expertise of the courts.[230]

C. Consistency with Landmark Rule 10b-5 Cases

Adopting a fact-specific rule in the context of a non-immediate price reaction also comports with Supreme Court precedent in the Rule 10b-5 context, which has repeatedly eschewed bright-line rules.[231] For example, in *Basic*, the Court was asked to hold that preliminary merger discussions are immaterial as a matter of law and, therefore, do not give rise to a reporting company's duty to disclose.[232] The Court declined such a holding and adopted the *TSC Industries* reasonable investor test.[233]

More recently, the Court declined to adopt a bright-line rule on the issue of materiality in *Matrixx Initiatives, Inc. v. Siracusano*.[234] In *Matrixx*, Matrixx Initiatives, a pharmaceutical company, received a statistically insignificant amount of adverse event reports for its best-selling drug Zicam, which accounted for up to 70% of its sales revenue.[235] The adverse event reports claimed that Zicam caused anosmia—the loss of the sense of smell—in several patients.[236] Matrixx Initiatives investigated the matter but did not disclose the reports to its shareholders.[237] Once this information made its way to the market, Matrixx Initiatives' price fell significantly.[238] Matrixx Initiatives argued that because the number of adverse event reports was statistically insignificant, the information was immaterial as a matter of law.[239] In an opinion by Justice Sotomayor, the Court, relying heavily on the

229. *See generally* Andrew M. Erdlen, *Timing Is Everything: Markets, Loss, and Proof of Causation in Fraud on the Market Actions*, 90 FORDHAM L. REV. 877 (2011); *but see* Kaufman & Wunderlich, *supra* note 88, at 196.

230. *See* Kaufman & Wunderlich, *supra* note 88, at 207–08 (discussing the primacy of expert testimony to interpret market movements for courts in securities litigation).

231. *See, e.g.*, TSC Indus., Inc. v. Northway, 426 U.S. 438 (1976); Basic Inc. v. Levinson, 485 U.S. 224 (1988); Matrixx Initiatives, Inc. v. Siracusano, 131 S. Ct. 1309 (2011); Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308 (2007).

232. *Basic*, 485 U.S. at 231–32.

233. *Id.*

234. 131 S. Ct. 1321 (2011).

235. *Id.* at 1313–14.

236. *Id.*

237. *Id.* at 1315.

238. *Id.* at 1316.

239. *Id.* at 1318–19.

reasoning in *Basic*, refused to adopt such a bright-line rule and reasserted the importance of the fact-specific inquiry, noting that "[a]ny approach that designates a single fact or occurrence as always determinative of an inherently fact-specific finding . . . must necessarily be overinclusive or underinclusive."[240]

In the context of scienter, the Supreme Court has also adopted a fact-specific rule. In *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*,[241] the Court considered the proper standard for pleading with particularity facts giving rise to a strong inference of scienter as required by the Private Securities Litigation Reform Act of 1995 (the "PSLRA").[242] In *Tellabs*, the respondent argued for dismissal of the complaint because it did not sufficiently allege that Tellabs' CEO had a pecuniary motive for making such misleading statements and, therefore, did not sufficiently allege scienter.[243] In an opinion by Justice Ginsburg, the Court, while acknowledging that motive does factor into the analysis, disagreed and held that "[t]o qualify as 'strong' within the [PSLRA] . . . an inference of scienter must be more than merely plausible or reasonable—it must be cogent and at least as compelling as any opposing inference of non-fraudulent intent."[244] Just as in *TSC Industries*, *Basic*, and *Matrixx*, the Court rejected a simultaneously over-inclusive and under-inclusive bright-line rule, in favor of a fact-specific, truth-seeking inquiry.[245]

Of course, none of these holdings is dispositive on the issue of non-immediate price depreciation in the context of loss causation. However, they do demonstrate a clear preference on the part of the Supreme Court to avoid bright-line rules that are necessarily imprecise and very likely preclusive of some meritorious claims.[246] Accordingly, because the

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240. *Id.* at 1318 (quoting Basic Inc. v. Levinson, 485 U.S. 224, 227–29 (1988)).

