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"DON'T BLAME ME, BLAME THE FINANCIAL CRISIS": A SURVEY OF DISMISSAL RULINGS IN 10b-5 SUITS FOR SUBPRIME SECURITIES LOSSES

*Christopher J. Miller**

This Note surveys thirty-four district court decisions on motions to dismiss in actions brought under SEC Rule 10b-5 for losses suffered during the recent financial crisis. This Note focuses on issues of scienter and loss causation, the elements of a 10b-5 claim most likely to be affected by a market-wide downturn. In the opinions surveyed, successfully pleading scienter proved the biggest hurdle for plaintiffs in surviving a motion to dismiss, and this Note proceeds to analyze the factors that influenced whether a district court found scienter to be adequately pleaded. This Note also examines efforts by both plaintiffs and defendants to use the financial crisis of 2007–08 to support their arguments for or against dismissal, again with particular focus on scienter and loss causation.

TABLE OF CONTENTS

* J.D. Candidate, 2012, Fordham University School of Law; B.A., 2006, Vassar College. I would like to thank my advisor, Professor Sean Griffith, for his advice, insight, and flexibility. I would also like to thank my family for their support and patience during my long absences while working on this Note. The quotation in the title of this Note is taken from Judge Shira Scheindlin's opinion granting class certification in *In re* Sadia, S.A. Sec. Litig., 269 F.R.D. 298, 317 (S.D.N.Y. 2010). The court noted that it was the "third time in as many months" that defendants attempted to argue that the recent financial crisis meant that plaintiffs could not prove a loss. *Id.*

INTRODUCTION

On September 15, 2008, Lehman Brothers announced that it would file for bankruptcy.[1] The 150-year-old firm was not the first victim of the growing crisis—the rushed sale of Merrill Lynch to Bank of America had been completed just a few days prior, and earlier that year Bear Stearns had been forced into the arms of JPMorgan Chase & Co.[2] In response, the United States stock market suffered its worst daily drop since the

1. *See* Susanne Craig et al., *AIG, Lehman Shock Hits World Markets*, WALL ST. J., Sept. 16, 2008, at A1.

2. *See* Aaron Lucchetti & Robin Sidel, *Dow Industrials Take a 504.48-Point Dive*, WALL ST. J., Sept. 16, 2008, at C1.

September 11th terrorist attacks.[3] In October 2010, the IMF estimated total bank losses from the financial crisis at $2.2 trillion.[4]

The tidal wave of litigation that has followed in the wake of the financial crisis has ranged from bribery cases[5] to public nuisance complaints.[6] This Note focuses only on one aspect of this maelstrom: suits brought under section 10(b) and Rule 10b-5 of the federal securities laws. Part I gives background information on the financial crisis and the federal securities laws, with a particular focus on the elements of scienter and loss causation. Part II first gives an overview of securities litigation in the wake of the crisis. Part II then reviews the dispositions of motions to dismiss in thirty-four suits for subprime securities losses, concluding that adequately alleging scienter has been the biggest hurdle for plaintiffs hoping to survive a motion to dismiss, and then proceeds to analyze issues that have proved important in adequately alleging scienter. Part III examines the efforts of plaintiffs and defendants to use the crisis itself to prevail on motions to dismiss in the thirty-four decisions surveyed. Finally, Part IV provides concluding observations on securities litigation in the wake of financial catastrophe.

I. BACKGROUND ON THE FINANCIAL CRISIS AND SECURITIES LAWS

This part first gives some brief background information on the financial crisis. Next, the historical development of the federal securities laws is examined. Finally, this part discusses the evolution of the current standards for loss causation and scienter in private actions under Rule 10b-5.

A. Financial Crisis: Attack of the Opaque Acronyms

1. Mortgage Loan Origination

Home ownership usually depends on the availability of credit. Individuals with strong credit histories qualify for traditional mortgages, while individuals with weaker histories qualify for subprime loans.[7] The importance of subprime mortgages to the overall mortgage market has increased over time—the percentage of mortgages originated that were

3. *See* Craig et al., *supra* note 1, at A1.

4. INT'L MONETARY FUND, OCTOBER 2010 GLOBAL FINANCIAL STABILITY REPORT x (2010).

5. *See, e.g.*, Mary Williams Walsh, *J.P. Morgan Settles Alabama Bribery Case*, N.Y. TIMES, Nov. 5, 2009, at B1.

6. *See* City of Cleveland v. Ameriquest Mortg. Sec., Inc., 615 F.3d 496 (6th Cir. 2010) (affirming dismissal of City's claims that subprime foreclosures constituted a public nuisance caused by defendant financial institutions' securitization practices).

