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# The Fraud-on-the-Market Tort

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# The Fraud-on-the-Market Tort

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## I. INTRODUCTION

It is commonplace to observe that there are differences between private 10b-5 actions and common-law actions for deceit, notwithstanding that both travel under the name of “fraud.”<sup>1</sup> It is equally commonplace to suppose that these differences primarily reflect the need to adapt law that was first developed in a world of face-to-face transactions to the modern reality of large-scale, impersonal markets. The poster children for the transition from common-law fraud to securities fraud are, first, the Supreme Court’s adoption in *Basic, Inc. v. Levinson* of the fraud-on-the-market doctrine<sup>2</sup> and, second, the related emergence of securities fraud class actions.<sup>3</sup>

Amidst this conventional wisdom, one can identify two distinct characterizations of the continuities and discontinuities between the old law of deceit and the new law of fraud on the market. The first holds roughly as follows. A securities fraud suit that invokes the fraud-on-the-market theory—though statutory in origin, and though in some ways an extension of common law—imposes liability on the same substantive terms as the law of deceit. To be sure, federal law does not incorporate every facet of common-law doctrine.<sup>4</sup> Still, at their core, fraud-on-the-market claims track claims for deceit. On this view, the divergences between deceit and fraud-on-the-market claims are primarily procedural and evidentiary, rather than substantive.

The Supreme Court’s 10b-5 jurisprudence seems to reflect this understanding of fraud-on-the-market claims. The Court has, after all, given close attention to the elements of deceit in defining the scope of liability for fraud on the market. This approach dates back to *Ernst & Ernst v. Hochfelder*, which read the common law’s scienter requirement into 10b-5 law.<sup>5</sup> More recently, in *Dura Pharmaceuticals, Inc. v. Broudo*, the Court held that fraud-on-the-market plaintiffs must prove “economic loss” and “loss causation,” two requirements it claimed to find in common-law deceit.<sup>6</sup> Even in *Basic*, the Justices insisted that the fraud-on-the-market doctrine did not eliminate the reliance element of

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1. To avoid ambiguities that attend use of the word “fraud,” we will primarily refer to the particular tort of fraud (sometimes called “intentional misrepresentation”) by its older common-law name of “deceit.”

2. 485 U.S. 224, 247 (1988).

3. On the relation of *Basic* to the emergence of securities fraud class actions, see Donald C. Langevoort, *Basic at Twenty: Rethinking Fraud on the Market*, 2009 WIS. L. REV. 151, 152.

4. *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 162 (2008) (noting that section 10(b) does not incorporate all aspects of common-law fraud).

5. 425 U.S. 185, 214 (1976).

6. 544 U.S. 336, 336 (2005).

deceit but instead merely adopted a rebuttable presumption of reliance.<sup>7</sup>

The Court's treatment of fraud on the market as akin to common-law deceit is also evidenced indirectly by the Justices' attention to the procedural aspects of securities litigation. Implicit in this attention is an assumption that the major challenges they face in defining the contours of fraud-on-the-market liability are procedural. The trick has been to figure out how courts can manage securities fraud litigation so that victims of deceit get appropriate relief without allowing litigation to spin out of control. The recent *Amgen* decision displays this aspect of the Justices' mindset.<sup>8</sup>

In contrast to the view we have just attributed to the Court, there is an alternative account—sometimes expressed by academics critical of the Court's decisions—of the differences between fraud on the market and common-law deceit.<sup>9</sup> On this view, the Justices have erred in supposing that the law of deceit sets the substantive terms of liability for securities fraud. Deceit, and its core requirement of reliance, were developed in a world of face-to-face transactions. It cannot be expected to apply comfortably in today's world of institutional investors and computerized trading. The Justices have been fooling themselves, or engaging in their own kind of deceit, by insisting that they are applying the traditional common law in establishing the contours of 10b-5 liability.

According to this view, modern securities law has departed fundamentally from its private-law roots, and appropriately so. Fraud-on-the-market claims are claims for a public or regulatory wrong, not a traditional tort or private wrong. They allege that the defendant has harmed a public resource—the market—by distorting prices.<sup>10</sup> Securities fraud class actions, on this view, are primarily mechanisms

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7. 485 U.S. at 243.

8. 133 S. Ct. 1184, 1191 (2013) (holding that the materiality of defendant's misrepresentation need not be proven to permit class certification); *see also* *Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179, 2186 (2011) (stating that plaintiffs need not prove loss causation to obtain class certification); *cf.* *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 545 (2007) (holding that plaintiff's Sherman Act complaint cannot rely on a mere recitation of the elements of a claim and must contain sufficient factual allegations). Obviously the Justices have disagreed among themselves about how to strike this balance correctly.

9. *See, e.g.*, Jill E. Fisch, *The Trouble with Basic: Price Distortion after Halliburton*, 90 WASH. U. L. REV. 895 (2013); Donald C. Langevoort, *Reading Stoneridge Carefully: A Duty-Based Approach to Reliance and Third-Party Liability Under Rule 10b-5*, 158 U. PA. L. REV. 2125, 2140–41, 2144 (2010) (suggesting that the Court in *Basic* effectively implemented, without owning up to doing so, an entitlement enjoyed by buyers and sellers of securities to trade at a nondistorted price and that liability on this basis goes well beyond compensating victims for their losses).

10. Fisch, *supra* note 9.

for the protection of markets rather than particular investors.<sup>11</sup> Of course, successful 10b-5 plaintiffs and their lawyers are entitled to compensatory damages. But they earn that compensation largely as private attorneys general whom society rewards for harnessing civil litigation to achieve a desirable policy goal. The Court's efforts to make them jump through common-law hoops in order to prevail have thus been misguided, according to the critics. The requirements of scienter, reliance, economic loss, and loss causation do not mesh with the goal of ensuring that securities fraud class actions are available to protect the integrity of markets.

Against the two views just outlined, we aim in this Article to articulate an alternative view of how fraud-on-the-market claims relate to the common law of deceit. We characterize our proposed "third way" in terms of three main ideas.

First, consistent with the Court's view, we reject the notion that deceit is a wrong that belongs to a bygone era of face-to-face transactions. Deceit is quite obviously applicable to impersonal interactions, as we point out in Part II. The gist of deceit is a defendant intentionally misrepresenting a fact and thereby inducing the plaintiff to act to his or her detriment. This is why, as we have argued previously, reliance is an element of deceit.<sup>12</sup> But the plaintiff and the defendant need not be in a face-to-face transaction in order for the defendant to dupe the plaintiff. Rather, the defendant deceives the plaintiff any time the defendant knowingly utters a misrepresentation, intending for persons such as the plaintiff to rely on it, and the plaintiff actually and justifiably relies on the substance of the misrepresentation.

Although we defend the applicability of the tort of deceit to impersonal transactions, we nonetheless agree with commentators who argue that the fraud-on-the-market version of securities fraud is not merely an application of the common law of deceit. This is our second claim, developed in Parts III and IV. These Parts examine aspects of the Court's reasoning in *Dura* and *Basic*, respectively. In *Dura*, the Court erred in asserting that it was merely applying standard deceit doctrines of economic loss and loss causation to fraud-on-the-market claims. The same is true of *Basic*. Despite the Court's assertions to the contrary, the fraud-on-the-market doctrine does something more than create a special evidentiary rule for deceit claims in the special context

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11. *Id.*

12. John C.P. Goldberg, Anthony J. Sebok & Benjamin C. Zipursky, *The Place of Reliance in Fraud*, 48 ARIZ. L. REV. 1001, 1004 (2006).

of mass transactions. Rather, these decisions have articulated a new tort: one that differs in substance from the wrong of deceit.<sup>13</sup>

Third, we reject the contention that this new wrong, first identified in *Basic* and refined in *Dura* and other decisions, is exclusively a public-law wrong that imposes liability on a private attorney general model. The Justices undoubtedly have had public policy goals such as deterrence and compensation in mind in fashioning securities fraud law. Still, we maintain in Part V that they have done so by articulating (even if not quite explicitly) a new tort cause of action. The issue of the Court's authority to identify implied rights of action in federal statutes is, of course, hotly contested and is not one we engage directly here. Instead, taking that general authority for granted, we argue that the Court's use of it to fashion fraud on the market as a distinct tort fits within a well-established common-law tradition of recognizing torts other than deceit—including negligence causing economic loss and tortious interference with prospective advantage—when misrepresentations cause injury without victim reliance.

Some members of the current Court now seem keen to reverse *Basic*,<sup>14</sup> at least in part because they are skeptical about the tenability of the fraud-on-the-market theory. If one accepts the premise that the theory is only justifiable to the extent that it helps to implement the reliance element of common-law deceit (which we do not), their skepticism is understandable and indeed justified. But this basis for skepticism is readily dispelled once one recognizes that “fraud on the market” is not—despite what *Basic* claims—the name for a special evidentiary rule that federal courts apply to the particular version of deceit found in federal securities laws. Rather, fraud on the market is its own tort—one that, unlike deceit, allows redress for intentional misrepresentations that result in economic loss to investors, irrespective of reliance.

Of course, there are other grounds on which one might question judicial recognition of the fraud-on-the-market tort, including the difficulty of distinguishing genuine victims from investors who advisedly took a risk and have no grounds to complain. However, both

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13. Our focus is specifically on 10b-5 claims that invoke *Basic*'s fraud-on-the-market doctrine. 10b-5 claims that do not invoke that doctrine often will, in substance, mirror claims for common-law deceit. In other words, the Court (in our view) has come to recognize at least two distinct wrongs as privately actionable 10b-5 claims: a wrong closely akin to common-law deceit and the distinct wrong of fraud on the market. See *infra* text accompanying notes 87–88 (distinguishing between fraud-on-the-market cases and cases involving either nonpublic affirmative misrepresentation or public misrepresentation where a plaintiff can prove actual reliance, which more closely resemble common-law deceit).

14. *Amgen Inc. v. Conn. Ret. Plans & Trust Funds*, 133 S. Ct. 1184, 1204 (2013) (Alito, J., concurring); *id.* at 1208 (Thomas, J., dissenting).

Congress and the Court have shown themselves willing and able to address this concern. Indeed, that concern provided much of the impetus for the Court's effort in *Dura* to define economic loss and loss causation. In sum, by grasping the distinctive nature of the tort that goes under the name "fraud on the market," one comes to appreciate both the justifiability of its recognition and the propriety of certain efforts to limit its scope.

## II. IMPERSONAL DECEIT

### A. *The Wrong of Deceit*

The tort of deceit, also known as "fraud" or "intentional misrepresentation," like all torts, proscribes conduct that is wrongful and injurious. Specifically, it renders unlawful a knowing misrepresentation intended to induce reliance by persons such as the victim that succeeds in inducing such reliance. The elements of the tort can be stated as follows: "a misrepresentation or a material omission of fact which was false and known to be false by defendant, made for the purpose of inducing the other party to rely upon it, justifiable reliance of the other party on the misrepresentation or material omission, and injury."<sup>15</sup>

In a prior article coauthored with Anthony Sebok, we devoted attention to the reliance element of deceit, arguing that it plays a distinct yet underappreciated role, which, if appreciated, sheds light on how best to characterize this particular legal wrong.<sup>16</sup> It is true that reliance is the means through which a defendant's misrepresentation harms the plaintiff. But, we argued, reliance is not a mere equivalent to, say, the actual causation component of the tort of negligence. The easiest way to appreciate this point is to observe that even if a misrepresentation actually harms a victim, the victim has no claim for deceit if she does not rely upon it.

Suppose, for example, a subcontractor uses low-quality materials when building a home but knowingly misrepresents to the general contractor that the materials are of suitable quality. The home is finished and sold with no express representations made to the purchaser other than that the house is newly constructed and contains no known defects. Later, the owner is required to make costly repairs because of the subcontractor's use of poor materials. Even if the

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15. *E.g.*, *Lama Holding Co. v. Smith Barney, Inc.*, 668 N.E.2d 1370, 1373 (N.Y. 1996) (citations omitted).

16. Goldberg, Sebok & Zipursky, *supra* note 12, at 1001.

subcontractor's misrepresentation was a necessary step in the sequence that led to the owner's injury, the owner was not injured by relying on the subcontractor's misrepresentations. Whatever claims the owner might possess against the subcontractor, the owner will not have a claim for deceit. The subcontractor did not *defraud the owner*.

The distinct role played by reliance in deceit, we argued, reflects a structural feature common to all torts. Reliance is essential because courts have defined deceit to be the particular wrong of duping or tricking someone into entering into a transaction. A plaintiff who seeks to prevail on a complaint about being duped must prove that she was actually duped. It is not enough to prove that she was injured because someone else was duped.<sup>17</sup>

In requiring the plaintiff to have been wronged in the requisite manner, deceit is on par with negligence and every other tort. A negligence plaintiff must prove something more than mere carelessness "in the air" or carelessness toward other, differently situated persons.<sup>18</sup> The plaintiff must prove that the defendant's conduct was careless *as to her* (that is, persons situated as she was situated in relation to the defendant's conduct). All torts are personal wrongs in this sense. A tort plaintiff prevails by proving that the defendant wronged her by committing a recognized tort. A tort plaintiff cannot prevail when the conduct in question was injurious to her but wrongful only to someone else. Hence, a deceit plaintiff must be able to say of the defendant: "You tricked me!" As we explained,

[T]he core of the legal wrong that historically has been labeled "fraud" or "deceit" is the wrong of interfering with a particular interest of the victim, namely her interest in making certain kinds of choices in certain settings free from certain forms of misinformation. . . . [Deceit] occurs when one person, through a knowing misrepresentation of material fact, induces another to make a decision in a transactional setting that she would not have otherwise made . . .<sup>19</sup>

### *B. Impersonal Deceit*

Because deceit is based on an interference with decisional autonomy, requires proof of reliance, and is a centuries-old tort,<sup>20</sup> one might suppose that it has little applicability to the modern world of impersonal financial transactions. There is something to this instinct.

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17. *Id.* at 1004–12.

18. *Palsgraf v. Long Island R.R.*, 162 N.E. 99, 99 (N.Y. 1928).

19. Goldberg, Sebok & Zipursky, *supra* note 12, at 1013.

20. See J.H. BAKER, AN INTRODUCTION TO ENGLISH LEGAL HISTORY 356 (4th ed. 2002) (dating the emergence of the tort of deceit to the 1700s); Elizabeth Chamblee Burch, *Reassessing Damages in Securities Fraud Class Actions*, 66 MD. L. REV. 348, 361–62 (2007) (discussing seventeenth-century antecedents to the modern deceit action).



Indeed, we will argue in Part IV that the Supreme Court has distinguished the fraud-on-the-market version of securities fraud from deceit largely because it has sought to provide redress for persons who suffer economic loss without a corresponding interference with their decisionmaking. Nonetheless, we want to caution against the further suggestion that deceit and its requirement of individualized reliance are somehow inherently ill-suited to address manipulation in modern financial transactions. There are important instances of misrepresentation that cause financial loss but do not amount to deceit, yet this is not because deceit lacks applicability to transactions conducted impersonally.

As is well known, courts long ago rejected the notion that a viable claim of deceit requires privity between defendant and plaintiff. At least under some circumstances, if the defendant intentionally or knowingly transmits the substance of his misrepresentation to certain persons with whom he does not communicate directly, any of them who justifiably relies on the misinformation has a valid claim for deceit.<sup>21</sup> In other words, it is not essential to a claim of deceit that the plaintiff hears or receives the defendant's misrepresentation *directly* from the defendant. What is essential is that the plaintiff relies on the *substance* of the misrepresentation. The domain of deceit is not limited to face-to-face interactions. It is limited to transactions in which the plaintiff actually and justifiably relies on the content of a misrepresentation that was knowingly made in order to influence the conduct of persons such as the plaintiff.