241. *See* Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308 (2007).

242. *Id.* at 313; *see* Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, § 101(b) 109 Stat. 737, 747 (codified as amended at 15 U.S.C. § 78u-4(b)(2) (2006)).

243. *See Tellabs*, 551 U.S. at 325.

244. *Id.* at 314.

245. *See id.* ("[C]ourts must consider the complaint in its entirety, as well as other sources courts ordinarily examine when ruling on a Rule 12(b)(6) motion to dismiss, in particular, documents incorporated into the complaint by reference, and matters of which a court may take judicial notice. The inquiry, as several Courts of Appeals have recognized, is whether all of the facts alleged, taken collectively, give rise to a strong inference of scienter, not whether any individual allegation, scrutinized in isolation, meets that standard.") (internal citations omitted).

246. *See supra* Part III.C.

question of how quickly the prices of equity securities incorporate information into price is an imprecise inquiry, courts should not adopt any rule that would preclude a plaintiff from succeeding on a Rule 10b-5 claim as a matter of law simply because of a time lag in price depreciation.[247]

D. ARGUMENTS IN FAVOR OF A BRIGHT-LINE RULE

Critics of the fact-specific rule are likely to argue that such an approach is an extension of Rule 10b-5 that (1) gives plaintiffs the benefit of a presumed efficient market at reliance[248] and the presumption of an inefficient market at loss causation;[249] (2) raises concerns regarding class formation under Federal Rule of Civil Procedure 23;[250] (3) improperly replaces informational efficiency with fundamental value efficiency;[251] and (4) is contrary to Congress's desire to limit private securities claims as expressed by the PSLRA.[252]

The most likely counter-argument to the proposed fact-specific rule is that it will be overly plaintiff-friendly. In other words, it provides plaintiffs with the benefit of a presumed efficient market without any of the logically following disadvantages.[253] As counsel for Apollo argued, "[i]t posits a market that is perfectly efficient, speedy, and omniscient for the purposes of granting plaintiffs the enormous benefit of the presumption of reliance on misrepresentations, but horribly inefficient, sluggish, and doltish in response to corrective disclosures."[254] Even more forcefully, securities lawyer Tower Snow has, in the context of *Apollo*, argued that "[t]he courts can't rely on the efficient market theory for the purposes of . . . reliance . . . and then ignore its underpinnings for

247. *Cf.* Dura Pharm., Inc. v. Broudo, 544 U.S. 336, 342–43 (2005).

248. *See Basic*, 485 U.S. at 224.

249. *See infra* note 253–61 and accompanying text.

250. Petition for Writ of Certiorari, Apollo Grp., Inc. v. Policemen's Annuity & Benefit Fund, 131 S. Ct. 1602 (2011) (No. 10-649), 2010 WL 4655891 at *14.

251. *See infra* notes 273–82 and accompanying text.

252. *See infra* notes 283–86 and accompanying text.

253. *See supra* Part II.A; *see also* Petition for Writ of Certiorari, Apollo Grp., Inc. v. Policemen's Annuity & Benefit Fund, 131 S. Ct. 1602 (2011) (No. 10-649), 2010 WL 4655891, at *5.

254. *Id.*

purposes of evaluating loss causation. Either one embraces the theory or one does not."[255]

It is tempting, for purposes of simplicity and judicial economy, to adopt a one-size-fits-all approach to Rule 10b-5 analysis.[256] Daniel Fischel has argued that in the context of an efficient market, "there is no need . . . for separate inquiries into materiality, reliance, [loss] causation, and damages . . . [and the] relevant inquiry in open-market transactions should be whether the market price was in fact artificially affected by false information."[257] Companies and investors alike could also benefit from the degree of market certainty that a symmetrical, litigant-neutral rule would provide. Given the volatility in today's markets and the fragility of the global economy, such an argument in favor of certainty and stability is all the more enticing.[258]