7. *See* Jennifer E. Bethel et al., *Legal and Economic Issues in Litigation Arising from the 2007–08 Credit Crisis*, *in* PRUDENT LENDING RESTORED: SECURITIZATION AFTER THE MORTGAGE MELTDOWN 163, 167 (Yasuyuki Fuchita, Richard J. Herring & Robert E. Litan eds., 2009). Banks customarily have charged higher interest rates to buyers considered to be at a higher risk of defaulting on their loans based on, for example, poor credit history or a small down payment compared to the overall value of the loan. *See* Rick Brooks & Constance Mitchell Ford, *The United States of Subprime*, WALL ST. J., Oct. 11, 2007, at A1.

rated subprime increased from 8.6 percent in 2001 ($190 billion) to 20 percent by 2005 (over $600 billion).[8] Many of these later mortgages were adjustable rate mortgages (ARMs).[9] One of the most common subprime ARMs was given the label "2/28," because it gave the borrower a low fixed rate (a "teaser rate") for the first two years, and then reset to a high variable rate for the next twenty-eight.[10] After the reset, a buyer's monthly payment could jump by 35 percent or more, even if market interest rates had not changed.[11] For subprime buyers, who often could afford the teaser rate but not the higher variable rate, this jump would create a need to refinance after two years in order to afford their monthly payments.[12] Because a significant number of subprime borrowers had borrowed the entire value of their home, a decline in housing prices could leave them owing more than the value of their home ("under water") and unable to refinance.[13] Without refinancing, they were likely to default on their monthly payments; thus ARMs left subprime borrowers with little flexibility to survive a drop in housing prices.[14]

Commercial banks and savings and loan associations were once the predominant originators of mortgage loans—however, with the advent of securitization, mortgage bankers[15] and brokers had the majority of the market share by the 1990s.[16] The market also consolidated: in 1990, 28 percent of the industry's roughly $500 billion in loans came from the top twenty-five originators; in 2005, 85 percent of the industry's $3.1 trillion in loans did.[17]

2. Securitization

Securitization refers to the process of pooling together assets that are not otherwise easily traded, including mortgages and credit card loans, and issuing securities that allow investors to receive payments based on cash flows from that pool.[18] The resulting securities are called asset-backed securities (ABS), of which mortgage-backed securities (MBS) are one

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8. *See* Bethel et al., *supra* note 7, at 167–68. *See also* David Schmudde, *Responding to the Subprime Mess: The New Regulatory Landscape*, 14 FORDHAM J. CORP. & FIN. L. 709, 722–24 (2009).

9. *See* Bethel et al., *supra* note 7, at 167–68.

10. *See id.*

11. *See* ELAINE BUCKBERG ET AL., SUBPRIME AND SYNTHETIC CDOS: STRUCTURE, RISK, AND VALUATION 11 (2010), *available at* http://www.nera.com/nera-files/PUB_CDOs_Structure_Risk_Valuation_0610.pdf.

12. *See id.*

13. *See id.*; *see also* Schmudde, *supra* note 8, at 719–21.

14. *See* BUCKBERG ET AL., *supra* note 11, at 11; *see also* Schmudde, *supra* note 8, at 719–21.

15. Mortgage banks do not take deposits and are significantly less regulated than commercial banks; Countrywide is one example. *See* Robert Hockett, *A Fixer-Upper for Finance*, 87 WASH. U. L. REV. 1213, 1254–56, 1272–73 (2010).

16. *See* BUCKBERG ET AL., *supra* note 11, at 5.

17. *See* Bethel et al., *supra* note 7, at 169.

18. *See* BUCKBERG ET AL., *supra* note 11, at 5.

type.[19] Sponsors of MBS purchase the loans from the originators; when a large enough pool of mortgages is assembled, it is sold to a special purpose vehicle (SPV) that issues MBS in order to fund its purchase of the mortgages.[20] MBS are split into "tranches."[21] Scheduled payments to some investors—those holding the more senior tranches—are prioritized over payments to investors holding less senior tranches.[22] These MBS cash flows represent the interest and principal payments made by the borrowers whose mortgages are owned by the MBS structures.[23]

A hypothetical can help demonstrate how these tranches prioritize payments. Imagine a MBS has $100 worth of underlying collateral in the form of residential mortgages. The most senior tranche of this hypothetical MBS has 20 percent subordination, which means it is entitled to all of the cash flow from the underlying mortgages until 80 percent of the debt is satisfied. Thus, if only $80 of the scheduled payments are made, perhaps because of homeowner defaults, the senior tranche will be paid in full, while the lower tranches will receive nothing. Each tranche is rated by rating agencies for its investment quality, with the most senior tranches receiving AAA ratings and the less senior, riskier tranches receiving lower ratings.[24]

Collateralized debt obligations (CDOs) share many traits with MBS. CDOs have been around since the late 1980s, but their growth as an asset class occurred primarily after 2000.[25] A CDO has been analogized to "a small, privately held finance firm with a [limited] lifespan."[26] A CDO is an independent legal entity that owns assets such as MBS.[27] A cash-based CDO issues debt classes, and pays them with the cash flows from the MBS it owns.[28] Synthetic CDOs, meanwhile, derive their cash flows from credit default swaps (CDS), a form of credit insurance on a portfolio of reference entities, which could include high-grade corporate bonds, but might also include MBS.[29] As with MBS, all CDO debt classes are divided into

19. *Id.* Residential Mortgage Backed Securities (RMBS) are an even more specific sub-classification of ABSs that distinguishes securities derived from residential mortgages from securities based upon commercial mortgages.