The notion that deceit can generate only a relatively narrow band of liability is most obviously rebutted by *Central Bank of Denver v. First Interstate Bank of Denver*<sup>22</sup> and *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*<sup>23</sup> In both decisions, the Supreme Court blocked plaintiffs' efforts to invoke doctrines drawn from the law of deceit precisely because those doctrines promised to *expand* the reach of federal securities fraud law. Allowing 10b-5 plaintiffs to rely on doctrines such as aiding and abetting or civil conspiracy, the Court reasoned, would inappropriately extend liability to a range of background actors beyond primary wrongdoers.<sup>24</sup> Quite clearly, these

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21. RESTATEMENT (SECOND) OF TORTS § 531 (1977) ("One who makes a fraudulent misrepresentation is subject to liability to the persons or class of persons whom he intends or has reason to expect to act or to refrain from action in reliance upon the misrepresentation . . .").

22. 511 U.S. 164, 191 (1994) (refusing to recognize 10b-5 claims of aiding and abetting securities fraud).

23. 552 U.S. 148, 159–61 (2008) (rejecting "scheme liability" for securities fraud).

24. *Id.* at 162; *Cent. Bank of Denver*, 511 U.S. at 184.

decisions demonstrate that the tort of deceit has potentially broad applicability to the modern world of impersonal transactions.<sup>25</sup>

### III. FROM DECEIT TO FRAUD ON THE MARKET: *DURA*, ECONOMIC LOSS, AND LOSS CAUSATION

In the course of discussing the place of reliance in deceit, our earlier article touched very briefly on securities fraud. Our tentative conclusion was that reliance is an element of claims for securities fraud because “Congress and the courts have continued to conceive of private rights of action for securities fraud as a means of empowering those who have actually been defrauded to sue their defrauders.”<sup>26</sup> In other words, we supposed that 10b-5 actions, including fraud-on-the-market claims, assert that the plaintiff was duped into making a losing transaction.

We now think we erred in too closely equating the wrong of deceit with the subset of securities fraud claims that invoke *Basic*’s fraud-on-the-market theory.<sup>27</sup> Although closely related, deceit and fraud-on-the-market claims allege the commission of two distinct wrongs.<sup>28</sup>

The core difference between the two might be summarized as follows. As we have seen, deceit protects one’s right against being tricked into a certain kind of transaction. As such, deceit is concerned in the first instance with protecting the victim’s decisional autonomy from wrongful interference. By contrast, a fraud-on-the-market claim

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25. It may be that the common law would recognize something like the limit on joint-tortfeasor liability identified in *Stoneridge*. Professor Langevoort reads that decision to borrow a page from the law of negligence by adopting a no-duty rule for securities fraud actions. Under this rule, not everyone who “speaks” about the financial condition of a firm owes a duty to the market to refrain from making misrepresentations in the course of so speaking. Rather, it is only speakers who operate in the realm of finance—for the most part, those who appreciate better the risks and responsibilities created by federal securities laws—who are charged with such a duty. Langevoort, *supra* note 9, at 2137, 2154–56. In this respect, Langevoort argues *Stoneridge* meshes with state courts’ use of no-duty rules in negligence cases to prevent the imposition of liability that is grossly disproportionate to the gravity of the tortfeasor’s wrongdoing. *Id.* at 2143–44.

We are inclined toward a somewhat different reading of the decision, in part because we doubt that tort law, as a general matter, is especially concerned to ensure that liability is proportionate to wrongdoing. *Stoneridge* instead seems to invoke (rightly or wrongly) a notion of “superseding cause” in that it refuses to impose liability for an actor’s knowing misrepresentations about the financial condition of another actor when those misrepresentations are embedded or subsumed within the other actor’s own misrepresentations.

26. Goldberg, Sebok & Zipursky, *supra* note 16, at 1020.

27. Needless to say, we are here speaking for ourselves and not for Professor Sebok.

28. Although we ultimately draw a different distinction, our argument builds on Jill Fisch’s important analysis of the Supreme Court’s *Dura* decision. See Jill E. Fisch, *Cause for Concern: Causation and Federal Securities Fraud*, 94 IOWA L. REV. 811, 860–64 (2009) (analyzing the Court’s decisions in *Basic* and *Dura* through the lens of tort law).

vindicates a victim's right not to lose wealth as a result of trading in a market tainted by deliberate misrepresentations. The latter injury pertains in the first instance to economic well-being, not freedom from manipulation.<sup>29</sup> Fraud-on-the-market claims are in this respect akin to negligence claims seeking recovery for pure economic loss. However, fraud-on-the-market claims, unlike negligence claims, obviously require a heightened showing of wrongdoing (intentional misrepresentations designed to distort market prices rather than mere carelessness).

In this Part and the next, we will criticize two prominent instances in which the Supreme Court has purported, erroneously, to fashion the fraud-on-the-market tort in a manner that tracks the contours of deceit. Within this Part, we consider the Court's claim in *Dura* that it was merely applying common-law principles when it required proof of economic loss and loss causation as a condition of recovery for fraud on the market.<sup>30</sup> The injury in deceit is that of *having been deceived* into a decision, not economic loss per se. In fraud on the market, though, it is the other way around. This is why proof of economic loss and loss causation, as *Dura* defined those terms, have not historically been essential to liability for deceit.

In Part IV, we will consider directly the place of reliance in fraud-on-the-market claims. In particular, we examine what the Court meant when it held in *Basic* that investor reliance can be "presumed" for cases in which the fraud-on-the-market theory applies.<sup>31</sup> To get a better sense of this holding, we first distinguish two kinds of presumptions: those that aim simply to ensure the proper application of substantive law in particular cases and those that aim to effect a change in substantive law. We then argue that *Basic*'s presumption of reliance, though presented as being of the former sort, is in fact of the latter. When a plaintiff invokes the fraud-on-the-market doctrine, she is not claiming to have acted in reliance on the defendant's misrepresentation. Rather, she is claiming that the defendant's misrepresentation caused her to suffer economic loss by distorting the market in which she traded.

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29. John Coates has suggested to us that there is arguably a sense in which a decisionmaker's autonomy is diminished whenever her decision is affected by misinformation. Accordingly, there is some basis for asserting that fraud-on-the-market claims, like deceit claims, concern interferences with autonomy. Even assuming this is so, one can still draw a qualitative distinction between the sort of autonomy interference that is at the center of deceit, which involves a defendant's exercise of control over the plaintiff's choice, and the interference that is at the center of the fraud on the market, which does not.

30. *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 342 (2005).

31. 485 U.S. 224, 247 (1988).

A. *Dura's Twin Holdings*

In *Dura*, the plaintiffs alleged that they had purchased shares in the defendant-company at a price inflated by the defendant's knowing misrepresentations.<sup>32</sup> The complaint further alleged that the misrepresentations later came to light and that this revelation caused a brief dip in share price.<sup>33</sup> However, the complaint did not allege that the plaintiffs sold their shares at this lower price.<sup>34</sup> Instead, it sought compensation for the difference between the purchase price and the lower price the plaintiffs would have initially paid had the alleged misrepresentations not been made.<sup>35</sup>

The Supreme Court held that these allegations were insufficient to state a fraud-on-the-market claim. The Court reasoned that economic loss and loss causation are essential elements of such a claim.<sup>36</sup> The Court then elaborated on these elements, observing that in an ordinary case, "an inflated purchase price will not itself *constitute or proximately cause the relevant economic loss.*"<sup>37</sup> It is important to appreciate both aspects of this proposition.

*Dura's* first point is that a defendant's sale of stock to a plaintiff at a price inflated by misrepresentations is not yet a completed instance of securities fraud as federal law defines that wrong.<sup>38</sup> To be sure, the defendant's action might eventually become an instance of securities fraud. But that would only be the case if the plaintiff were to experience certain further adverse consequences, such as economic losses resulting from a sale of the shares at a price below the purchase price.<sup>39</sup>

In this respect, the Court treated the plaintiff's allegations as akin to some courts' treatment of negligence claims seeking compensation for toxic exposures.<sup>40</sup> Suppose a negligence complaint alleges that the plaintiff inhaled asbestos fibers because the owner of a

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32. 544 U.S. at 339–40. The crucial alleged misrepresentation concerned *Dura's* prospects for obtaining FDA approval of a spray device for delivering asthma medication.

33. *Id.* at 339.

34. *Id.* at 339–40.

35. Reply Brief at 2–3, *Dura*, 544 U.S. 336 (No. 03-932), 2004 WL 2988614.

36. 544 U.S. at 341–42.

37. *Id.* at 342 (emphasis added).

38. *Id.* at 342–43, 346–47.

39. See Merritt B. Fox, *After Dura: Causation in Fraud-on-the-Market Actions*, 31 J. CORP. L. 829, 846–62 (2006) (identifying questions left open by *Dura* as to what, beyond purchase at an inflated price, can count as economic loss); see also Burch, *supra* note 20, at 360, 380–82 (noting questions left open by *Dura* and arguing in favor of an out-of-pocket measure of damages on deterrence grounds).

40. See Fisch, *supra* note 28, at 852–53 (noting that *Dura* can be read to treat purchases at an inflated price as generating a risk of future harm to purchasers and that courts in personal injury tort cases have been reluctant to treat risk of physical injury, itself, as a harm).

nearby industrial plant was careless, but the complaint also acknowledges that the plaintiff has not yet manifested any asbestos-related illness. A court might deem this complaint legally deficient on the ground that the inhalation of asbestos fibers, by itself, does not constitute an injury so far as negligence law is concerned.<sup>41</sup> It is only if the plaintiff later develops an illness as a result of the inhalation that the defendant's carelessness ripens into the wrong of negligence. Similarly, *Dura* seems to suppose that the purchase of shares in a market distorted by the defendant's misrepresentation is not yet a completed instance of securities fraud—the defendant has merely exposed the purchaser to a risk of economic injury. So its initial holding—expressed in terms of the plaintiff's purchase at an inflated price failing to constitute economic loss—is that the plaintiffs had not alleged the sort of setback that completes a fraud-on-the-market claim of securities fraud.

The Court's second holding—that liability will attach only if the defendant's misrepresentations “proximately cause” the plaintiff's economic loss—identifies an additional limitation on fraud-on-the-market claims. Even if the plaintiffs sold their *Dura* shares at a price below the inflated purchase price, that would not suffice to establish the defendants' liability. Rather, the plaintiffs would also have to prove that the price drop was attributable specifically to the market's reaction to the revelation of the defendant's misrepresentations, as opposed to other independent forces (such as a general economic downturn or a coincidental exodus of key *Dura* employees).

Note that a defendant's alleged misrepresentations still operate as an *actual cause* of the plaintiffs' losses even when intervening forces such as these are at work. But for the misrepresentations, the plaintiffs never would have purchased the shares and thus never would have been at risk of losing money when the shares dropped, regardless of what other events were necessary to generate that drop. However, an actual causal connection, the *Dura* Court insisted, is not sufficient to establish liability. If intervening events bring about the drop in share price, the connection between the defendant's misrepresentations and the plaintiff's losses will be too remote or fortuitous, and hence the

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41. See John C.P. Goldberg & Benjamin C. Zipursky, *Unrealized Torts*, 88 VA. L. REV. 1625, 1657–60 (2002) (discussing courts' reluctance to recognize risk imposition as a cognizable injury). Some courts recognize claims for medical monitoring expenses incurred as a result of wrongful conduct exposing the plaintiff to an increased risk of disease. See, e.g., *Donovan v. Philip Morris USA, Inc.*, 914 N.E.2d 891, 901 (Mass. 2009) (defining the conditions under which a plaintiff can recover medical monitoring costs from a defendant who wrongfully caused the plaintiff to incur those costs). We have argued that claims of this form are not best understood as imposing liability for completed torts, but instead seek a special form of pre-tort injunctive relief. Goldberg & Zipursky, *supra*, at 1701–15.

misrepresentations cannot be deemed to have “proximately cause[d]” those losses.<sup>42</sup>

To reiterate, *Dura* holds that the mere purchase of shares at a price inflated by a defendant’s misrepresentations does not satisfy the economic-loss element of the fraud-on-the-market cause of action. Thus, a suit alleging only such a purchase fails to allege a completed instance of securities fraud. *Dura* further holds that even where the right sort of loss is pleaded, the defendant’s misrepresentation must also bring about that loss in the right way—through the market’s reaction to the revelation of the defendant’s misrepresentation, rather than through forces operating independently of the misrepresentation.

### B. Deceit and Economic Loss

The Court in *Dura* justified its twin holdings on several grounds. We will focus here only on one: the claim that *Dura*’s rendering of fraud on the market tracks the common law’s definition of deceit.

On the issue of what counts as economic loss, the Court reasoned as follows:

Judicially implied private securities fraud actions resemble in many (but not all) respects common-law deceit and misrepresentation actions. . . . And the common law has long insisted that a plaintiff in such a case show not only that had he known the truth he would not have acted but also that he suffered actual economic loss. See, e.g., *Pasley v. Freeman*, 3 T.R. 51, 65, 100 Eng. Rep. 450, 457 (1789) (if “no injury is occasioned by the lie, it is not actionable: but if it be attended with a damage, it then becomes the subject of an action.”); *Freeman v. Venner*, 120 Mass. 424, 426 (1876) (a mortgagee cannot bring a tort action for damages stemming from a fraudulent note that misrepresentation led him to execute unless and until the note has to be paid) . . .<sup>43</sup>

In support of the loss-causation requirement, the Court cited more contemporary common-law authorities, including the Second Restatement of Torts:

[T]he Restatement of Torts, in setting forth judicial consensus, says that a person who “misrepresents the financial condition of a corporation in order to sell its stock” becomes liable to a relying purchaser “for the loss” the purchaser sustains “when the facts . . . become generally known” and “as a result” share value “depreciate[s].”<sup>44</sup>

*Dura* thus claimed that its rendering of the economic-loss element of fraud-on-the-market claims merely instantiates the longstanding common-law rule requiring deceit plaintiffs to plead and prove damage, and that its loss-causation requirement tracks respectable authorities, including the Second Restatement of Torts.

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42. *Dura*, 544 U.S. at 342.

43. *Id.* at 343–44 (citations omitted).

44. *Id.* at 344 (quoting RESTATEMENT (SECOND) OF TORTS § 548A cmt. b (1977)).

It may be that *Dura's* economic-loss and loss-causation requirements are properly incorporated into fraud-on-the-market claims as a matter of statutory interpretation or as reasonable prudential limits on the scope of liability for such claims.<sup>45</sup> The Court nonetheless erred in supposing that the common law of deceit provides support for these requirements. If anything, *Dura's* insistence that economic loss and loss causation are elements of fraud-on-the-market claims establishes quite convincingly that this particular wrong, as the Court (and perhaps Congress) has defined it, differs significantly in substance from deceit.

*Dura's* invocation of the 1789 English decision *Pasley v. Freeman* is understandable, for *Pasley* contains canonical language about the need to prove damage in claims for deceit. In the words of Justice Buller, "Fraud without damage, or damage without fraud, gives no cause of action; but where these two concur, an action lies."<sup>46</sup> This oft-quoted phrase seems to support *Dura's* insistence that the plaintiffs prove that they sold their shares at a loss attributable to the revelation of the defendant's misrepresentations. And yet it does not.