These criticisms, however, fail to take an individual, temporally accurate approach to Rule 10b-5 analyses. The one-size-fits-all approach would be acceptable if, from the time of misstatement to the time of sale at an economic loss (i.e., from time t_1 to time t_4), the market for the securities in question exhibited semi-strong form characteristics at all times.[259] There is, however, no way to verify semi-strong form market behavior without an *ex post* analysis of relevant pricing data. Semi-strong form behavior should not be assumed.[260] Accordingly, to ensure a result that approaches the true movement of the market and the reasons behind such movement, courts should examine market

255. Kevin LaCroix, *Guest Post: Tower Snow Comments on the Ninth Circuit's Apollo Group Opinion*, D&O DIARY (June 28, 2010), http://www.dandodiary.com/2010/06/articles/securities-litigation/guest-post-tower-snow-comments-on-the-ninth-circuits-apollo-group-opinion/.

256. *See generally* Fischel, *supra* note 3, at 13.

257. Fischel, *supra* note 3, at 13.

258. As of the date of this writing, the 50 day moving average of the Chicago Board of Options Exchange Volatility Index, colloquially known as the "VIX" or the "fear index" is just below 35.00. *See (VIX) Volatility (S & P 500)*, CBOE, http://www.cboe.com/DelayedQuote/DQBeta.aspx (insert "vix" into Get Quote) (accessed Nov. 6, 2011); *see also Volatility Indexes at CBOE*, CBOE (Jan. 2012) http://www.cboe.com/micro/VIX/pdf/VolatilityIndexQRG2012-01-30.pdf ("CBOE Volatility Index (VIX®), based on S&P 500 Index Options, is considered by many to be the world's premier barometer of investor sentiment and market volatility.").

259. *Cf.* Fischel, *supra* note 3, at 13.

260. *See supra* notes 176–81 and accompanying text.

efficiency both at time of purchase (at time t_2) and at the time of corrective disclosure (at time t_3).[261]

A second likely argument against the fact-specific rule approach is that it creates confusion at the class certification stage in the context of Federal Rule of Civil Procedure 23.[262] The most obvious hypothetical fact pattern in this regard relates to investors who purchase ABC Company securities after a corrective disclosure is made (i.e., after time t_3) but before the market—in this instance exhibiting weak form market characteristics—incorporates the information and yields an economic loss (i.e., before time t_4).[263] Such investors, if they were permitted to participate in the plaintiff class, would have free insurance on their investment because any losses would be recouped in damages.[264] Despite being a plaintiff-friendly rule, such an outcome appears at odds with considerable precedent.[265]

This argument, while persuasive in the abstract, is overblown. First, because the vast majority of Rule 10b-5 cases settle, very few investors would receive full payment in the form of damages.[266] Second, regardless of whether the case is disposed of via settlement or verdict, investors will not recoup their investment in full because legal fees will temper any settlement or damages.[267] In the case of a contingency fee, the final figure could see a hair cut of up to 40%.[268] Third, the fact-specific rule is very unlikely to incentivize opportunistic investors who are aware of the misstatement but nonetheless purchase

261. *See supra* notes 216, 221 and accompanying text.

262. FED R. CIV. P. 23.

263. *Cf.* Petition for Writ of Certiorari, Apollo Grp., Inc. v. Policemen's Annuity & Benefit Fund, 131 S. Ct. 1602 (2011) (No. 10-649), 2010 WL 4655891, at *14.

264. *See, e.g.*, Basic Inc. v. Levinson, 485 U.S. 224, 252 (1988) (White, J., concurring in part and dissenting in part) (quoting Shores v. Sklar, 647 F.2d 462, 469 n.5 (5th Cir. 1981); Malack v. BDO Seidman LLP, 617 F.3d 743, 752 (3d Cir. 2010).

265. *See, e.g.*, *Basic*, 485 U.S. at 252 (1988) (White, J., concurring in part and dissenting in part) (quoting Shores v. Sklar, 647 F.2d 462, 469 n.5 (5th Cir. 1981); *Malack*, 617 F.3d at 752 (3d Cir. 2010).