20. *See* Bethel et al., *supra* note 7, at 170.

21. Tranche is the French word for slice. MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY, 1327 (11th ed. 2003). Each tranche is a slice of the entity as a whole owned by a class of investors with certain rights. *Id.*

22. *See* Bethel et al., *supra* note 7, at 169.

23. *See* BUCKBERG ET AL., *supra* note 11, at 8.

24. *See* Bethel et al., *supra* note 7, at 170. The ratings given by rating agencies are based upon the perceived likelihood that an investment will fail. The most senior tranche in MBS would receive the highest rating, AAA, because it was considered extremely unlikely that so many of the mortgages pooled into the MBS would default that the lower tranches would be unable to absorb the entire loss. *See* RICHARD A. POSNER, A FAILURE OF CAPITALISM 52 (2009).

25. *See* BUCKBERG ET AL., *supra* note 11, at 8; JANET M. TAVAKOLI, COLLATERALIZED DEBT OBLIGATIONS AND STRUCTURED FINANCE 6–13 (2003).

26. BUCKBERG ET AL., *supra* note 11, at 8.

27. *See id.*

28. *See id.*

29. *See id.* at 14. The cash stream is derived from the premiums paid on the CDSs by the insured. *See id.*; TAVAKOLI, *supra* note 25, at 31.

tranches by seniority.[30] A key difference between cash-based and synthetic CDOs is the way liabilities are funded: cash-based CDOs are fully funded, meaning that investors pay in advance for their bonds.[31] Synthetic CDOs, however, include an unfunded class (usually the super-senior tranches) that need not put any money down initially, but may be subject to calls requiring them to put up cash to fund payments should large credit events (e.g., mass defaults in the underlying assets) significantly disrupt cash flow.[32] Finally, adding to the complexity, CDOs will sometimes own tranches of other CDOs as part of their portfolio; depending on the portion of the portfolio that consists of other CDOs, these may be referred to as CDOs-squared.[33]

3. Crisis

Housing prices began to decline nationally by mid-2006, dropping by about 1.5 percent between 2006 and 2007.[34] Interest rates increased at a time when over two million homeowners faced the first interest-rate resets on their ARMs.[35] Moreover, the rating agency Fitch found that poor underwriting standards and outright fraud were driving the underperformance of many subprime loans.[36]

With default rates unexpectedly high, banks sought to enforce repurchase agreements, requiring lenders to buy back troubled mortgages.[37] These thinly capitalized loan originators faced financial distress—by the end of 2007, more than twenty-five subprime mortgage originators had filed for bankruptcy, including New Century Financial Corp.[38] Nor was the wave of bankruptcies limited to subprime lenders; even lenders without significant subprime portfolios fell as investors fled the mortgage market.[39] The unexpectedly high default rates on subprime mortgages also caused rating agencies to downgrade their ratings of MBS and CDOs.[40] Financial institutions then had to write down these assets as their value became impaired.[41] Because of these write-downs, firms needed to raise capital to meet regulatory requirements by selling unwanted mortgage-related assets; with so many firms seeking to do so at the same time, the market for these assets was glutted and illiquid, and firms faced steep discounts on asset

30. *See* BUCKBERG ET AL., *supra* note 11, at 8.

31. *See id.* at 15.

32. *See id.* at 14–15; TAVAKOLI, *supra* note 25, at 197.

33. *See* BUCKBERG ET AL., *supra* note 11, at 13.

34. *See* Bethel et al., *supra* note 7, at 180.

35. *See id.*

36. *See* Press Release, Fitch Ratings, Fitch: Underwriting & Fraud Significant Drivers of Subprime Defaults; New Originator Reviews (Nov. 28, 2007), *available at* www.americansecuritization.com/uploadedFiles/Fitch_Originators_1128.pdf.

37. *See* Carrick Mollenkamp et al., *Banks Go on Subprime Offensive*, WALL ST. J., Mar. 13, 2007, at A3.

38. *See* Bethel et al., *supra* note 7, at 182.

39. *See American Home Mortgage Seeks Chapter 11 Bankruptcy Protection*, N.Y. TIMES, Aug. 7, 2007, at C3; Kemba J. Dunham, *Subprime Woes Slap Other Lenders*, WALL ST. J., Mar. 14, 2007, at B7.

40. *See* Bethel et al., *supra* note 7, at 183.