To see where *Dura* went wrong, it will be helpful to distinguish among three closely related and frequently conflated concepts: "injury," "damage," and "damages." "Injury is the illegal invasion of a legal right; damage is the loss, hurt, or harm which results from the injury; and damages are the recompense or compensation awarded for the damage suffered."<sup>47</sup> While courts and commentators have unhelpfully used these terms inconsistently and interchangeably, attending to the distinctions among them will permit a better understanding of the *Pasley* principle.

*Pasley's* famous maxim emphasizes the need for proof of damage, but its holding equally implicates the concept of injury.<sup>48</sup> The justices in the majority were keen to emphasize that deceit, like every other tort, requires more than misconduct by the defendant. There must also be

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45. The Private Securities Litigation Reform Act of 1995 states that a plaintiff in a rule 10b-5 case "shall have the burden of proving that the act or omission of the defendant . . . caused the loss for which the plaintiff seeks to recover damages." 15 U.S.C. § 78u-4(b)(4) (2012).

46. *Pasley v. Freeman*, (1789) 100 Eng. Rep. 450 (K.B.) 453; 3 Term Rep. 51, 56. For his language, Justice Buller relied on the opinion of Justice Croke in *Baily v. Merrell*, (1615) 81 Eng. Rep. 81 (K.B.) 81; 3 Bulst. 94, 95. However, Croke's language is somewhat confusing and possibly confused. See *Baily*, 81 Eng. Rep. at 81 (suggesting that, for a case in which the owner and lessee of a cart have agreed upon a price per load, after which the lessee overloads the cart, "an action lieth for this fraud *without damage*, for damage without fraud gives no cause of action; but where these two do concur and meet together, there an action lieth") (emphasis added).

47. *Giammanco v. Giammanco*, 625 N.E.2d 990, 997 (Ill. App. Ct. 1993) (quoting BALLENTINE'S LAW DICTIONARY 303 (3d ed. 1969)).

48. *Pasley*, 100 Eng. Rep. at 455.

the requisite effect on the plaintiff. The majority in turn broke down this effect into two components. The first is the injury—the interference with the plaintiff’s right. The second is the damage— some relatively concrete deleterious effect on the plaintiff flowing from the interference with the right.

In *Pasley*, the defendant, Freeman, knowingly and falsely reassured the plaintiffs that a third party, Falch, was creditworthy. In reliance on Freeman’s affirmations, the plaintiffs sold goods on credit to Falch for which Falch never paid. Over a dissenter who maintained that the defendant had merely offered his opinion as to Falch’s creditworthiness, the majority, including Justices Buller, Ashhurst, and Kenyon, held that an action for deceit would lie.<sup>49</sup>

Justice Buller described the deceit as the defendant’s having “procured the plaintiffs to sell goods on credit to one whom they would not otherwise have trusted, by asserting that which he knew to be false.”<sup>50</sup> Justice Ashhurst added that the plaintiffs had properly averred a claim of deceit by alleging that the defendant, “intending to deceive and defraud the plaintiffs, did deceitfully encourage and persuade them to do the act, and for that purpose made the false affirmation, in consequence of which they did the act.”<sup>51</sup> Note that on both these descriptions, the wrong of deceit is completed or realized when the plaintiff acts in justifiable reliance on the defendant’s misrepresentation.

For his part, Chief Justice Kenyon offered a seemingly puzzling analogy on the issues of injury and damage (admittedly using those terms interchangeably):

If, indeed, no injury is occasioned by the lie, it is not actionable: but if it be attended with a damage, it then becomes the subject of an action. As calling a woman a whore, if she sustain no damage by it, is not actionable; but if she loses her marriage by it, then she may recover satisfaction in damages.<sup>52</sup>

Kenyon here likens the deceit action to a particular kind of slander claim: namely, one based on a statement that, though capable of harming reputation, is not so facially defamatory that harm can be presumed to have followed from its utterance.<sup>53</sup> A plaintiff alleging this

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49. *Id.* at 450–51.

50. *Id.* at 455.

51. *Id.* at 456.

52. *Id.* at 457.

53. Facially defamatory slander, for which damage is presumed, is classified as slander per se. At the time of *Pasley* and, indeed, until the end of the nineteenth century, “a statement imputing unchastity to a woman, or even professional unchastity, was not considered slanderous per se.” *Hollman v. Brady*, 233 F.2d 877, 877 (9th Cir. 1956) (footnote omitted). The rule was changed by legislation in England in 1891. *Id.* at 877–78.



sort of slander was (and still is) required to prove not only that the defendant verbally communicated a statement about her that was capable of damaging her reputation, but also that the communication caused her to suffer “special damages,” that is, some concrete or tangible loss.<sup>54</sup>

One might suppose that Kenyon’s slander analogy supports *Dura*’s reading of *Pasley*. After all, it seems to suggest that a fraud plaintiff must come to court with evidence demonstrating that things really did go badly for her, which is what the Supreme Court wanted to see from the *Dura* plaintiffs. But the analogy cuts the other way. The insistence on proof of a further deleterious consequence in the slander cases flows from a particular understanding of the nature of the right undergirding the slander tort. The injury in slander is the plaintiff’s suffering a reputational hit, irrespective of whether it produces further negative consequences for the plaintiff, such as the loss of a business opportunity. That is, the law defines slander in such a way that the wrong is realized at the moment at which a third party thinks less of the plaintiff because of the defendant’s utterance of defamatory remarks about the plaintiff.

If so, why do courts require some slander plaintiffs to offer proof of special damages, such as the proof of a ruined marriage that Justice Kenyon contemplated? The answer is partly epistemic. Evidence of special damages supports an inference that the defendant’s statement had the effect one would expect a defamatory statement to have; it really did cause others to think worse of the plaintiff. Additionally, courts have long worried that making available a cause of action for slander will encourage suits by complainants who are merely outraged over having been insulted or humiliated. While courts have long insisted that insults do not count as defamatory speech and hence are not a basis for liability, the requirement of proof of special damages has served to reinforce this limit on liability.<sup>55</sup>

Finally, and most importantly, the special-damages requirement for non-*per se* slander claims is grounded in a judgment about the relative importance of allowing individuals redress for different kinds of rights violations. The right to bodily integrity at the center of the tort of battery, along with the right to exclude that is at the heart of trespass to land, has been deemed important enough to

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54. Typically, special damages are proven by showing loss of wealth, loss of a job, or loss of a concrete opportunity resulting from the defamation. *Liberman v. Gelstein*, 605 N.E.2d 344, 347 (N.Y. 1992) (“Special damages contemplate ‘the loss of something having economic or pecuniary value.’” (citing RESTATEMENT (SECOND) OF TORTS § 575 cmt. b (1977))).

55. See *BAKER*, *supra* note 2020, at 440–42 (discussing common-law courts’ concern over the abuse of defamation actions and steps they took to prevent such abuse).

warrant its vindication irrespective of whether a given interference has generated follow-on, concrete harm. This is why a battery plaintiff can recover for an offensive but harmless touching and why a trespass plaintiff can recover damages without suffering tangible property damage.<sup>56</sup> So long as there has been a “touching” of the right sort, there is an actionable tort. However, courts will not deem valid certain claims of slander without a showing of follow-on losses. In their eyes, the right not to have one’s reputation besmirched by spoken words has not warranted the fulsome protection given to bodily integrity and the right to exclude others from one’s property.

For similar reasons, courts dealing with claims of deceit have insisted on proof of damage beyond proof of injury. The presence of follow-on damage attests indirectly to the plausibility of the plaintiff’s claim that she was duped. Courts probably have also worried that the availability of the deceit action will fuel a tendency among remorseful buyers and sellers to transform their disappointment into accusations of wrongdoing. Most importantly, courts long ago concluded that interference with decisional autonomy is not the sort of interference

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56. See, e.g., *Jacques v. Steenberg Homes, Inc.*, 563 N.W.2d 154 (Wis. 1997) (holding that a trespass to land does not require damage to plaintiff’s property to be actionable). Admittedly, in 1841, the New York Supreme Court once analogized deceit claims to claims for trespass to land: “When a man is drawn into a contract of sale or demise by fraud, a right of action attaches immediately, as much so as if trespass had been committed against him . . .” *Allaire v. Whitney*, 1 Hill 484, 486 (N.Y. Sup. Ct. 1841).

Tony Sebok has pressed us to consider the relation between the requirement of proof of damage in deceit and the requirement of proof of damage in actions for trespass to chattels. This turns out to be a question that warrants more attention than we can give it here.

Early on, some courts in the U.S. distinguished claims for trespass to chattels from claims for trespass to land by requiring proof of damage to render the former actionable. See, e.g., *Marentille v. Oliver*, 2 N.J.L. 379, 380 (1808) (stating that a trespass to chattel requires the plaintiff to establish damage to the chattel). This view seems to have been adopted by the Second Torts Restatement. RESTATEMENT (SECOND) OF TORTS § 218 cmt. e (1965). One might thus suppose that the damage requirement in trespass to chattels offers another (and more direct) analogue to the damage requirement in deceit than does the requirement of proof of special damages in slander. There may be something to this. In *Marentille*, for example, the court seems concerned to keep out of the courts de minimis trespass to chattels claims, such as a claim by *P* that *D* struck *P*’s horse without injuring the horse. 2 N.J.L. at 380.

However, this line of reasoning is complicated by at least two countervailing considerations. First, although the issue apparently did not often arise, English courts seem to have been prepared to treat claims for trespass to land and to chattels comparably, such that proof of damage was not required for either. See, e.g., FREDERICK POLLOCK, *THE LAW OF TORTS: A TREATISE ON THE PRINCIPLES OF OBLIGATIONS ARISING FROM CIVIL WRONGS IN THE COMMON LAW* 220–21 (1887) (noting the courts’ symmetrical treatment of trespass to land and chattels). Second, at least according to the Second Restatement, today, damage is treated as an *element* of a claim for trespass to chattels rather than a condition of actionability standing apart from the elements of the tort. RESTATEMENT (SECOND) OF TORTS, *supra*. It is possible that, in fashioning the Restatement, the ALI glossed over the distinction between elements and conditions of actionability, but this is an issue requiring further exploration.

that warrants recognizing claims merely upon evidence of such interference. Rather, it is only if the interference generates a concrete setback that it becomes sufficiently important to justify making the courts available to a plaintiff pursuing a claim of fraud.<sup>57</sup>

The important point is this: proof of damage was understood as a *prudential limit* designed to screen out *valid* but de minimis deceit claims, not as an *element* of the wrong of deceit.<sup>58</sup> The tort was understood to be complete just as soon as there was an interference with the plaintiff's right to decisional autonomy. In the words of Lord Justice Stephenson:

[I]t is settled law that A's misrepresentation, however fraudulent and morally wrong, does not become tortious until B not merely receives it but acts upon it. The damage may be suffered when and where B acts or begins to act upon the representation, but it may be suffered at a later time and at a different place. Although A's part of the tort is committed when and where he speaks or . . . writes the misrepresentation, B's part is needed to complete the tort by acting upon the representation, and the tort is committed, in my judgment, when and where he does so act.<sup>59</sup>

And yet, without proof of particularized damage, there was insufficient reason for a court to get involved. Thus we find Stephenson concurring with his predecessor Kenyon on the analogy between claims for slander and for deceit: "In deceit, as in slander, the false representation or (in most cases) the defamatory publication has to cause damage to be actionable, *but no damage to the plaintiff is necessary for the tort to be committed.*"<sup>60</sup> When Justice Buller in *Pasley* insisted that there cannot

57. Using the language of duty and injury, rather than right, injury, and damage, Arthur Sedgwick similarly distinguished deceit from battery and false imprisonment. Whereas courts will vindicate claims for interferences with a plaintiff's right not to be subjected to inappropriate touches, or to be confined merely upon proof of a violation of one of those rights, they require a more substantial showing from a plaintiff alleging an interference with his decisional autonomy. ARTHUR G. SEDGWICK, *ELEMENTS OF DAMAGES: A HANDBOOK FOR THE USE OF STUDENTS AND PRACTITIONERS* 204–05 (2d ed. 1909) ("The duty to tell the truth, unlike the duty not to invade the rights of personal security or personal liberty, is recognized by the law only when it becomes productive of injury, either substantial or to a legal right.").

58. This is why, when a slander plaintiff proves special damages—that is, a concrete effect such as the loss of her marriage or the loss of wealth attributable to the defamation—she recovers compensation not only for these items, but also "general damages" meant to compensate for the harm to reputation itself. RESTATEMENT (SECOND) OF TORTS § 575 cmt. a (1977).

59. *Diamond v. The Bank of London & Montreal*, [1979] Q.B. 333, 349 (citations omitted).

60. *Id.* (emphasis added). Some English authorities that follow *Pasley* arguably collapse the issue of damage into the issue of injury, thereby eliminating the need for corroborating evidence of damage to establish the injury. For example, Lord Blackburn in *Smith v. Chadwick*, (1884) 9 App. Cas. 187 (H.L.) 195, cites *Pasley* for the proposition that damage is an element of deceit. *Id.* Yet Blackburn concludes that if the plaintiff proves that "he did act upon [the defendant's misleading] representations, he shews damage." *Id.* at 196.

In *4 Eng. Ltd. v. Harper*, [2007] EWHC (Ch) 1568, [50], the defendants argued that even if their misrepresentations induced the plaintiff to buy their company at an inflated price, there remained a triable issue of whether plaintiff's losses were fully recouped under a set-off specified

be a cause of action for fraud without damage, he was not treating “damage” as an element of the plaintiff’s prima facie case, but instead requiring it to substantiate the plaintiffs’ allegations that their decision to sell goods to Flach was not authentically theirs, and to establish that the stakes were sufficient for a court to get involved.

An appreciation of *Pasley*’s emphasis on proof of damage as a token of the authentic and sufficiently serious nature of the interference with the plaintiff’s autonomy helps to clarify certain features of the law of deceit. First, the requirement of proof of concrete damage dissipates (or, perhaps, disappears) when the plaintiff’s suit does not seek compensatory damages but instead aims to undo the fraudulently induced transaction and return both parties to the status quo ante.<sup>61</sup> The plaintiff’s entitlement to rescission and restitution rests on the defendant’s commission of the wrong of deceit; in other words, the plaintiff’s having been induced to enter into a transaction through justifiable reliance on the defendant’s misrepresentation. But when the plaintiff merely wishes to unwind the transaction, the ordinary requirement of proof of damage is waived.

Second, and more importantly for present purposes, *Pasley*’s notion of damage has long been construed flexibly and modestly.<sup>62</sup> On this understanding, courts are essentially asking deceit plaintiffs to demonstrate that something of significance is at stake beyond the mere possibility of interference with the plaintiff’s autonomy. Indeed, at least one line of English decisions flowing directly out of *Pasley* suggests that damage can be proven merely by establishing that, for the transaction

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in the contract of sale. Justice Briggs for the Chancery Division of the High Court of Justice, relying in part on *Smith v. Chadwick*, rejected this argument as a ground for denying that the defendants had committed deceit:

Here the tort of deceit was complete . . . when the [plaintiff] entered into the agreement to buy the [defendant’s company]. The question is whether it matters that there may be an arguable case that the claimant had fully recouped its loss. . . . That question only goes to the assessment of damages. . . . In my judgment, it is sufficiently clear that there is a completed cause of action in deceit at the time of the sale agreement. . . .