266. *See In re* Oxford Health Plans, Inc. Sec. Litig., 182 F.R.D. 42, 47 n.5 (S.D.N.Y. 1998) ("An overwhelming percentage of securities class actions are settled . . . .") (citing Joseph A. Grundfest & Michael A. Perino, *Ten Things We Know and Ten Things We Don't Know About the Private Securities Litigation Reform Act of 1995*, 1015 PLI/Corp. 1015, 1027 (1997)).

267. *See* Venegas v. Mitchell, 495 U.S. 84 (1990); *see also* Blanchard v. Bergeron, 489 U.S. 87 (1989).

268. *See, e.g.*, Venegas, 495 U.S. at 84 (discussing contingent fee arrangements in which the plaintiffs' lawyers take as much as forty percent of the gross recovery).

shares expecting either a profit or damages. As an initial matter, affirmative proof of non-reliance is sufficient to rebut a presumption of reliance.[269] While such rebuttal is very unlikely,[270] it is possible and may well deter certain opportunistic investors. More practically, this type of litigation-insured investment is unlikely because it assumes a foolish investment strategy. Such an investor would be betting on the likelihood of damages in a case that is unlikely to be resolved expeditiously. Such an investor also would be betting on the ability of the plaintiff class to plead with particularity facts giving rise to a strong inference of scienter. Finally, because the fact-specific rule requires a more nuanced approach to class formation, the number of investors who purchased shares following the misstatement, but prior to the price inflation, who are ineligible to join the class should, in the aggregate, offset any number of investors who purchase after the corrective disclosure but before the price depreciation who are eligible to join the class.[271] In other words, excluding investors that purchased ABC Company securities after time t_2 but before time $t_{2'}$ should offset the inclusion of investors who purchased ABC Company securities after time t_3 but before time $t_{3'}$.[272]

A third likely argument against the fact-specific rule is that it creates investors' insurance by substituting information-arbitrage efficiency ("IA Efficiency") for fundamental-valuation efficiency ("FV

269. *See Basic*, 485 U.S. at 245; Affiliated Ute Citizens v. United States, 406 U.S. 128, 153–54 (1972); *see also* Oldham, *supra* note 83, at 1005; Silverman, *supra* note 70, at 1800 nn.116–18.

270. *See* Cammer v. Bloom, 711 F. Supp. 1264, 1288 (D.N.J. 1989).

271. Concerns over perverse incentives remain. If the fact-specific rule is adopted, some investors who simply neglected to research the companies in which they invested will make up part of the plaintiff class. One could argue that the courts should not incentivize investors not to perform due diligence with respect to their investments and thereafter reward them in the form of damages or a settlement. While ultimately the question of whether the social costs of the fact-specific rule outweigh its benefits is one of public policy, it is important to note that the Court in *Basic* made the informed decision to include such investors in the plaintiff class via the FOTM. *See Basic*, 485 U.S. at 245–47; *but see* Malack v. BDO Seidman LLP, 617 F.3d 743, 749–53 (3d Cir. 2010) (rejecting the fraud-created-the-market theory because, *inter alia*, adopting it would reward investors who failed to perform due diligence with respect to their investments).

272. This fact pattern assumes that $t_3 < t_{3'}$.

Efficiency").[273] The price of a security is IA Efficient if it reflects all publicly available information with respect to that security.[274] In this respect, a security that is IA Efficient is identical to a security that exhibits semi-strong market characteristics.[275] To be FV Efficient, however, the price of a security must accurately reflect its true value.[276] A staunch defender of the ECMH might argue that a time lag between a corrective disclosure and price depreciation is demonstrative of the market's lack of FV Efficiency but not the market's lack of IA Efficiency.[277] Accepting such an argument as true, it follows that the fact-specific rule would allow investors to recover on the basis of a market's FV Inefficiency while concomitantly benefiting from the same market's IA Efficiency.[278]

First, it is important to note that, although it has not explicitly differentiated between IA and FV efficiency, the Supreme Court used language more commonly attributed to IA Efficiency in *Basic*.[279] Rather, the Supreme Court and the circuit courts have analyzed market efficiency without specifically referring to either IA or FV efficiency.[280] Secondarily, even assuming that Rule 10b-5 fraud claims turn on IA and not FV Efficiency, it is not possible to determine whether a particular price depreciation resulted from IA Efficiency or FV Efficiency *ex ante* at the motion to dismiss stage.[281] Accordingly, the courts should leave the granular determination of why the price of a security depreciated to expert witnesses.[282]

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273. *See* Wang, *supra* note 186, at 344; *see also* Daniel R. Fischel, *Efficient Capital Markets, the Crash, and the Fraud on the Market Theory*, 74 CORNELL L. REV. 907, 913 (1989).