41. *See id.* at 182–84; *see also* POSNER, *supra* note 24, at 68.

prices.[42] The write-downs and deeply discounted asset sales raised fears in the market about the creditworthiness of financial institutions.[43] The result was a run on the funding of banks; while "in the Great Depression, depositors of commercial banks withdrew their deposits, here providers of capital withdrew secured and unsecured funding from banks."[44] The impact on the financial services sector was massive—Bear Stearns and Merrill Lynch were sold,[45] Lehman Brothers went bankrupt,[46] and Morgan Stanley and Goldman Sachs became commercial bank holding companies instead of investment banks.[47] The damage was not contained to the financial services sector: commercial banks, including IndyMac Bancorp, were taken into federal receivership.[48] The federal government also seized control of Fannie Mae and Freddie Mac[49] and the troubled insurance giant AIG.[50]

Total losses from the financial collapse are estimated in the trillions, and responses by governments and private actors have varied widely.[51] The private 10b-5 action is one tool by which investors have sought to recoup their losses, which is especially fitting considering the historical context in which that action developed.

B. The Securities Acts

Modern securities laws have their origins in another historic financial catastrophe: the stock market crash of 1929.[52] The "industrial prosperity" of the decade leading up to the Great Depression led to a historic rise in the trading, valuation, and underwriting of securities.[53] Many Americans gambled on securities with borrowed funds, often making no attempt to establish whether the prices had any foundation in the success of the issuing companies.[54] The lack of fair dealing by some underwriters and dealers aided this speculation—such distributors made statements to prospective purchasers without proper investigation of their truth, and used misleading literature and high-pressure sales tactics.[55] Once the rampant speculation

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42. *See* Bethel et al., *supra* note 7, at 183–84; *see also* POSNER, *supra* note 24, at 66–67.

43. *See* Bethel et al., *supra* note 7, at 183–84.

44. *Id.*

45. *See* Luchetti & Sidel, *supra* note 2.

46. *See* Craig et al., *supra* note 1.

47. Andrew Ross Sorkin & Vikas Bajaj, *Radical Shift for Goldman and Morgan*, N.Y. TIMES, Sept. 22, 2008, at A1 ("Now, the firms will look more like commercial banks, with more disclosure, higher capital reserves and less risk-taking.").

48. Robin Sidel, *Bank Fears Spread After Seizure of IndyMac*, WALL ST. J., July 14, 2008, at A1.

49. Charles Duhigg et al., *As Crisis Grew, a Few Options Shrank to One*, N.Y. TIMES, Sept. 8, 2008, at A1.

50. Matthew Karnitschnig et al., *U.S. to Take Over AIG in $85 Billion Bailout; Central Banks Inject Cash as Credit Dries Up*, WALL ST. J., Sept. 17, 2008, at A1.

51. *See generally* INT'L MONETARY FUND, *supra* note 4.

52. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 194–95 (1976).

53. *See* EDWARD T. MCCORMICK, UNDERSTANDING THE SECURITIES ACT AND THE S.E.C. 18 (1948).

54. *See id.*

55. *See id.* at 19–20.

reached its breaking point, the severity of the stock market crash and the sheer number of people who suffered losses "led inevitably to [calls] for legislative reform."[56]

The main focus of the resulting legislation was ensuring proper disclosure of information by issuers and underwriters. Within a month of his inauguration, President Franklin D. Roosevelt sent a message to Congress emphasizing the importance of information disclosure, stating that his government had "an obligation . . . to insist that every issue of new securities to be sold in interstate commerce shall be accompanied by full publicity and information, and that no essentially important element attending the issue shall be concealed from the buying public."[57] With this aim in mind, Congress passed the Securities Act of 1933 ('33 Act), which protects investors by requiring extensive disclosures before new securities are issued.[58] The Securities Exchange Act of 1934 ('34 Act) expanded this protection by requiring periodic disclosures with respect to previously issued securities in order to prevent the manipulation of stock prices.[59] The '34 Act also created the Securities and Exchange Commission (SEC) to oversee enforcement and rulemaking under both the '33 and '34 Acts.[60]

1. Section 10(b) of the '34 Act and Rule 10b-5

Section 10(b) is arguably the most important and expansive provision of the Securities Acts, providing the SEC with broad authority to prohibit manipulative or deceptive conduct connected with the purchase or sale of a security.[61] Under section 10(b), it is unlawful to:

> use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe as necessary or appropriate in the public interest or for the protection of investors.[62]

In 1942, the SEC used its congressionally authorized rulemaking authority to enact Rule 10b-5, which specifically describes the conduct barred by section 10(b).[63] Though Rule 10b-5 would ultimately prove to be one of the foremost anti-fraud provisions in federal law, its creation was not the result of precise and careful legislative deliberation. Instead, the Rule was "a hastily drafted response to a situation clearly involving intentional misconduct."[64] The SEC had learned that the president of a corporation