*Id.*

61. See Robert B. Thompson, *The Measure of Recovery Under Rule 10b-5: A Restitution Alternative to Tort Damages*, 37 VAND. L. REV. 349, 367 & n.65 (1984) (arguing for the availability of restitution in securities fraud cases and noting common-law deceit cases “in which the court permitted rescission and restitution even absent a showing that defendant’s misrepresentation caused the plaintiff’s pecuniary harm—a showing required for tort damages.”); see also WILLIAM L. PROSSER, HANDBOOK OF THE LAW OF TORTS § 90, at 770 (1st ed. 1941); RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 13 cmts. c & e (2010) (noting that a transfer can be invalidated upon a showing that the defendant’s misrepresentation induced the transfer and without regard to whether plaintiff can show economic injury).

62. WILLIAM W. KERR, A TREATISE ON THE LAW OF FRAUD AND MISTAKE 94 (1872) (footnotes omitted) (“Fraud without damage is not sufficient to support an action or to be a ground for relief in equity. But it is enough if the representation operates to the prejudice of a man to a very small extent. Fraud gives a cause of action if it leads to any sort of damage.”).

in question, the plaintiff parted with a thing of value on the basis of the defendant's misrepresentation. In other words, one who shows detrimental reliance—the giving over or unconditional promising of value—has shown sufficient damage to confirm that she has suffered the sort of interference with autonomy that counts as a deceit. Lord Justice Hobhouse states this point in *Downs v. Chappell*: “For a plaintiff to succeed in the tort of deceit it is necessary for him to prove that (1) the representation was fraudulent, (2) it was material and (3) it induced the plaintiff to act (to his detriment).”<sup>63</sup>

As noted above, *Dura* cites *Freeman v. Venner*,<sup>64</sup> an early Massachusetts decision, for the claim that common-law deceit demands a showing of economic loss as defined by the Court. Admittedly a terse and dense decision, *Freeman* does not hold anything so specific. Freeman had loaned \$3,500 to two debtors. The loan was evidenced by a note and secured by a mortgage on certain land. A few months later, Freeman assigned the note and the mortgage to Venner. By “mistake and inadvertence on his part and through the false and fraudulent representations of the defendant,” Freeman endorsed the note “in blank.”<sup>65</sup> Doing so rendered him a guarantor of the debt—if the debtors defaulted on the loan and the mortgaged land was insufficient to cover the debt, Freeman would be personally liable to Venner for the shortfall. Freeman realized that he had mistakenly assumed this obligation and sought to qualify his endorsement, but Venner refused to allow the qualification and instead, over Freeman's objections, sold the note and mortgage to a third party named Tenney.

Freeman promptly sued Venner for conversion of the note. Sometime after the filing of Freeman's suit but before its resolution, the debtors defaulted on an interest payment due under the loan. In response, Tenney, now the holder of the note and mortgage, arranged for the mortgaged land to be sold in partial satisfaction of the underlying debt. Tenney then sued Freeman as guarantor on the note for the portion of the debt not covered by the proceeds of the sale. While Tenney's suit against Freeman as guarantor was still pending, the trial judge presiding over Freeman's conversion claim against Venner awarded Freeman damages equal to the amount that Tenney sought from Freeman.<sup>66</sup>

The Massachusetts Supreme Judicial Court reversed. It reasoned that the note had been lawfully transferred to Venner, not

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63. [1997] 1 W.L.R. 426, 433.

64. *Freeman v. Venner*, 120 Mass. 424, 424 (1876).

65. *Id.*

66. *Id.* at 426–27.

converted, and hence lawfully resold to Tenney. The Court acknowledged Freeman's allegation that Venner had fraudulently obtained Freeman's unrestricted endorsement on the note. However, it concluded that this allegation was not ripe for adjudication when Freeman first sued. At the moment of filing, the Court reasoned, Freeman's liability as guarantor was still inchoate; he had not yet been sued by Tenney, much less been held liable on the guarantee, and in principle he might never have been subject to liability as guarantor (if, for example, the debtors fulfilled their obligation to pay the note). In short, until Freeman was actually made to pay on the fraudulently induced guarantee,

[t]here will have been no concurrence of damage with fraud, within the rule on which such actions are founded. And as there has been no invasion of the plaintiff's right, no breach of promise, and no interference with his property, there can be no recovery of even nominal damages in this action.<sup>67</sup>

Freeman's claim was problematic, according to the Supreme Judicial Court, because it was premature. This helps to explain why the *Dura* Court could plausibly invoke *Freeman* in support of the contention that the *Dura* plaintiffs had pleaded an inchoate or unrealized case of securities fraud.<sup>68</sup>

Still, the cases are distinguishable. Freeman was not complaining about being duped into transferring his rights under the note and the mortgage. Rather, he was complaining about being tricked into assuming the role of guarantor. The right against being tricked to enter into that sort of role, the *Freeman* Court reasoned, is not interfered with until the obligations attending that role are triggered. One who is induced to purchase or sell goods or money by another's misrepresentation can claim a rights violation just as soon the transaction takes place, and perhaps as soon as one is unconditionally bound to enter into the transaction through a contract. By contrast, because guarantees are by their nature conditional obligations, one who is induced to issue a guarantee cannot claim a rights violation until actually called upon to live up to the guarantee. This is why, according to the court, Freeman had not only failed to allege damage, but had further failed to allege even an injury (i.e., an "invasion of [his] right"). The true analogue to *Freeman*, in other words, would have been a case in which the *Dura* plaintiffs claimed to have been tricked into entering into an agreement that conditionally obligated them to purchase *Dura*'s stock at an inflated price but then sued before the condition triggering that obligation kicked in.

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67. *Id.* at 427.

68. *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 344 (2005).

Neither *Pasley* nor *Freeman* introduced into the law of deceit *Dura's* narrow conception of economic loss, nor do they support the notion that a claim for deceit is inchoate upon the occurrence of the transaction induced by the defendant's misrepresentation. Insofar as state-court decisions dismiss deceit claims for lack of damage under *Pasley*, they do so on the ground that by failing to show any plausible conception of what might count as damage, the claimant did not present sufficient evidence of an injury worthy of judicial resolution, even assuming that he had been deceived by the defendant.<sup>69</sup> That *Dura's* notion of economic loss was not a component of the common law of deceit is also evidenced by decisions affirming judgments for deceit plaintiffs alleging exactly the sort of damage that *Dura* deemed not to count as economic loss (i.e., damage in the form of purchase at an inflated price). Notably, these decisions involved not only fraud with respect to the purchase of tangible goods, such as livestock,<sup>70</sup> but also involved fraud with respect to the purchase of shares.<sup>71</sup>

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69. *Gaffney v. Graf*, 238 P. 1054, 1055 (Cal. Dist. Ct. App. 1925) (holding that a car dealer cannot recover in fraud based on a customer's misrepresentation that his trade-in was from an earlier model year than represented; there was no evidence that the dealer suffered a loss as a result of the misrepresentation); *Alden v. Wright*, 49 N.W. 767, 768 (Minn. 1891) (providing that if defrauded purchasers of stock received stock that was in fact worth what the plaintiff gave for it, no fraud action will lie); *Castleman v. Stryker*, 213 P. 436, 439-40 (Or. 1923) (stating that parties alleging that they were tricked into buying a business must offer evidence that on the date of sale, the business was worth less than the amount paid); *Nye v. Merriam*, 35 Vt. 438, 444 (1862) (holding that plaintiff suffered no damage from defendant's fraud once the defendant promised to make up for any underpayment resulting from the fraud).

70. *See Miller v. Wilson*, 381 S.W.2d 31, 38 (Mo. Ct. App. 1964) (holding that deceit plaintiff was entitled to bring claim based on difference between value of cow actually purchased and cow as misrepresented by the defendant); *Salmon v. Brookshire*, 301 S.W.2d 48, 54 (Mo. Ct. App. 1957) (providing that buyer who paid inflated price for a cow based on defendant's misrepresentations has a valid claim for fraud); *White v. Mowbray*, 3 N.Y.S. 225, 226 (Sup. Ct. 1888) (finding a deceit plaintiff entitled to recover purchase price plus expenses incurred in caring for diseased horse sold to plaintiff by defendant); *Maynard v. Maynard*, 49 Vt. 297, 301 (1877) (stating that a seller of impotent bull was liable to deceived buyer for all damages which resulted directly from the buyer's inability to use the bull for purposes contemplated at the time of sale).

71. *See, e.g., Sriver v. Maley*, 151 N.E.2d 518, 521-22 (Ind. Ct. App. 1958) (finding that although fraud without damage is not actionable, evidence that the defendants hid certain debts owed by their company establishes that the plaintiff suffered damage by paying an inflated price for shares in the company); *Menefee v. Blitz*, 179 P.2d 550, 564 (Or. 1947) (providing that the measure of damages for deceit in sale of stock is difference between sum paid and value at time of purchase); *Shine v. Dodge*, 157 A. 318, 319 (Me. 1931) (stating, in dictum, that a deceit plaintiff in a sale of stock case was entitled to the difference between the actual value of the property at the time of the purchase and its value as if it had been represented); *Nielsen v. Hansford*, 242 P. 677, 678 (Colo. 1926) (holding that a plaintiff who was misled into purchasing stock properly alleged damage in that stock, at the time of purchase, was of lesser value than represented); *Johnson v. Niles Invisible Door Check Co.*, 222 Ill. App. 65, 68 (1921) (noting that standard rules of damages for deceit apply to claim based on sale of stock); *Chapman v. Bible*, 137 N.W. 533, 534 (Mich. 1912) (allowing stock purchaser to recover damages notwithstanding that stock was selling at a higher price than the inflated purchase price paid by plaintiff); *see also Neiheisel v. Malone*, 375 P.2d 197,

Let us sum up our analysis so far. *Dura* erroneously asserts that its economic-loss requirement is supported by the longstanding recognition of damage (conceived as concrete economic loss) as an *element* of the common-law tort of deceit. Damage so conceived is not an element of the tort of deceit. Deceit plaintiffs have been required to prove damage to recover compensatory damages. But this is because damage has served as a prudential filter by which judges have excluded certain *well-formed but trivial* deceit claims. Contra *Dura*, the tort of deceit has long been understood to be complete or realized when the plaintiff justifiably relies on the defendant's intentional misrepresentation. However, if a deceit plaintiff who seeks compensatory damages fails to allege and prove that he suffered concrete economic losses as a result of the deception, courts will deem the matter *de minimis* and refuse to entertain it.

By this description, *Dura*'s mistake might seem merely academic—a matter only of the Court having put damage in the wrong conceptual box. But the mistake is more significant than that. Precisely because courts have understood proof of damage as a pragmatic filter designed to exclude *de minimis* claims, they have approached the question of proof of loss with considerable flexibility. Certainly they have not insisted on the exacting conception of economic loss invoked by *Dura*.

More fundamentally, the Court in *Dura* failed to appreciate that, by adopting a particular and narrow conception of economic loss as an element of fraud-on-the-market claims, it was defining that cause of action on terms that render it quite distinct from deceit. Deceit is a wrong based on an interference with autonomy: a deceit plaintiff complains about having been tricked into making a decision she would not otherwise have made. By contrast, under *Dura*, the wrong of securities fraud—or at least the fraud-on-the-market version of that wrong—is not an autonomy-based wrong, but an economic tort. A fraud-on-the-market plaintiff, like a plaintiff alleging negligence causing pure economic loss, complains of losses caused by the defendants' manipulation of the market. The fact that the plaintiff was tricked might provide the causal link between the defendant's manipulation and her losses, but being tricked is no longer the gist of the wrong. As we discuss below, *Dura* thus further crystallized a doctrinal schism between deceit and securities fraud that traces all the way back to *Basic*

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198 (Colo. 1962) (requiring deceit plaintiffs seeking damages, rather than rescission, to offer evidence as to the value of the stock purchased and what the stock "might have been worth" had the defendant not made misrepresentations).



*v. Levinson's* initial recognition of fraud-on-the-market claims under 10b-5.

### *C. Deceit and Loss Causation*

Under *Dura*, a fraud-on-the-market plaintiff who can prove that she suffered economic loss must further prove that the loss flowed from the defendant's misrepresentation in the right way. Specifically, the plaintiff must prove that her injury occurred because the market absorbed the putative facts that the defendant had misrepresented, as opposed to some other independent force.

As we noted above, the *Dura* Court relied primarily on the Second Restatement of Torts, which transplanted the language of "legal cause" from negligence into deceit.<sup>72</sup> Specifically, section 548A excludes liability for deceit if the losses suffered by the plaintiff come about in a fortuitous or entirely unexpected manner.<sup>73</sup> Commentary to that section illustrates this principle with the example of a purchaser who is tricked into buying shares in a company, the value of which drops only because of the unexpected death of key company employees: "Although the misrepresentation has in fact caused the loss . . . it is not a legal cause of the loss for which the maker is responsible."<sup>74</sup>

*Dura's* invocation of section 548A's legal cause requirement turns out to rest on a subtle mistake. It is true that the section specifies legal cause as an element of claims for deceit. It is also true that the aforementioned illustration suggests that this element would defeat a claim by a purchaser of shares very much resembling the purchasers in *Dura*. But critically, neither section 548A nor the illustration presupposes, as *Dura* does, that deceit plaintiffs generally must plead and prove "economic loss" as *Dura* defines that phrase. Rather, the illustration simply assumes that the plaintiff in the imagined case *has opted to sue for economic loss of that sort*. Insofar as the plaintiff is seeking compensatory damages for selling at a loss, the illustration maintains, the plaintiff must be prepared to show that the loss is not attributable to the coincidental operation of forces independent of the defendant's misrepresentation. But there is no suggestion that a deceit plaintiff must always establish economic loss of this sort to prevail.

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72. See *supra* note 44. Years before serving as Reporter for the Second Restatement, Prosser in his torts treatise had introduced a notion of proximate cause into his description of deceit. PROSSER, *supra* note 61, at 769 (stating that a fraud plaintiff must establish that the damage sued upon was proximately caused by the defendant's misrepresentation). No "legal cause" restriction on liability for deceit is stated in the First Torts Restatement.

73. RESTATEMENT (SECOND) OF TORTS § 548A (1977).

74. *Id.* at cmt. b.

Indeed, section 549 of the Second Restatement states that a deceit plaintiff can recover “the difference between the value of what he has received in the transaction and its purchase price or other value given for it.”<sup>75</sup> Commentary to this section further explains that this kind of loss consists of “the difference between the price paid . . . and the value of the thing acquired,” with the latter determined by “the price at which it could be resold . . . if its quality or other characteristics that affect its value were known.”<sup>76</sup> On these terms, it is perfectly viable for a deceit plaintiff to allege purchase at an inflated price as the relevant damage that is needed to render her claim legally cognizable.

To be sure, section 548A treats legal cause as an element of all deceit claims and hence requires a plaintiff alleging damage in the form of purchase at an inflated price—no less than the plaintiff in the *Dura*-like illustration to the section—to establish that her losses did not result from the coincidental operation of independent forces. But when the allegation of damage is payment at an inflated price, the legal cause requirement is obviously satisfied and hence a nonissue—much like proximate cause is an element of, but also a nonissue for, a negligence case in which a pedestrian who was lawfully crossing a public street sues the careless driver who ran her down. In this imagined negligence case, the causal connection between the defendant’s careless driving and the plaintiff’s injury is so obviously *not* serendipitous that there is nothing to discuss under the heading of proximate cause—the element is clearly satisfied. The same goes for legal cause in a case of deceit in which the damage alleged is payment at an inflated price.