274. *See, e.g.*, Wang, *supra* note 186, at 344; Fischel, *supra* note 283, at 913.

275. *See id.*

276. *See id.*

277. *Cf.* Petition for Writ of Certiorari, Apollo Grp., Inc. v. Policemen's Annuity & Benefit Fund, 131 S. Ct. 1602 (2011) (No. 10-649), 2010 WL 4655891.

278. Such an argument also fails to take into account that the fact-specific rule, in the aggregate, pares down the size of plaintiff's classes at the reliance stage. Moreover, if markets are FV Inefficient, then it stands to reason that the amount of damages payable to plaintiff's classes would be less significant, because the price increase at the time of the material misstatement (i.e., at time t_1) would also be less significant.

279. *See* Basic Inc. v. Levinson, 485 U.S. 224, 225, 245 (1988).

280. *See id.* at 245; *see also* Dura Pharm., Inc. v. Broudo, 544 U.S. 336, 342 (2005).

281. *See generally* Fama, *supra* note 3 (determining market behavior based on an ex post analysis of relevant market data).

282. *See* Cammer v. Bloom, 711 F. Supp. 1264, 1286–87 (D.N.J. 1989).

Finally, opponents are likely to argue that, because determinations of market efficiency will often require expert testimony, the fact-specific rule runs contrary to the Congress's intent in limiting frivolous strike suits at the motion to dismiss stage as expressed by the PSLRA.[283] As an initial matter, the fact-specific rule recognizes, as did the Court in *Lormand*, that "proof of causation would be more difficult when significant time elapses before the market allegedly reacts."[284] This built-in, rebuttable presumption of market efficiency ensures, at least in part, that this approach will not be abused by the plaintiff's bar. Additionally, and perhaps even more importantly, the element of scienter protects against unintended consequences.[285] Because plaintiffs need to plead facts giving rise to a strong inference of scienter, concerns related to frivolity are superfluous.[286]

CONCLUSION

Due to economic scholarship calling into question the accuracy of the ECMH, the practical reality of imprecise market behavior, and the importance of adopting and maintaining fact-specific, truth-seeking rules, the courts should follow the Fifth Circuit's guidance in *Lormand* with respect to the question of non-immediate price depreciation in 10b-5 litigation. In addition to ensuring that the federal court system will, to the extent practicable, seek to determine the actual cause of market movements, the fact-specific rule provides a consistent, litigant-neutral mechanism to analyze alleged fraud in the securities markets. While the ECMH may be an effective analytical tool in certain, specific circumstances, it nevertheless remains a hypothesis and should be treated as such in the context of Rule 10b-5 litigation. For the courts to continue to treat the ECMH as economic dogma borders on irresponsible. This strict adherence to the ECMH is tantamount to

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283. *See* H.R. REP. NO. 104-369, at 31–32 (1995) (Conf. Rep.), *reprinted in* 1995 U.S.C.C.A.N. 730, 730–31.

284. Lormand v. US Unwired, Inc., 565 F.3d 228, 266 n.33 (5th Cir. 2009).

285. *See* Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 308 (2007); Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (1995) (codified in scattered sections of 15 U.S.C.).

286. *See Tellabs*, 551 U.S. at 308; Private Securities Litigation Reform Act, Pub. L. No. 104-67, 109 Stat. 737.

"repeating what [was] read in antiquated textbooks,"[287] to the detriment of investors with potentially meritorious claims.

287. *Street Signs: Interview with Stephen Roach* (CNBC television broadcast Oct. 27, 2011), *available at* http://video.cnbc.com/gallery/?video=3000052760.