56. *See id.* at 20.
57. 77 CONG. REC. 937 (1933) (statement of President Franklin D. Roosevelt).
58. 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a–77aa (2006)); *see also* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 194–95 (1976) (citing H.R. Rep. No. 85, at 1-5 (1933)).
59. 48 Stat. 881 (codified as amended at 15 U.S.C. §§ 78a–78nn (2006)) ('34 Act).
60. *Id.* § 4(a), 15 U.S.C. § 78d(a) (2006).
61. *See* Nicholas Fortune Schanbaum, *Scheme Liability: Rule 10b-5(a) and Secondary Actor Liability After* Central Bank, 26 REV. LITIG. 183, 186 (2007).
62. 15 U.S.C. § 78j (2006).
63. 17 C.F.R. § 240.10b-5 (2010).
64. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 212 n.32 (1976).

was telling shareholders that the corporation was doing poorly and purchasing their shares at low prices, when in fact the company was doing exceptionally well.[65] The rule was drafted and approved on the day the SEC learned of this misconduct.[66]

Rule 10b-5 is "as broad as almost any statute, a sort of long-arm provision in which the SEC forbids everything the statute gives it power to forbid."[67] Despite this breadth, Congress has never expressly provided for a private right of action for violation of section 10(b).[68] Since 1946, however, courts have recognized that section 10(b) and Rule 10b-5 create an implied private right of action.[69] While some commentators have objected that implying a private right of action goes against congressional intent,[70] the United States Supreme Court itself has stated that the implied remedy's "existence . . . is simply beyond peradventure."[71]

2. Loss Causation and Scienter: Common Law Development

The implied private right of action under Rule 10b-5 "resembles, but is not identical to, common-law tort actions for deceit and misrepresentation."[72] The Supreme Court has identified six elements of a claim for securities fraud under section 10(b) and Rule 10b-5: (1) a material misrepresentation or omission, (2) scienter, (3) a connection with the purchase or sale of a security, (4) reliance (transaction causation), (5) economic loss, and (6) loss causation.[73] This Note focuses on loss causation and scienter. These two elements of a plaintiff's claim are most likely to be affected by the global financial crisis. In regards to loss causation, this is because of the issue of intervening causation—the possibility that the investor's loss was caused by the market-wide downturn

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65. *Id.*

66. *Id.* Rule 10b-5 states in full:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (2010).

67. Steve Thel, *The Original Conception of Section 10(b) of the Securities Exchange Act*, 42 STAN. L. REV. 385, 463 (1990).

68. *See* Matthew L. Fry, *Pleading and Proving Loss Causation in Fraud-on-the-Market-Based Securities Suits Post-*Dura Pharmaceuticals, 36 SEC. REG. L.J. 31, 33 (2008).

69. Herman & MacLean v. Huddleston, 459 U.S. 375, 380 & n.10 (1983) (citing Kardon v. Nat'l Gypsum Co., 69 F. Supp. 512 (E.D. Pa. 1946) as the first time a private right of action under Rule 10b-5 was recognized).

70. *See, e.g.*, James D. Gordon III, *Acorns and Oaks: Implied Rights of Action Under the Securities Acts*, 10 STAN. J.L. BUS. & FIN. 62 (2004).

71. *Huddleston*, 459 U.S. at 380.

72. Dura Pharm., Inc. v. Broudo, 544 U.S. 336, 341 (2005).

73. *See id.* at 341–42.

in share prices and not the defendant's misrepresentations.[74] In regards to scienter, this is because of the rule against pleading "fraud by hindsight" to hold defendants responsible for failing to predict future events.[75] Some scholars predicted that these two elements would be most difficult for plaintiffs to prove in the wake of the financial collapse.[76]

a. Loss Causation

In *Schlick v. Penn-Dixie Cement Corp.*,[77] the Second Circuit recognized the term "loss causation" as a required component of a 10b-5 claim.[78] The court opined that loss causation can be demonstrated "rather easily by proof of some form of economic damage," compared with the reliance element of transaction causation.[79] Indeed, transaction causation received more attention by courts than loss causation for many years, until the Supreme Court greatly eased a plaintiff's burden by accepting the "fraud on the market" theory in *Basic Inc. v. Levinson*,[80] creating a rebuttable presumption of reliance where materially misleading statements are disseminated into a well-developed, impersonal market.[81]

Courts continued to emphasize loss causation's foundation in common law tort, with Judge Richard Posner going so far as to state that "what securities lawyers call 'loss causation' *is* the standard common law fraud rule . . . merely borrowed for use in federal securities fraud cases."[82] The Second Circuit, meanwhile, has stated that the "tort analogy is imperfect" because while "[a] foreseeable injury at common law is one proximately caused by the defendant's fault," devaluation of a security is caused by "the underlying circumstance that is concealed or misstated," not the misstatement itself.[83] Despite these differences, the common law development of the loss causation element informed its ultimate codification in the Private Securities Litigation Reform Act of 1995[84] (PSLRA).