In short, the *Dura* Court could have fairly invoked section 548A for two propositions, neither of which was sufficient to resolve the case before it. The first states that legal cause is an element of the tort of deceit. The second states that, insofar as a deceit plaintiff claims that her damage consists of selling a good at a price below the inflated price that she paid, the legal cause element is not satisfied if the lower sales price resulted from forces operating independently of the defendant’s misrepresentation. One can only arrive at *Dura*’s conclusion by adding to these two a third proposition—namely, that the purchase of a good at a price inflated by the defendant’s misrepresentation is not itself damage within the meaning of the law of deceit. As we have seen, however, this third proposition is indefensible as a descriptive matter;

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75. *Id.* § 549(1)(a); see Fisch, *supra* note 28, at 842–43 (noting that section 549’s treatment of the measure of damages for fraud claims seems consistent with judicial decisions prior to *Dura*, which treated the damage as consisting of overpayment).

76. RESTATEMENT (SECOND) OF TORTS, § 549 cmt. c (1977).

the law of deceit has recognized purchase at an inflated price as damage.<sup>77</sup>

There is another problem with *Dura's* invocation of section 548A, though this is admittedly a problem internal to the Restatement's treatment of deceit. Section 548A claims that its legal cause requirement is analogous to the requirement of legal (or proximate) cause in negligence. This analogy is problematic for two reasons.

First, section 548 imposes a foreseeability limit on liability even though deceit is an intentional tort. Foreseeability poses an intelligible limit on *negligence* liability precisely because the gist of negligence is injuring someone through a failure to take care to avoid conduct that poses an undue *risk* of injury. When one is trying to determine whether taking a particular risk counts as a breach of a duty of care, and whether that breach proximately caused an injury, it is entirely natural and appropriate to invoke notions of foreseeability. Most obviously, if an actor's conduct posed only an unforeseeable risk of injury to persons such as the plaintiff, then there is no ground for asserting that the actor was careless as to the plaintiff for failing to take appropriate precautions. By contrast, when the gist of the wrong is an intentional harming of another, the propriety of posing a liability limit based on foreseeability is less obvious.<sup>78</sup> Indeed, it may be that the Restatement was departing from the traditional common law in offering a rule that excludes liability for deceit that causes losses in an unforeseeable manner.<sup>79</sup>

Second, and more fundamentally, proximate cause in negligence is an element of the wrong. When a court concludes that a defendant's carelessness was not a proximate cause of the plaintiff's injury, the court is asserting that the defendant did not actually commit the tort of negligence and thus cannot be held liable. As noted above, however, the tort of deceit is very different from the tort of negligence. A negligence plaintiff complains of having wrongfully suffered bodily harm, property damage, emotional distress, or economic loss. Until such harm is experienced, the tort is not complete. A deceit plaintiff, by contrast, complains of a wrongful interference with her decisional autonomy. This wrong is completed when the plaintiff justifiably acts upon the defendant's intentional misrepresentation.

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77. See *supra* notes 69–70 (citing deceit cases that treat purchase at an inflated price as damage).

78. See Fisch, *supra* note 28, at 831–32 (discussing the awkwardness of importing proximate cause principles drawn from negligence into the law of deceit).

79. See Mark P. Gergen, *Causation in Disgorgement*, 92 B.U. L. REV. 827, 839 (2012) (“Under the traditional common-law rule, a wrongdoer generally bears the loss unless the cause is wholly unrelated to the deception.”).

It follows that the question of whether and how the plaintiff suffered economic loss as a result of interference with her decisional autonomy is *not* a question about whether the wrong of deceit has been committed—it has.<sup>80</sup> Rather, it is a question about the scope or extent of the defendant's liability. In other words, it is a question of the extent of damages a deceit defendant can properly be made to pay for having wronged the plaintiff, not a question of whether the defendant has committed a wrong in the first place.

This distinction, too, is not merely taxonomic or conceptual. In tort law, the rules pertaining to computation of damages do not always treat fortuitous causation as cutting against the plaintiff's claim. Most famously, the “thin skull rule” permits a successful negligence plaintiff to recover compensation even for injuries of an unforeseeable magnitude.<sup>81</sup> Thus, a defendant whose carelessness causes injury to the plaintiff by mere fortuity is spared liability altogether under the doctrine of proximate cause, but a defendant whose carelessness nonfortuitously causes injury to a plaintiff can be held liable even for damage of an unforeseeable magnitude.

One of several possible justifications for this difference between rules determining liability and rules determining damages is that tort law embraces a principle somewhat akin to criminal law's presumption of innocence. In determining whether an actor has committed a tort such as negligence, the law, to a certain degree, protects actors from fortuities. But once one is deemed a tortfeasor, one forfeits one's entitlement to the law's solicitousness. To recognize that section 548A's legal cause requirement is more appropriately analogized to rules of damages than to proximate cause rules is thus to recognize that the requirement should be framed and applied flexibly, not rigidly.

Our point is not that tort law always saddles tortfeasors with liability for unforeseeable losses. Rather, it is that tort law contains some prominent remedial rules that allow for such liability. And this in turn suggests that courts have leeway to incorporate these principles in sculpting the 10b-5 tort. Hence, once again, the *Dura* Court erred in

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80. Indeed, it would be bizarre to suggest that the purchaser in section 548A's illustration has not been the victim of deceit. In justified reliance on the defendant's intentional misrepresentations, the plaintiff exchanged money for shares. This is not misrepresentation in the air, nor is it “fraud without damage.” KERR, *supra* note 62, at 94. Nor was the plaintiff's purchasing of the shares an unforeseen consequence of the defendant's misrepresentations. Quite the opposite—it was an intended consequence. There is nothing missing here; we have an instance of deceit. This much seems clear from the fact that the plaintiff could, from the moment of the purchase, seek rescission on the basis of the deceit.

81. See, e.g., *Vosburg v. Putney*, 50 N.W. 403, 404 (Wis. 1891) (holding that a tortfeasor is liable for losses resulting from his tortious conduct even if, because of a hidden vulnerability in the plaintiff, their magnitude was unforeseeable).

claiming that by requiring proof of loss causation, it was merely following the dictates of the common law.<sup>82</sup> Moreover this error—no less than the error of supposing that deceit requires economic loss—indicates that the Court has (deliberately or unintentionally) recast fraud-on-the-market securities fraud as an economic tort. Section 548A's illustration of legal cause served as the focal point for the Court's analysis precisely because it has come to view fraud on the market as the wrongful causation of economic loss rather than the tricking of a plaintiff into making a certain kind of decision.

#### IV. FROM DECEIT TO FRAUD ON THE MARKET: *BASIC* AND THE PRESUMPTION OF RELIANCE

In *Basic*, the Supreme Court famously insisted that 10b-5 claims, like claims for deceit, include the element of reliance.<sup>83</sup> At the same time, it characterized reliance as “provid[ing] the requisite causal connection between a defendant’s misrepresentation and a plaintiff’s injury” and emphasized that “[t]here is . . . more than one way to demonstrate the causal connection.”<sup>84</sup> Reliance qua causation, the Court continued, can be presumed in certain cases, namely, those involving shares bought and sold in efficient markets.<sup>85</sup> Even where applicable, however, the presumption of reliance is rebuttable.<sup>86</sup>

Preliminarily, it is worth reiterating that *Basic* and its progeny—despite their importance and visibility—establish only one type of privately actionable 10b-5 claim. As the Court emphasized in its 2008 *Stoneridge* decision, there is a substantial domain of 10b-5 cases involving nonpublic affirmative misrepresentations that do not fit the mold of fraud-on-the-market claims and do not afford plaintiffs a presumption of reliance.<sup>87</sup> Additionally, plaintiffs in public

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82. See *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 343–44 (2005) (noting that private securities fraud actions resemble common-law deceit actions, where plaintiffs must show “actual economic loss”).

83. *Basic Inc. v. Levinson*, 485 U.S. 224, 243 (1988).

84. *Id.*

85. See *id.* at 243–44 (noting that interpretation of the rule 10b-5 reliance requirement should take note of the difference between “the face-to-face transactions contemplated by early fraud cases” and those taking place in modern securities markets.)

86. *Id.* at 245.

87. See *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 159 (2008):

Reliance by the plaintiff upon the defendant’s deceptive acts is an essential element of the § 10(b) private cause of action. . . . We have found a rebuttable presumption of reliance in two different circumstances [citing *Basic*, 485 U.S. at 247; *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153–54 (1972)]. . . . Neither presumption applies here. Respondents had no duty to disclose; and their deceptive acts were not communicated to the public.

misrepresentation cases who fail to qualify for *Basic*'s presumption of reliance do not automatically find themselves claimless; they might still have viable claims if they can prove actual reliance without the benefit of the presumption. Liability for claims brought by these two categories of 10b-5 plaintiffs more closely resembles liability for common-law deceit than for fraud-on-the-market claims. Finally, even before *Basic*, the Court recognized in *Affiliated Ute Citizens v. United States* a presumption of reliance in the context of failure-to-disclose claims.<sup>88</sup>

In this Part, we consider the nature of the presumption in the *Basic* line of cases and what it tells us about fraud-on-the-market claims. We do so by way of a more general discussion of presumptions in tort law. Although presumptions appear throughout the law, the topic of presumptions has traditionally fallen within the purview of evidence scholars.<sup>89</sup> And yet, as with other general topics like damages, causation, and reasonableness, tort law illuminates particularly well the topic of presumptions. In the thirty-five years since *Basic* was decided, fraud-on-the-market claims have become a cornerstone of federal securities fraud litigation, in no small part because the secondary market for publicly traded companies is enormous and fraud-on-the-market claims are available to secondary market buyers and sellers.<sup>90</sup>

#### A. Compliance-Enhancing Presumptions, Substance-Morphing Presumptions, and Mixed Presumptions

It goes without saying that presumptions are typically motivated, at least in part, by policy rationales even though they present themselves as facially neutral evidentiary rules.<sup>91</sup> And, of

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88. See *Affiliated Ute*, 406 U.S. at 153–54 (explaining that a plaintiff need not prove reliance to recover in a failure-to-disclose claim so long as the facts withheld are “material in the sense that a reasonable investor might have considered them important”). We leave open the question of whether failure-to-disclose claims are their own kind of 10b-5 claim or instead are best viewed as a special subset of the kind of 10b-5 claims that, like those in *Stoneridge*, resemble deceit claims.

89. A valuable analytical overview of presumptions is provided by the “Presumptions” chapter in MICHAEL M. MARTIN ET AL., *NEW YORK EVIDENCE HANDBOOK* 57–104 (2d ed. 2003). The purpose-based distinctions drawn in our Article run perpendicular to several of the helpful distinctions set forth in that chapter, including distinctions between evidentiary and burden presumptions, permissive and mandatory presumptions, and rebuttable and irrebuttable presumptions.

90. Cf. Allen Ferrell & Atanu Saha, *Forward-Casting 10b-5 Damages: A Comparison to Other Methods*, 37 J. CORP. L. 365, 366 (2012) (noting the importance of 10b-5 litigation and the vastness of possible liability exposure given the size of secondary markets).

91. Cf. Edmund M. Morgan, *Some Observations Concerning Presumptions*, 44 HARV. L. REV. 906, 906 (1931) (noting that a presumption may be supported “on logical grounds[,] because it accomplishes a procedural convenience, . . . because it furthers a result deemed to be socially desirable,” or because of some combination of these three justifications).

course, there is not just one policy at work. Our aim is to distinguish among different kinds of policies that lie behind the presumptions in tort law. The types of policies laid out below are broad; they likely include subcategories.

The most common presumptions in tort law aim to provide a more faithful application of the relevant legal rules to certain recurring fact patterns.<sup>92</sup> We will call these “compliance-enhancing” doctrines. The idea is that the normal rules of evidence, including the normal allocation of standards of proof, while reasonably well designed to effectuate the substantive rules of law, tend to perform poorly in certain pockets of case law. These pockets feature certain recurring attributes that cause the normal evidentiary and procedural rules to distort outcomes; for example, there is a consistent asymmetry in the ability of plaintiffs and defendants to access evidence. In response, courts sometimes craft special evidentiary rules as correctives. These presumptions are compliance enhancing because their aim is to enhance the capacity of our system of adjudication to deliver results consistent with the substantive laws being applied.<sup>93</sup>

*Res ipsa loquitur* is probably the most famous tort doctrine utilizing presumptions, and it is a compliance-enhancing doctrine. Without *res ipsa*, a certain category of cases would too frequently be subject to a successful defense motion for judgment as a matter of law. By enabling claims in this category to go to verdict even in the absence of evidence as to how exactly the defendant was careless, the doctrine promises a distribution of wins and losses that better reflects substantive negligence law. The rebuttable presumption of fault that *res ipsa* creates is designed to produce wins for plaintiffs where there

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92. See generally JAMES BRADLEY THAYER, A PRELIMINARY TREATISE ON EVIDENCE AT THE COMMON LAW 313–52 (1898) (describing the process by which courts, when faced with recurring facts, “cut short” the process of reasoning by “affix[ing], by a general declaration, the character and operation which common experience has assigned to them”).

93. For present purposes, we utilize a broad conception of what can count as a compliance-enhancing presumption: one that aims to include what might otherwise be deemed a distinct category of presumptions that serve the goal of administrative ease or efficiency. Consider the presumption that a person who drives a car owner’s vehicle was authorized to drive it. A court might adopt this presumption in part to save litigants and judges time and expense in resolving automobile-collision litigation. Such a presumption can nonetheless be recast as compliance enhancing in the following sense: given that our system is prepared to devote only so much time to litigation over the authorization issue, and given the role that stale testimony and implicit understandings are likely to play in resolving that issue, one can expect a more accurate distribution of results if the presumption is given to the plaintiff than if the plaintiff is required to establish authorization. More generally, the selection of a presumption for compliance-enhancing reasons is always made against a backdrop of understandings about the allocation of resources in our adjudicative system, broadly speaking. We leave to another occasion the question of whether it is untenably reductive to say, as a general matter, that presumptions motivated primarily by administrative ease should be subsumed into the compliance-enhancing category.

was careless conduct causing injury and wins for defendants where there was not.

The classic *res ipsa* case is *Byrne v. Boadle*.<sup>94</sup> There, a barrel fell out of a window onto the plaintiff standing below on a public street. The plaintiff brought a negligence claim against the owner of the barrel, who also owned the business occupying the premises from which the barrel fell. The defendant moved for dismissal because the plaintiff was unable to produce any evidence of careless conduct by the defendant. The court rejected this argument, reasoning that a jury could infer carelessness from the fact that barrels ordinarily do not fall out of windows absent someone's carelessness, that the defendant was in exclusive control of the barrel, and that there was nothing pointing to carelessness by the plaintiff.<sup>95</sup> Under these circumstances, the falling barrel—the thing itself—bespoke fault on the part of the defendant.

The court in *Byrne* was not eliminating careless conduct as a condition of negligence liability. It was, for a certain kind of case, eliminating the need for the plaintiff to provide specific evidence of carelessness. The substantive rule is the same: no liability for an injury unless the defendant acted carelessly in causing the injury. The problem is that in certain kinds of cases the ordinary requirement is apt to lead to false negatives. The trick, then, is to fashion a rule that converts the false negatives to true positives without also converting true negatives to false positives.

*Res ipsa* is perhaps an atypical legal presumption because it creates a rebuttable permissive inference, rather than a rebuttable mandatory inference. But there are presumptions in torts that fall into the rebuttable mandatory category. An example is the presumption, upon proof that a defendant in an automobile-accident case owned the vehicle in question, that the driver of the vehicle at the time of the accident was operating the automobile with the owner's permission.<sup>96</sup> Like *res ipsa*, this presumption is a compliance-enhancing rule.

A different kind of aim that sometimes leads courts to recognize a presumption in tort law is a desire to change the substantive legal rules that apply to a category of cases. Here, the thought is that altering the burden of proof on an element or defense can be an elegant and effective way to implement a substantive change in the law. We will call these kinds of presumptions “substance morphing.” Note that we will

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94. See 2 H. & C. 722, 159 Eng. Rep. 299, 300 (Exch. 1863) (“There are certain cases of which it may be said *res ipsa loquitur*, . . . that the mere fact of the accident having occurred is evidence of negligence . . .”).

95. *Id.*

96. MARTIN ET AL., *supra* note 89, at 79.



sometimes call a presumption “substance morphing” even where more straightforwardly evidentiary issues are also part of the reason for its adoption. (For example, the presumption that a person is aware that his sexual partner is below the age of consent is clearly substance morphing even if it is also driven by access-to-evidence problems.)

The so-called tender years doctrine provides a nice example of a substance-morphing presumption.<sup>97</sup> In many jurisdictions, a child below a certain age (for example, six years old) is conclusively presumed not to have been careless in injuring the plaintiff or in failing to protect herself from injury. This presumption, based on the mere fact of age, is justified for two reasons. First, it is a reasonable generalization with respect to children under a certain age. Second, our system rejects tort liability for unintentional injuries caused by young children, as well as the denial or reduction in a young child’s tort damages, because of the child’s careless contribution to her own injury. By contrast, nothing about the tender years doctrine is really about evidence: there seems little reason to worry that juries will frequently treat a five-year-old’s conduct as careless when it is not.

By adopting this rule of substantive law through a presumption of noncarelessness, courts shape liability in cases brought by and against very young children in a manner that creates lawyerly comfort with the idea of a bright-line age limit and that integrates these cases into a spectrum that includes cases in which older children are given certain accommodations yet nonetheless held responsible for their actions. Moreover, courts do so without inviting a range of all-things-considered judgments about whether it is really fair to hold very young children responsible for injuries they cause or suffer, even if they did act carelessly. And while substantive lawmaking through presumption is perhaps less transparent than other modes of lawmaking, there may well be good reasons to effect some substantive changes in this way, and there is certainly a long history in law of doing so.<sup>98</sup>

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97. See, e.g., *Chi. City Ry. Co. v. Tuohy*, 63 N.E. 997, 1002 (Ill. 1902) (holding that negligence could not be imputed to a six-year-old child who, as a matter of law, was “incapable of exercising care for his own safety”).

98. The so-called presumption of damages in the common law of libel is another example of a substance-morphing presumption. The basic idea is that if a defamatory statement is published and heard, then unless it is not conceivable that it will be believed or entertained, reputational injury necessarily follows. It is a presumption of damages only relative to a rule that includes damages as an element.

It may be tempting to suppose that a compliance-enhancing presumption such as *res ipsa* and a substance-morphing presumption such as the tender years doctrine are, in the end, the same thing. Both in part aim to promote deterrence, compensation, or the doing of justice. It seems foolish to deny that both presumptions are, in this sense, policy-driven, and we are not wedded to any such denial. Rather, we are distinguishing between presumptions that operate in a manner that essentially adds to or alters substantive legal rules and those that do not alter substantive

Some presumptions do not fall cleanly in either of the categories we have thus far identified and can be deemed “mixed.”<sup>99</sup> The *Summers v. Tice* presumption concerning tortfeasor identification fits this description.<sup>100</sup> In *Summers*, two careless hunters each shot in the direction of the plaintiff, but only one actually hit the plaintiff. No evidence available to the plaintiff indicated that either of the hunters was more likely to have been the one who caused the injury. The court held that the two defendants were each subject to liability unless one could prove that he was not the hunter who actually injured the plaintiff.

By definition, *Summers’s* notion of “alternative liability” arises where there is substantial evidence as to each of two tort defendants, but the evidence against each is, in effect, weakened because there is equally strong evidence as to both. These situations generally foreclose the ready availability of tie-breaking evidence. This means that the application of the normal preponderance-of-the-evidence standard virtually guarantees what the law regards as an unjust outcome—an innocent victim of a completed tort will be left to bear the loss even though the victim has identified the only two possible tortfeasors, and we know that one of them actually committed the tort.

Alternative liability switches the burden so that the innocent victim can recover from both defendants while preserving the possibility that one defendant can avoid liability by demonstrating that he probably did not cause the injury. In this way, the presumption reduces the likelihood of an unwarranted dismissal under the substantive law while, as to each defendant, increasing the chances of imposing liability. In these respects, alternative liability is arguably compliance enhancing. It is also compliance enhancing because of the incentives it produces to those who are likely to have superior access to

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legal rules, but instead alter evidentiary rules in order to achieve better compliance with extant substantive legal rules.

99. Another tort doctrine, negligence per se, is perhaps sufficiently distinct to merit its own category. When it applies, a litigant aiming to establish that another party acted carelessly need not prove to a factfinder’s satisfaction that the other party failed to use ordinary care. It is sufficient to prove that the other party violated a particular statute or regulation. A standard rationale for this rule resides in the relationship of courts to legislatures (and to agencies created by legislatures): where another political institution is competent to articulate a legally binding standard of conduct in the context of defining appropriate levels of precaution and has done so in a manner that reaches the acts in question, courts should apply that standard of conduct rather than the factfinder’s in determining the content of the duty of care. *See, e.g.,* *Martin v. Herzog*, 126 N.E. 814, 815 (N.Y. 1920) (“[T]he omission of a safeguard prescribed by statute is put upon a different plane, and is held not merely some evidence of negligence, but negligence in itself.”).

100. *See Summers v. Tice*, 199 P.2d 1, 4 (Cal. 1948) (holding that, where two defendants were identically careless toward the plaintiff, but only one actually harmed the plaintiff, the burden to disprove causation of harm shifts to each defendant).

evidence (the defendants). However, *Summers* further appears to put in place a substantive rule that differs from the default substantive rule. Absent disproof of causation, a careless actor who did not commit the tort of negligence against the plaintiff will share liability for an injury inflicted by another actor who did commit the tort. This substantive rule is warranted, the *Summers* court believed, in light of the two defendants' identically faulty behavior and the precisely equal probability that each was the actual tortfeasor. In this situation, the faulty actors were deemed more deserving of bearing the loss than the victim.

*Summers* raises the possibility that some compliance-enhancing presumptions are, from another perspective, substance morphing. Part of what the substance of the law does, one might argue, is to designate who ought to win a decisively important factual issue when evidentiary inadequacy renders the issue irresolvable. This perspective is quite attractive to the extent that burden-shifting presumptions are more concerned with shifting the victor when the case is in equipoise than with generating higher-quality applications of the substantive law.

Perhaps the closest match in the common law of torts to the fraud-on-the-market doctrine is the so-called "heeding presumption" that is sometimes adopted for failure-to-warn products liability claims.<sup>101</sup> These claims assert that a product was unreasonably dangerous because it lacked adequate warnings of certain risks. Standard rules placing the burdens of production and persuasion on the plaintiff would thus require a failure-to-warn plaintiff to prove that she probably would not have been injured had a proper warning been provided. In other words, she would have to argue that the warning would have induced her not to use the product or to use it in a safer manner. Yet many courts have adopted a presumption that had an adequate warning been provided, the plaintiff would have read it and

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101. See, e.g., *Theer v. Philip Carey Co.*, 628 A.2d 724, 728–29 (N.J. 1993) (applying the heeding presumption to "ease an injured plaintiff's burden of proof" and to avoid speculation about whether the plaintiff would in fact have heeded a hypothetical warning). Arguably, in *Affiliated Ute*, the Supreme Court adopted a comparable presumption for 10b-5 claims alleging that the defendant's misrepresentation consisted of a failure to disclose information that the defendant was required to disclose. See *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153–54 (1972) (holding that "positive proof of reliance is not a prerequisite to recovery"). In such cases, a rebuttable presumption of reliance is created that, unlike *Basic's* presumption, can, in principle, genuinely be rebutted by evidence that the plaintiff would not have behaved differently had disclosure been made.

heeded it. This is the heeding presumption. It is accepted in a large number of jurisdictions, if not quite at the level of a majority rule.<sup>102</sup>

Strikingly, the heeding presumption is rebuttable. If the defendant is able to prove that the plaintiff probably would not have read the warning even if had it been there (or would not have heeded it even if she read it), then the defendant prevails. And the ability to rebut the heeding presumption is not merely notional. Defense lawyers frequently elicit in deposition testimony that the plaintiff did not read the label or the instructions that were on the product, disposed of accompanying documentation containing the relevant warnings without reading it, was not literate in the language(s) of the warnings, was in the habit of ignoring warnings, or did in fact read the warnings but did not heed them.<sup>103</sup> Moreover, in pharmaceutical cases in which the learned-intermediary rule applies, physicians sometimes testify that they already knew what was in the omitted warning and, hence, that the warning would not have changed their decision to prescribe the defendant's medication to the plaintiff.<sup>104</sup> It may well be that the heeding presumption ends up enhancing compliance with products liability law by generating more evidence on the issue of heeding than would otherwise have existed. Realistically, though, it also alters the rule on equipoise, in part so that the failure-to-warn branch of products liability law does not become utterly toothless.

### *B. Basic's Mixed Presumption of Reliance*

Armed with our tripartite taxonomy of presumptions, we can now consider the proper categorization of *Basic's* presumption of reliance.

At least superficially, *Basic* appears to articulate a compliance-enhancing doctrine. The problem was not so much that plaintiffs *could not*, in theory, prove reliance, but that the difficulty of doing so was substantial given the nature and fact intensiveness of the question. And the difficulty multiplied by hundreds or thousands of class members

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102. See DAVID G. OWEN, PRODUCTS LIABILITY LAW § 11.4, at 760–61 (2005) (noting that “almost half the states” have adopted the heeding presumption to help plaintiffs prove causation for certain types of claims).

103. See, e.g., *Sharpe v. Bestop, Inc.*, 713 A.2d 1079, 1089–92 (N.J. Super. Ct. App. Div. 1998), *aff'd*, 730 A.2d 285 (N.J. 1999) (discussing principles governing the admissibility of evidence put forward to rebut the heeding presumption and affirming the jury's finding against plaintiff on proximate cause).

104. See, e.g., *Ingram v. Novartis Pharms. Corp.*, 888 F. Supp. 2d 1241, 1245–48 (W.D. Okla. 2012) (granting summary judgment to a pharmaceutical company, notwithstanding the heeding presumption, in light of a treating physician's testimony that he would not have changed treatment if a different warning had been given).

would be enormous—so enormous that securities fraud class actions would be impracticable. By comparison, a class action that finessed the reliance issue by invoking fraud on the market would be manageable. If one believes that the legal framework that Congress put in place to deal with securities fraud was meant to grant persons a legal right not to be defrauded on the stock market (and therefore, implicitly, a legal right to recoup losses from having been defrauded), then one would probably think that a systematic inability to recover is a failure of the legal system to implement the governing law.

By the same token, one might reasonably suppose that in securities fraud class actions, the presumption of reliance tends to convert unwarranted defendant wins into rightful plaintiff wins more often than it does the opposite. In short, the need for a refurbished approach to proof of reliance stems from the need to have class actions, a procedural device that, in turn, is required to implement substantive law. The fraud-on-the-market doctrine, put differently, is needed because a requirement of proof of individual reliance would largely defeat the possibility of class certification, a result that would significantly hamper this form of securities fraud regulation. Of course, as with *res ipsa loquitur*, fraud on the market does not count as compliance enhancing unless the presumption will in practice produce results that track the underlying substantive law well enough to counterbalance the distorting effects of the presumption. Hence, the Court has insisted on the class action prerequisites of publicity, efficiency, and materiality, which limit the classes of cases in which fraud on the market can be invoked.

There is thus some basis for supposing that fraud on the market is a compliance-enhancing presumption. Nonetheless, we suggest that the far better view is that it should be understood as substance morphing or mixed, and in any event not purely (or even principally) compliance enhancing. The simplest way to demonstrate that the fraud-on-the-market doctrine is not purely compliance enhancing (relative to a rule requiring individual reliance) is to point out that there is no need for the fact finder to find that the plaintiff herself actually read or heard about the defendant's alleged misrepresentations or knew that they were made. The typical rebuttals of fraud on the market—truth on the market, for example—go to the issue of whether the misrepresentation actually altered the price of the shares. But even if the misrepresentations did affect the price, it does not follow that a plaintiff relied on *the content of the defendant's misrepresentation* in any way. What would follow instead is that the plaintiff suffered a financial impact caused by the misrepresentation—a different matter altogether. Defendants who rebut the reliance presumption with individualized

proof do so by showing that the plaintiff did not view the market price as a true reflection of the value of the shares. If the plaintiff did not come into direct contact with the misrepresentations or with verbal reiterations of them, then the plaintiff did not rely upon them, but this fact, even if accepted by the fact finder, does not undermine a fraud-on-the-market claim. *Relying upon the truth of what the defendants represented and trusting in the nondistortedness of the market price* are entirely different. And yet, the plaintiff may recover on the basis of the latter. Here, there is a clear distinction between the *Basic* presumption of reliance and the heeding presumption in failure-to-warn cases. The fraud-on-the-market theory does not preserve *reliance on the substance of the defendant's misrepresentations* as a genuine element of the legal wrong of securities fraud.

The suggestion that *Basic's* presumption is substance morphing raises two questions: (1) In what sense does the fraud-on-the-market doctrine generate different substantive rules? (2) If it does generate different substantive rules, why is the presumption rebuttable, rather than irrebuttable? The short answer is that fraud on the market accomplishes two things. It both changes the substantive rules and affords presumptions in order to ensure better compliance with the now-changed substantive rules. We can explain these features of fraud-on-the-market doctrine as follows.

*Substantive rules.* Fraud on the market significantly alters the substance of the elements of a private right of action relative to what they would have been without the doctrine and what they are in the common law of deceit. Without *Basic*, securities law would contain the following rule, which we will call “Rule 1”:

Rule 1. A private 10b-5 claim for securities fraud exists only when:

the plaintiff bought or sold a security relying upon the truth of the propositions that the defendant knowingly and falsely asserted.

Instead, *Basic* adopts a different Rule—“Rule 2”:

Rule 2. A private 10b-5 claim for securities fraud exists not only when Rule 1 is satisfied, but also when:

- (a) the defendant's misrepresentation (or illegal conduct under 10b-5) has distorted the market price of the security, and
- (b) a private plaintiff bought or sold the security at the distorted market price while justifiably relying on the market price's being undistorted.

*Evidentiary rules.* Given the usual allocation of evidentiary burdens in civil litigation, Rule 1 would normally lead to the following corollary rule of evidence, which we will label “E1”:

E1. A plaintiff asserting a private 10b-5 claim must prove by a preponderance of the evidence that in buying or selling a security, she justifiably relied upon the truth of the defendant’s misrepresentations.