b. Scienter

The requirement that any material misstatements be made with scienter is perhaps less intuitive than the requirement of a causal connection between

74. *See infra* Parts I.B.4.a.ii, III.B, and IV.B.2.
75. *See infra* Parts I.B.4.b, III.A, and IV.B.1.
76. *See* Bethel et al., *supra* note 7, at 204–14.
77. 507 F.2d 374 (2d Cir. 1974).
78. *See id.* at 380.
79. *Id.* Transaction causation involves showing "that the violations in question caused the [plaintiff] to engage in the transaction in question." *Id.*
80. 485 U.S. 224 (1988).
81. *See* Jill E. Fisch, *Cause for Concern: Causation and Federal Securities Fraud*, 94 IOWA L. REV. 811, 817–19 (2009).
82. Bastian v. Petren Res. Corp., 892 F.2d 680, 683 (7th Cir. 1990).
83. Lentell v. Merrill Lynch & Co., 396 F.3d 161, 172–73 (2d Cir. 2005).
84. Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C.); *see* Fisch, *supra* note 81, at 822.

the misstatements and the loss suffered by an investor. Indeed, in the thirty-year period following the establishment of a private right of action under section 10(b) and Rule 10b-5, "[c]ourts and commentators . . . differed with regard to whether scienter is a necessary element of such a cause of action, or whether negligent conduct alone is sufficient."[85] The Supreme Court resolved this dispute in 1976 with its decision in *Ernst & Ernst v. Hochfelder*.[86] The Court held that Congress's use of the word "manipulative" and other words indicative of intentional or willful conduct indicated congressional intent to proscribe a type of wrongful conduct exceeding negligence.[87]

The Circuit Courts of Appeals were in agreement that the heightened pleading requirement of Federal Rule of Civil Procedure 9(b) applied to this scienter element.[88] Rule 9(b) requires the circumstances of a fraud to be pleaded with particularity, but allows that "[m]alice, intent, knowledge, and other conditions of a person's mind may be alleged generally."[89] The Circuits split, however, on the interpretation of Rule 9(b) in the securities context. The Ninth Circuit had the least demanding standard, merely requiring a plaintiff to state that scienter existed.[90] On the opposite end of the spectrum, the Second Circuit had the most demanding standard, requiring a plaintiff to state, with particularity, facts that give rise to a "strong inference" of scienter.[91] The uncertainty and inconsistency arising from this split in standards was one of the reasons that Congress enacted the PSLRA.

3. Congress Acts: The Private Securities Litigation Reform Act

The PSLRA codified the judicially developed elements of a section 10(b) and Rule 10b-5 claim, including loss causation and scienter. In 1995, Congress sought to "reassert its authority" in the area of 10b-5 litigation.[92] Organized efforts to reform private securities litigation had begun in 1991, when the "Big Six" accounting firms and the American Institute of Certified Public Accountants began to build bipartisan support for legislative action to rein in what they saw as an overly plaintiff-friendly

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85. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 197 (1976).

86. *See id.*

87. *See id.* at 199.

88. *See* James B. Fipp, Case Note, *How Strong Is Strong Enough?: The* Tellabs *Court Lacked the Needed Strength for Pleading Scienter in Securities Fraud*, 8 WYO. L. REV. 629, 636 (2008) (citing *In re* GlenFed, Inc. Sec. Litig., 42 F.3d 1541, 1546 (9th Cir. 1994)); *see also* Shields v. Citytrust Bancorp, Inc., 25 F.3d 1124, 1127–28 (2d Cir. 1994) (acknowledging that Federal Rule of Civil Procedure 9(b) applies to securities fraud); Greenstone v. Cambex Corp., 975 F.2d 22, 25 (1st Cir. 1992) (holding Federal Rule of Civil Procedure 9(b) applies to actions brought under the federal securities laws).

89. FED. R. CIV. P. 9(b).

90. *See In re GlenFed*, 42 F.3d at 1546–47.

91. *See Shields*, 25 F.3d at 1128.

92. S. REP. NO. 104-98, at 4–5 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 683–84.

system of securities litigation.[93] Congress enacted the PSLRA in order to combat abusive practices in private securities litigation.[94] Congress was concerned primarily with preventing "strike suits"—shareholder suits filed solely for their settlement value, not because of a meritorious claim.[95] Faced with expensive discovery, "deep pocket" defendants would settle otherwise non-meritorious claims, and cases were generally "settled based not on the merits but on the size of the defendant's pocketbook."[96]

The PSLRA had three primary goals: "(1) to encourage the voluntary disclosure of information by corporate issuers; (2) to empower investors so that they—not their lawyers—exercise primary control over private securities litigation; and (3) to encourage plaintiffs' lawyers to pursue valid claims and defendants to fight abusive claims."[97] To that end, the PSLRA sought to heighten and standardize the pleading requirements for section 10(b) and Rule 10b-5 suits. Congress adopted the Second Circuit's standard for pleading scienter,[98] requiring that a plaintiff must "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind."[99] Congress did not, however, define the key term "strong inference," leaving it up to the Supreme Court to clarify the standard at a later time.[100]

As to loss causation, the PSLRA stated only that "the plaintiff shall have the burden of proving that the act or omission of the defendant alleged to violate this chapter caused the loss for which the plaintiff seeks to recover damages."[101] Thus, while the PSLRA codified the elements of a section 10(b) and Rule 10b-5 suit, it left the details of the pleading standards to be determined by the courts.