Similarly, Rule 2 would normally generate the following evidentiary corollary:

E2. A plaintiff asserting a 10b-5 claim who does not seek to impose liability under Rule 1 must prove by a preponderance of the evidence that:

- (a) the defendant’s misrepresentation distorted the market price of the security, and
- (b) the plaintiff bought or sold the security while justifiably relying on the market price being nondistorted.

In fact, *Basic* does not adopt corollary E2. Rather, it adopts a different corollary:

E3. A plaintiff asserting a 10b-5 claim who does not seek to impose liability under Rule 1 must prove by a preponderance of the evidence that:

- (a) the defendant’s misrepresentation was publicly made, the market was efficient, and the statement was material, and
- (b) the plaintiff bought or sold the security.

In justifying the choice of corollary E3(a), rather than corollary E2(a), the *Basic* Court reasoned that publicity, efficiency, and materiality generate a rebuttable presumption that the misrepresentation distorted the price of the security. In justifying the choice of corollary E3(b) rather than corollary E2(b), the Court also stated that investors presumptively rely on the integrity of the market and therefore presumptively rely on open-market transactions not being distorted. The Court then allowed defendants to rebut this presumption of reliance on nondistortedness.

As noted above, the fact that the reliance presumption is rebuttable might seem to demonstrate that *Basic*’s presumption must be of the compliance-enhancing variety. And indeed, there is an aspect of the presumption that is compliance enhancing. What is compliance enhancing, however, is the choice to implement Rule 2 by corollary E3 rather than by corollary E2. And what is truly remarkable about *Basic* is that instead of choosing corollary E1 to implement Rule 1, the Court replaced Rule 1 with Rule 2 and then chose corollary E3 as a means of implementing Rule 2. *Basic* is confusing because the Court sometimes seems to suggest that corollary E3 can be understood as a means of implementing Rule 1, which it is not. Corollary E3 *is* compliance enhancing, but it is only compliance enhancing given the replacement

of substantive Rule 1 with substantive Rule 2. This is why *Basic* is both substance morphing and compliance enhancing.

The wrong identified by *Basic* remains similar to common-law deceit in several respects. It is like deceit because it deems a knowing misrepresentation (or manipulative conduct) to be a predicate wrongful act and requires the plaintiff's injury to have been brought about by this wrongful act. Moreover, an active choice by the plaintiff is an essential component of the chain of events culminating in the plaintiff being damaged. And indeed, if the plaintiff made that choice without trust in the integrity of the transaction, then the plaintiff cannot recover.

Still, the causal pathway in a deceit case is fundamentally different from that in a fraud-on-the-market case. In deceit, the plaintiff relies on the misrepresentation or its reiteration. The wrong is complete when the plaintiff enters a transaction in reliance on a misrepresentation that the defendant made to induce such reliance. In a fraud-on-the-market case, by contrast, the wrong is completed only when the potential loss of value due to the misrepresentation (an exchange made at a distorted price) is realized in an actual loss of wealth suffered by the plaintiff.

The foregoing analysis allows us to identify and elucidate otherwise troubling aspects of Justice Blackmun's *Basic* opinion. A major slide in his analysis is contained in the statement that "[b]ecause most publicly available information is *reflected* in market price, an investor's reliance on any public material misrepresentations, therefore, may be presumed for purposes of a Rule 10b-5 action."<sup>105</sup> The term "reflected" in this passage is ambiguous. The passage is defensible insofar as he is claiming that prices are *influenced* by publicly available information and in fact distorted by misinformation. However, it is also possible to understand the statement to be asserting that prices express the meaning, or at least the significance, of the misrepresentations—that prices are a virtual *translation* of the defendant's misrepresentations. On the latter view, it is as if the misrepresentations were about the company's magnitude of debt and the prices were bond ratings. Price would be a "reflection" of the misrepresentation in the particular sense of being a winnowed-down and transformed reiteration of it.

Unfortunately, the "translation" version of Justice Blackmun's claim that prices will (under the right conditions) "reflect" a defendant's misrepresentations is wholly untenable. As commentators have long noted, investors do not necessarily rely on market prices to be accurate valuations; indeed, they often make stock purchases precisely because

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105. *Basic Inc. v. Levinson*, 485 U.S. 224, 247 (1988) (emphasis added).



they believe a stock is incorrectly valued.<sup>106</sup> A price is not an assertion or a representation. To be sure, if *Basic* only stands for the softer proposition that misrepresentations *influence* prices, its reasoning is quite a bit more plausible, especially in efficient markets. However, on this understanding of what it means for prices to “reflect” the defendant’s misrepresentation, the plaintiff can never be said to have relied on that representation. If one takes this view, then one must see the fraud-on-the-market presumption as something other than an application of common-law deceit. In other words, permitting fraud-on-the-market plaintiffs to recover is not simply a way of allowing more deceit plaintiffs to win by diminishing their burden of proof, as a purely compliance-enhancing presumption would do.

None of this is to say that Justice Blackmun was unjustified in embracing the fraud-on-the-market theory or that he was wrong to craft the law in a manner that involved a presumption. There is no fundamental reason why the Court should have assumed that it was limited to versions of common-law fraud. After all, the legal authorities in question were section 10(b) and rule 10b-5. Hence, the key question was whether the injured parties in fraud-on-the-market claims could be understood to be among those whom Congress intended to protect from certain harms caused by misrepresentations. “Yes” is a reasonable answer to this question. When actors in the securities market engage in misrepresentations and other misleading conduct, those who have bought and sold securities at distorted prices are among their most direct victims. And certainly such investors are exactly the people the Securities Act was aimed to protect.

One advantage of our analysis of the nature of *Basic*’s presumption is that it can help make sense of a tension between two aspects of *Basic* that have been a source of puzzlement. The first is its statement that “[a]n investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price.”<sup>107</sup> The second is its statement that an investor who demonstrably did not rely upon the integrity of the price should not be able to recover, even if the price was in fact distorted.<sup>108</sup> Even before the Court issued *Basic*, the relation between these two claims caused confusion. Indeed, as the Court’s internal correspondence indicates, Justice Brennan thought that Justice Blackmun was making a mistake by allowing a fraud-on-

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106. Barbara Black, *Fraud on the Market: A Criticism of Dispensing with Reliance Requirements in Certain Open Market Transactions*, 62 N.C. L. REV. 435, 455 (1984) (cited in *Basic*, 485 U.S. at 247 n.26).

107. *Basic*, 428 U.S. at 247.

108. *Id.* at 249.

the market defendant to avoid liability by proving that the plaintiff was not relying on the integrity of the market in deciding to purchase or sell a security.<sup>109</sup> Brennan thought that Blackmun's allowance of rebuttal on this ground amounted to backsliding on what Brennan understood to be *Basic's* commitment to impose liability for fraud on the market on a fundamentally different basis from liability for deceit.

Brennan's concern was understandable, in part because Justice Blackmun was not always clear as to why he was keen to give defendants the opportunity to prove lack of plaintiff reliance on market integrity. But in the end, the two propositions need not be in tension. The key is to understand that the second proposition is really concerned with a very special case of nonreliance—namely, a case in which the plaintiff undertakes the relevant transaction with his eyes wide open to the presence of a distorted price or the risk of such distortion. Justice Blackmun, in other words, was concerned with a future case in which the defendant could plausibly assert something akin to consent, assumption of risk, or *volenti non fit injuria*<sup>110</sup>—a familiar set of defenses found throughout tort law. Roughly speaking, the idea common to each is that if one is aware of the harmfulness or riskiness of another's wrongful conduct but freely chooses to confront it anyway, one may not afterwards complain about resulting injuries.

Notably, the common law of fraud does not recognize any of these affirmative defenses by name. But it does not do so for a very particular reason: a version of these defenses is already built into the prima facie case through the requirement that the plaintiff's reliance on the defendant's misrepresentation be justified or reasonable. However, with the switch in *Basic* to a price-distortion, economic-loss tort, there was no longer a place within the prima facie case to account for how the plaintiff's knowing choices contributed to her injury. And yet, there remained for Justice Blackmun the powerful intuition, given expression in various tort doctrines, that at least some victims who knowingly choose to encounter certain risks of harm and then experience those harms should not be empowered to recover damages, even from a wrongdoer who caused those harms.

The correspondence between the Justices reveals that it took Justice Blackmun some time to connect the *volenti* issue to the issue of rebutting *Basic's* presumption of reliance.<sup>111</sup> His first instinct seems to

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109. Letter from Justice Harry A. Blackmun to Justice William J. Brennan, Jr. (Jan. 15, 1988) (on file with Library of Congress, Thurgood Marshall Collection, No. 86-279).

110. The Latin maxim can be paraphrased to state: "No wrong is done (*non fit injuria*) to a person who is willing (*volenti*)."

111. Correspondence between Justice Harry A. Blackmun and Justice William J. Brennan, Jr. (Jan. 1988) (on file with Library of Congress, Thurgood Marshall Collection, No. 86-279).

have been that an investor who really does not care about whether a defendant's representations were true or false should not be able to recover for securities fraud, however defined. In correspondence with Justice Brennan, he gave expression to this instinct through the "principled investor" problem: the example of an investor who sells his shares in a company upon learning that the company has investments in apartheid South Africa, irrespective of the profits or losses he stood to make from the sale. In Blackmun's view, this investor should not recover, even assuming that the company's misrepresentation had distorted the sales price. To permit recovery, he maintained, would grant the investor a "windfall."<sup>112</sup> Justice Brennan resisted this example because, as he pointed out, such an investor could still have suffered economic loss based on the price distortion caused by the defendant's misrepresentation.<sup>113</sup>

The Justices did not resolve the issue in their correspondence.<sup>114</sup> However, by the time Justice Blackmun produced his final opinion in *Basic*,<sup>115</sup> he had solved the principled investor problem to his satisfaction:

Petitioners also could rebut the presumption of reliance as to plaintiffs who would have divested themselves of their Basic shares without relying on the integrity of the market. For example, a plaintiff who believed that Basic's statements were false and that Basic was indeed engaged in merger discussions, and who consequently believed that Basic stock was artificially underpriced, but sold his shares nevertheless because other unrelated concerns, e.g., potential antitrust problems, or political pressures to divest from shares of certain businesses, could not be said to have relied on the integrity of a price *he knew had been manipulated*.<sup>116</sup>

In this example, it is no longer simply that the plaintiff did not care that he was trading at a nonmanipulated price. Rather, the opinion posits a case in which the plaintiff has knowingly and voluntarily sold shares at less than they are worth. Surely this sort of plaintiff, the opinion reasons, is not entitled to invoke the judicial system to recover for his losses. This is the sort of "windfall"<sup>117</sup> that concerned Blackmun—the recovery of damages by a plaintiff who chooses to buy or sell

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112. Letter from Justice Blackmun to Justice Brennan, *supra* note 109.

113. Letter from Justice William J. Brennan, Jr., to Justice Harry A. Blackmun (Jan. 22, 1988) (on file with Library of Congress, Thurgood Marshall Collection, No. 86-279).

114. Letter from Justice William J. Brennan, Jr., to Justice Harry A. Blackmun (Jan. 27, 1988) (on file with the Library of Congress, Thurgood Marshall Collection, No. 86-279).

115. It appears that this was a version of the analysis he contemplated in his second letter to Justice Brennan. Letter from Justice Harry A. Blackmun to Justice William J. Brennan, Jr. (Jan. 25, 1988) (on file with the Library of Congress, Thurgood Marshall Collection, No. 86-279).

116. *Basic Inc. v. Levinson*, 485 U.S. 224, 249 (1988) (emphasis added).

117. Letter from Justice Blackmun to Justice Brennan, *supra* note 109.

notwithstanding the fact that he actually disbelieves the defendant's misrepresentations.

To rephrase the point in the language of presumptions, the principled investor problem arises mainly because the common law of deceit normally provides defendants with a presumption of *volenti*. It is the job of deceit plaintiffs to rebut this presumption by proving that their reliance on a defendant's misrepresentation was justified. In moving from the wrong of deceit to the wrong of fraud on the market, the Court in *Basic* effectively removed this presumption, leaving defendants with no legal space in which to make a *volenti* argument. Justice Blackmun's insistence that the presumption of reliance is rebuttable was an effort to create that space. Rather than building it into the prima facie case, he followed the more typical pattern in tort law by fashioning it as an affirmative defense.<sup>118</sup>

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Because our analysis of *Basic* has several moving parts, a brief summary is in order. *Basic's* treatment of fraud-on-the-market claims departed in two respects from the common law of deceit, and each departure contained complexities of its own. The first departure concerned the nature of the *injury* underlying the tort. The second concerned the role of the *plaintiff's conduct* in determining liability.

The introduction of a new notion of injury was the more important innovation. It had both a substantive and an evidentiary aspect. *Basic* claimed merely to be creating an evidentiary rule—a presumption of reliance. Yet this presumption applies even if the plaintiff was entirely unaware of the content of the defendant's misrepresentations and hence could not have relied on that content. The fact that *Basic's* presumption cannot be rebutted by a showing of nonreliance demonstrates that, despite its claim to the contrary, the

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118. A recent case from the Southern District of New York shows how a fraud-on-the-market defendant might succeed in rebutting the presumption of reliance in an individual investor case where distortion has been proven (and other differently situated investors who benefited from the presumption prevailed). *GAMCO Investors, Inc. v. Vivendi, S.A.*, No. 09 Civ. 7962(SAS), 2013 WL 765122, at \*11 (S.D.N.Y. Feb. 28, 2013). In *GAMCO*, Judge Scheindlin held a bench trial to resolve defendant Vivendi's assertion that subsidiaries of Gabelli Asset Management, Inc.—which relied upon their own idiosyncratic market analyses in making investment decisions—had not relied on the defendant's misrepresentations about corporate liquidity. *Id.* at \*1. Judge Scheindlin determined that the defendant had carried its burden of proving that “[p]laintiffs were value-based investors who utilized a proprietary metric . . . to evaluate the intrinsic value of Vivendi securities [and that] . . . the liquidity crisis at Vivendi was irrelevant to [p]laintiffs’ investment decisions, except to the extent that each corrective disclosure made Vivendi a *more attractive* investment.” *Id.* at \*5 (emphasis added). *Gamco* nicely illustrates the sense in which a rebuttal of the reliance presumption in a fraud-on-the-market case resembles a traditional *volenti* defense in tort.

Court did not merely shift the burden to the defendant on the issue of reliance. Instead, it replaced the conception of injury at the core of deceit—the *injury of being tricked by a defendant's representation*—with something different. The relevant injury is now *the injury of being economically harmed by price distortions flowing from a defendant's misrepresentations*.

While *Basic* thus departed from deceit law in its definition of what counts as an injury, its holding with respect to injury was not only substantive. For with that substantive change, it also introduced a new evidentiary rule. Specifically, it held that a plaintiff need not directly prove that the defendant's misrepresentations distorted the price of the securities that the plaintiff bought or sold. Rather, the price-distorting effect of the misrepresentations will be presumed when the plaintiff proves that the misrepresentations were material and were made in an efficient market. *This* presumption is rebuttable—for example, by proof that the market already had absorbed the relevant misinformation. But it is not a rebuttable presumption of *reliance*. It is instead a rebuttable presumption of *distortion*. Distortion is substituted for reliance precisely because being economically harmed is the injury at the center of the fraud-on-the-market tort, rather than the injury of being duped. The evidentiary presumption of reliance goes hand in hand with *Basic's* substantive redefinition of injury.