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93. *See* Richard M. Phillips & Gilbert C. Miller, *The Private Securities Litigation Reform Act of 1995: Rebalancing Litigation Risks and Rewards for Class Action Plaintiffs, Defendants and Lawyers*, 51 BUS. LAW. 1009, 1018 (1996).

94. *See* David S. Escoffery, Note, *A Winning Approach to Loss Causation Under Rule 10b-5 in Light of the Private Securities Litigation Reform Act of 1995 ("PSLRA")*, 68 FORDHAM L. REV. 1781, 1809 (2000).

95. S. REP. NO. 104-98, at 4–5, *reprinted in* 1995 U.S.C.C.A.N. at 683; *see also* H.R. REP. NO. 104-50, at 15 (1995) ("Strike lawsuits are lawsuits filed by class action attorneys on behalf of shareholders whose once attractive stock purchases have failed to live up to their expectations. Volatile stock prices, rapid product development, and technological changes make growing companies a target. As a result, high technology, biotechnology, and other growth companies are hardest hit.").

96. S. REP. NO. 104-98, at 9, *reprinted in* 1995 U.S.C.C.A.N. at 688.

97. *Id.* at 4, *reprinted in* 1995 U.S.C.C.A.N. at 683.

98. *Id.* at 15, *reprinted in* 1995 U.S.C.C.A.N. at 694. The Senate Committee on Banking, Housing and Urban Affairs "chose a uniform standard modeled upon the pleading standard of the Second Circuit." *Id.* The Senate Committee noted, however, that it did "not intend to codify the Second Circuit's caselaw interpreting this pleading standard, although courts may find this body of law instructive." *Id.*

99. 15 U.S.C. § 78u–4(b)(2) (2006).

100. *See infra* Part I.B.4.b.

101. 15 U.S.C. § 78u–4(b)(4).

4. The Supreme Court Clarifies: *Dura* and *Tellabs*

This section explains the current state of the pleading requirements for loss causation and scienter in light of the Supreme Court's most recent decisions on the topic. First, this section analyzes the Supreme Court's decision in *Dura Pharmaceuticals, Inc. v. Broudo*. This section also examines a Second Circuit opinion that directly addressed the effect of an intervening cause on pleading loss causation, *Lentell v. Merrill Lynch & Co.* Finally, this section discusses the Supreme Court's decision addressing scienter, *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*

a. Loss Causation: Dura Pharmaceuticals, Inc. v. Broudo *and* Lentell v. Merrill Lynch & Co.

i. *Dura Pharmaceuticals, Inc. v. Broudo*

In *Dura Pharmaceuticals, Inc. v. Broudo*,[102] the Supreme Court formalized the requirement that a misrepresentation must be the proximate cause of a 10b-5 plaintiff's loss. The Ninth Circuit had ruled that a plaintiff may satisfy the loss causation element solely by demonstrating that the price of the stock was inflated on the date of purchase.[103] A unanimous Supreme Court overruled, holding that the plaintiff must prove that the alleged misrepresentation is the proximate cause of the loss suffered.[104] The Court reasoned that while purchasing stock at a price inflated by a misrepresentation might often lead to a later loss, it is far from invariably so.[105] Rather, "that lower price may reflect, not the earlier misrepresentation, but changed economic circumstances, changed investor expectations, new industry-specific or firm-specific facts, conditions, or other events, which taken separately or together account for some or all of

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102. 544 U.S. 336 (2005).