*Basic's* second alteration, concerning the significance of a plaintiff's conduct, is less consequential but more nuanced. Deceit, like negligence, battery, trespass, and virtually every tort, deems certain contributions by a plaintiff to her own injury as undermining or limiting her claim. These plaintiff-conduct limits on liability—which include comparative fault, assumption of risk, waiver, and consent—are usually framed as affirmative defenses.

In common-law deceit, plaintiffs who are tricked by a defendant's knowing misrepresentation cannot recover if they unjustifiably relied on the misrepresentation. This plaintiff-conduct limit on liability is part of the *prima facie* case: it is the plaintiff who must prove that her reliance was justifiable. In replacing reliance with distortion, the *Basic* Court eliminated the doctrinal vehicle through which the law of deceit allows a court to consider a plaintiff's contribution to her own injury. Not wanting to abandon the notion that a plaintiff's voluntary decision to confront a defendant's potentially injurious conduct should count against the plaintiff, Justice Blackmun enabled fraud-on-the-market defendants to avoid liability by proving that the plaintiff was not relying in any way on the integrity of (i.e., the undistorted nature of) the market price. In doing so, he departed from the common law's casting of the principle of *volenti non fit injuria* as

part of a deceit plaintiff's prima facie case, instead placing it in its more traditional role as an affirmative defense. Conveniently but confusingly, Justice Blackmun folded this aspect of fraud-on-the-market law into the idea of the rebuttable presumption of reliance, thereby further muddying the meaning of that presumption. This distinct aspect of the presumption holds as follows: although purchasers of publicly traded securities are presumed to rely on the integrity of the market, that presumption can be rebutted when the plaintiff proceeds with the transaction knowing of, yet indifferent to, the possibility of price distortion.

In sum, under the unitary banner of the "presumption of reliance," *Basic* first changed the definition of injury for fraud-on-the-market claims. In introducing that change, it also conferred on plaintiffs the benefit of an evidentiary presumption of price distortion if certain conditions are met. At the same time, it altered the way in which securities fraud law—in a manner broadly consistent with general tort principles—blocks recovery by a plaintiff who is injured only after choosing to proceed in the face of the defendant's wrongful conduct.

#### V. THE VIABILITY OF THE FRAUD-ON-THE-MARKET TORT

A careful examination of the common law of deceit, and of *Dura* and *Basic*, reveals that the Supreme Court has not stayed true to the common law in the course of articulating the dimensions of liability for the fraud-on-the-market version of securities fraud, despite its protestations to the contrary. Rather, it has fashioned a new statutory tort.

As we noted in Part I, some commentators suggest that fraud-on-the-market claims have not merely left behind the law of deceit but have left the realm of tort law altogether. The thought is that *Basic*'s nominally rebuttable but practically irrebuttable presumption of reliance allows for liability without anything like the sort of setback that tort law would ordinarily consider a cognizable injury. Investors stand to recover merely for having participated in a stock market that contained distorted prices. On this view, *Dura*'s insistence on economic loss is incoherent because it demands proof of tort-like damages for claims that, at the end of the day, really are not tort claims. Instead, they are best understood as actions by private attorneys general that aim to protect and vindicate the integrity of markets rather than to compensate victims for their losses.

It is correct to assert that fraud-on-the-market claims are not claims for deceit. But it is erroneous to assert that the former no longer

count as tort claims—in other words, relational, injurious, legal wrongs that, when committed, confer on their victims a right to seek redress for the wrongs done to them.<sup>119</sup> The legal norm implicit in the common-law tort of deceit directs actors to refrain from tricking others into taking detrimental actions, and it simultaneously confers a legal power upon whomever is so tricked and suffers damage as a result to obtain redress from the fraudster. The right to sue on a fraud-on-the-market theory, by contrast, does not derive from a common-law legal norm enjoining persons from tricking each other. It derives from a statute (and regulations) forbidding actors from making misrepresentations and misleading statements about securities—a statute put in place to make markets safer for investors. Accordingly, the legal power provided through decisions such as *Basic* and *Dura* does not require the plaintiff to have been tricked by the misrepresentation; it affords an avenue of redress to investors who suffer an economic hit in the securities markets because of a market distortion caused by a knowing misrepresentation. Reliance by the victim on the substance of the actor's misrepresentation is *not* required, but proof of economic loss and loss causation *is*. In these ways, life is both easier and harder for the fraud-on-the-market plaintiff than a deceit plaintiff.

In sum, the fraud-on-the-market tort defines injury and connects misrepresentation to injury in a manner distinct from the tort of deceit. But as we noted in our earlier article on fraud and reliance, the recognition of distinct wrongs involving misrepresentation is hardly unknown to common law.<sup>120</sup> Intentional misrepresentations sometimes give rise to torts other than deceit. For example, when an actor's intentional misrepresentation to person *X* foreseeably causes physical injury to person *Y*, *Y* may have a negligence claim against that actor.<sup>121</sup> The actor's defrauding of *X* in this instance happens also to amount to the careless injuring of *Y*. Intentional misrepresentations not relied upon by the plaintiff also can sometimes give rise to claims for tortious interference with contract or prospective advantage.<sup>122</sup> Here, the gist of the plaintiff's complaint is not that the defendant duped her, but rather that the defendant's duping of another amounted to an intentional

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119. See JOHN C.P. GOLDBERG & BENJAMIN C. ZIPURSKY, *THE OXFORD INTRODUCTIONS TO U.S. LAW: TORTS* 4 (2010).

120. Goldberg, Sebok & Zipursky, *supra* note 12, at 1021–25.

121. See, e.g., *Randi W. v. Muroc Joint Unified Sch. Dist.*, 929 P.2d 582, 591 (Cal. 1997) (holding that the writer of a letter of recommendation owes third persons a duty not to make misrepresentations that cause a substantial, foreseeable risk of physical harm to such persons).

122. See, e.g., *Duggin v. Adams*, 360 S.E.2d 832, 837 (Va. 1987) (finding that allegations that defendant maliciously and fraudulently mislead seller to breach contract of sale with plaintiff were sufficient to plead a claim of tortious interference through improper means).

interference, through wrongful means, with the plaintiff's contract or business prospects.

The Supreme Court's fraud-on-the-market cause of action, on the other hand, imposes liability on terms that go beyond these common-law wrongs. The negligence example described immediately above would provide recourse for a traditional personal injury but not for economic loss. To be sure, negligence that causes only economic loss can sometimes give rise to liability. However, courts usually require a special relationship between the defendant and plaintiff before they will impose liability for such loss. And the limited class of cases in which courts recognize negligence claims for economic loss in the absence of a special relationship tends to involve allegations that the defendant's carelessness caused a nuisance-like interference with the plaintiff's right to use, or pursue the acquisition of, certain tangible property, as opposed to causing a mere reduction in wealth.<sup>123</sup>

More to the point, courts' recognition of fraud-on-the-market claims seems roughly consistent with their recognition of claims in which the plaintiff alleges that the defendant's defrauding of a third party amounted to interference by wrongful means with a business opportunity enjoyed by the plaintiff. Tortious interference actions of this sort and fraud-on-the-market actions arguably vindicate the same interest: pursuing business transactions free from the market-distorting effects of intentional misrepresentations.<sup>124</sup> For the most part, these common-law claims are more tightly circumscribed than fraud on the market. A tortious-interference plaintiff typically complains that she was wrongfully prevented from taking advantage of a particular transaction or opportunity, not that she merely lost wealth. In addition, the wrongful conduct in question usually involves the defendant specifically targeting the plaintiff, rather than making a misrepresentation meant to influence markets generally. In both respects, fraud on the market invokes a looser, more open-ended notion of what can count as the wrongful injuring of another.

Yet even if fraud on the market sits at the expansive edge of tort law, it nonetheless occupies a legitimate place. As noted above, claims for securities fraud have statutory backing, unlike common-law torts. Obviously, the question of whether federal courts should be in the business of recognizing implied rights of action is a controversial one,

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123. See John C.P. Goldberg & Robert H. Sitkoff, *Torts and Estates: Remedying Wrongful Interference with Inheritance*, 65 STAN. L. REV. 335, 386–88 (2013) (discussing tort cases protecting “prospective advantage”); see also *People Express Airlines, Inc. v. Consol. Rail Corp.*, 495 A.2d 107, 118 (N.J. 1985) (allowing recovery for negligence causing “purely economic loss” that took the form of temporarily rendering the plaintiff unable to use its commercial office space).

124. See Goldberg & Sitkoff, *supra* note 123, at 386–88.



and it seems entirely possible that the Supreme Court today would not choose to go down the road that the Court in the 1960s took when it recognized private rights of action for violations of federal securities laws.<sup>125</sup> Moreover, even if federal courts should be in this business, there are difficult questions as to whether all the species of securities fraud that would warrant an SEC enforcement action should also give rise to a private right of action.<sup>126</sup> Still, unless the Court decides to undo fifty years of 10b-5 jurisprudence—notwithstanding Congress's active participation<sup>127</sup>—the question at hand is not whether there should be private rights of action for securities fraud, but rather how we should define them. In enacting the federal securities laws, Congress clearly sought to vindicate the interests of individual investors and to compensate for limitations in SEC enforcement.<sup>128</sup> Against this backdrop, it is reasonable for the Court to have identified as a tort the intentional causing of economic loss through material misrepresentations in connection with the sale or purchase of securities. In practice, moreover, both Congress and the courts have developed fraud-on-the-market law with an eye toward circumscribing the potential breadth of this tort. This, of course, was the whole point of *Dura*. And, while the Justices have obviously disagreed among themselves as to the proper procedures through which fraud-on-the-market claims are to be litigated, they have, to say the least, been attentive to concerns that the new tort, when coupled with the class action device, will make life too easy for plaintiffs and too difficult for defendants.

This last thought leads us, finally, to consider whether our particular characterization of the fraud-on-the-market tort has pro-plaintiff or pro-defendant implications. Our sense is that it has some of each. We mentioned at the outset that some commentators have criticized the Court's articulation of the elements of fraud-on-the-market claims as unmotivated or incoherent. Our own view is that while a decision such as *Dura* cannot be defended simply as applying settled deceit doctrine, its notions of economic loss and loss causation are at least plausible features of a tort that compensates victims for

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125. Compare *Touche Ross & Co. v. Redington*, 442 U.S. 560, 575–79 (1979) (declining to recognize a private right of action for violations of section 17(a) of the Securities Exchange Act of 1934 and questioning more generally the propriety of recognizing implied rights of action in federal statutes), with *J.I. Case Co. v. Borak*, 377 U.S. 426, 432–33 (1964) (recognizing an implied right of action for violations of section 14(a) of the Securities Exchange Act of 1934).

126. *SEC v. Tex. Gulf Sulphur Co.*, 401 F.2d 833, 866–68 (2d Cir. 1968) (Friendly, J., concurring).

127. Of course, Congress passed the Private Securities Litigation Reform Act in 1995 and has since amended it. See 15 U.S.C. § 78u-4 (2012).

128. *Borak*, 377 U.S. at 432.

suffering economic loss as a result of intentional misrepresentations that distort the market. It may be that *Dura* in the end adopted an overly narrow view of what counts as economic loss, or an overly broad view of when a loss is the result of independent forces apart from the defendant's misrepresentation. But the Court was nonetheless reasonable to require something more than purchase at an inflated price and but-for causation to establish liability for the wrong of fraud on the market.

If in this respect our approach is defendant friendly, it may be less so in others. We noted at the outset that some of the Justices seem inclined to abandon any version of fraud on the market.<sup>129</sup> For the reasons canvassed above, their skepticism is in one sense understandable: *Basic's* attempt to justify fraud on the market as a mere compliance-enhancing presumption fails. But this warranted skepticism is, in the end, skepticism about a particular understanding of and justification for fraud on the market rather than about the idea in general. Insofar as fraud on the market is the name for a distinct tort that redresses intentional misrepresentations that proximately cause a certain kind of economic loss, irrespective of whether the victim relied on the substance of the misrepresentation, it is a viable—and probably manageable—tort.

## VI. CONCLUSION

Common-law deceit involves the manipulation of one person by another. At its core, it forbids and renders actionable the intentional use of a false representation to induce another to enter into a transaction. If one intentionally makes a misrepresentation knowing that a person such as the plaintiff will rely on it, and if the misrepresentation justifiably induces the plaintiff to act, the tort has been committed. As such, deceit is entirely applicable to a broad range of impersonal transactions.

And yet not every transaction influenced by a misrepresentation amounts to deceit. In particular, there is no deceit when a misrepresentation negatively affects a losing transaction but the plaintiff never actually relied on its substance. This kind of plaintiff cannot complain of having been manipulated in the requisite sense.

In articulating the contours of securities fraud liability, the Supreme Court sought in *Basic* to relax the reliance requirement, thereby allowing certain 10b-5 actions to move forward as class actions.

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129. *Amgen Inc. v. Conn. Ret. Plans & Trust Funds*, 133 S. Ct. 1184, 1204 (2013) (Alito, J., concurring).

It purported to do so by giving investors who trade in efficient markets on the basis of material misrepresentations the benefit of a presumption that relieves them of the burden of proving reliance. But as we have explained, this presumption does not merely alter evidentiary burdens; it alters substantive law. *Basic* in fact marked the recognition of a new legal wrong—the fraud-on-the-market tort. In contrast to deceit, this tort imposes liability on an actor who intentionally makes a material misrepresentation that distorts market prices and thereby inflicts economic loss on an investor. The gist of the wrong is not the defrauding, manipulation, or tricking of another person, per se. Rather, it consists of causing another to suffer economic loss by circulating false information that distorts market prices.

*Basic* itself was careful to insist that this new tort has limits of its own. In particular, defendants can avoid liability by establishing that a given plaintiff's investment decision was made for reasons having nothing to do with any price distortion generated by the defendant's misrepresentations. Many Justices, including Justice White in *Basic* itself, have taken the view that this stated limit is insufficient—that it allows savvy investors falsely to claim to have been victimized when they were merely taking a calculated risk that turned out badly.<sup>130</sup> In light of this concern—one magnified by the allegedly amplifying effects of class action litigation—the Court has for some time now aimed to tighten up fraud on the market. This tightening has been both procedural and substantive, focusing on pleading and proof requirements with respect to issues such as materiality, economic loss, and loss causation.

As did *Basic* itself, subsequent decisions have understated the degree to which these tightening efforts have been exercises in lawmaking as opposed to straightforward applications of settled tort doctrine. But to say that the Court has been engaged in lawmaking is not to say that it has thereby acted illegitimately or in an unprincipled fashion. In recognizing the fraud-on-the-market tort, and in continuing to refine it, the Court has, in the context of interpreting a statutory and regulatory scheme, mimicked the common-law tradition that allows judges a certain amount of leeway to articulate new legal wrongs that provide victims with a right of action against wrongdoers. Perhaps if the Justices had been more forthcoming or self-aware about the degree to which they have been engaged in this task, they would have defined fraud on the market somewhat differently, with less concern about whether its limits track the limits of common-law deceit and greater

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130. *Basic Inc. v. Levinson*, 485 U.S. 224, 262 (1988) (White, J., concurring in part and dissenting in part).

clarity about its contours. Regardless, a clearer recognition of the nature of the Court's undertaking should assuage any doubts as to its legitimacy. Fraud on the market is neither a jury-rigged device for enabling disappointed investors to prevail without proof of reliance nor a securities-enforcement engine providing plaintiffs' lawyers with a means of circumventing traditional class-certification requirements. It is a tort in its own right.