103. *See id.* at 343. There is currently a split between the circuits on the pleading standard for loss causation after *Dura*. *See* Evan Hill, Note, *The Rule 10b-5 Suit: Loss Causation Pleading Standards in Private Securities Fraud Claims After* Dura Pharmaceuticals, Inc. v. Broudo, 78 FORDHAM L. REV. 2659, 2677–78 (2010). The Fifth and Ninth Circuits require a plaintiff to allege the misrepresentations plausibly caused their loss. *See* Lormand v. US Unwired, Inc., 565 F.3d 228, 258 (5th Cir. 2009); *In re* Gilead Scis. Sec. Litig., 536 F.3d 1049, 1057 (9th Cir. 2008). The Fifth Circuit explicitly interprets this plausible causation requirement under Federal Rule of Civil Procedure 8(a), while the Ninth Circuit "also appears to consider FRCP 8(a) appropriate, although without expressly stating so." Hill, *supra*, at 2677–78. The Fourth and Seventh Circuits have a more stringent standard, with the Fourth Circuit explicitly applying FRCP Rule 9(b) and the Seventh Circuit requiring plaintiffs to plead the "very facts" that caused their loss. *See id.* Finally, plaintiffs in the Second Circuit must satisfy a two-part test in pleading loss causation, and demonstrate that (1) the loss was foreseeable and (2) within the zone of the risk of the misrepresentation. *See Lentell*, 396 F.3d at 173; *see also* ATSI Commc'ns, Inc. v. Shaar Fund, Ltd., 493 F.3d 87, 106–07 (2d Cir. 2007) (applying *Lentell*'s two-part test after *Dura*). Significantly for this Note, the Second Circuit does not specify the stringency of pleading, instead stating that loss causation is a "fact-based inquiry and the degree of difficulty in pleading will be affected by [the] circumstances." *Lentell*, 396 F.3d at 174.

104. *Dura*, 544 U.S. at 343.

105. *Id.*

that lower price."[106] This "tangle of factors" affecting price requires a plaintiff to prove that the misrepresentation caused a loss.[107]

Building on its holding that a plaintiff need prove proximate causation and economic loss, the Court moved on to discuss the requirement that a plaintiff plead such a loss.[108] In doing so, the Court presumed the applicability of Federal Rule of Civil Procedure 8(a)(2) to loss causation, which requires only a "short and plain statement of the claim showing that the pleader is entitled to relief."[109] The Court noted that ordinary pleading standards do not impose a high burden on plaintiffs, but indicated that it "should not prove burdensome for a plaintiff . . . to provide a defendant with some indication of the loss and the causal connection that the plaintiff has in mind."[110]

ii. *Lentell v. Merrill Lynch & Co.*

The *Dura* Court did not consider any other issues surrounding loss causation, and thus did not directly consider the effect an intervening event might have. The Second Circuit in *Lentell v. Merrill Lynch & Co.*,[111] however, delved deeper into the effect a non-fraud explanation might have on pleading loss causation.

The plaintiffs in *Lentell* were a group of investors who alleged that Merrill Lynch, through its "star analyst" Henry M. Blodget, issued false and misleading reports recommending that investors purchase shares of two companies, 24/7 Real Media, Inc. and Interliant, Inc.[112] The crux of the plaintiffs' complaint was that between May 12, 1999 and February 20, 2001, Merrill Lynch recommended that investors buy stock in the two companies not because they were actually sound investments, but instead to further Merrill Lynch's banking-client relationship with the companies and increase their share price.[113] The United States District Court for the Southern District of New York dismissed the complaint for failure to plead loss causation, among other deficiencies.[114]

The Second Circuit affirmed the dismissal, establishing a two-part test for pleading loss causation.[115] The court emphasized that proximate causation in securities fraud suits differs from causation in other torts in that the loss is not caused directly by the defendant's fault, but by the underlying circumstance that is concealed or misstated.[116] Thus, the court held, a plaintiff must plead "both that the loss be foreseeable *and* that the

106. *Id.*
107. *Id.*
108. *See id.* at 346.
109. FED. R. CIV. P. 8(a)(2); *Dura*, 544 U.S. at 346.
110. *Dura*, 544 U.S. at 347.
111. 396 F.3d 161 (2d Cir. 2005).
112. *See id.* at 164.
113. *See id.* at 166–67.
114. *See In re* Merrill Lynch & Co. Research Reports Sec. Litig., 273 F. Supp. 2d 351, 362 (S.D.N.Y. 2003).
115. *See Lentell*, 396 F.3d at 173.
116. *See id.*

loss be caused by the materialization of the concealed risk."[117] Merrill Lynch did not actually conceal or misstate any of the actual underlying risks associated with an investment in 24/7 Media or Interliant; instead, the plaintiffs alleged that Merrill Lynch falsely recommended investment in those companies.[118] Thus, because the plaintiffs did not allege that it was the falsity of these recommendations that caused the decline in their stock value, they did not properly plead loss causation.[119]

In the course of its opinion, the Second Circuit also discussed the impact a non-fraud explanation may have on pleading loss causation in one key passage.[120] After beginning by noting that "[l]oss causation is a fact-based inquiry and the degree of difficulty in pleading will be affected by the circumstances,"[121] the Second Circuit quoted *Emergent Capital Investment Management, LLC v. Stonepath Group, Inc.*[122] for the proposition that "[i]f [a plaintiff's] loss was caused by an intervening event, like a general fall in the price of Internet stocks, the chain of causation . . . is a matter of proof at trial and not to be decided on a Rule 12(b)(6) motion to dismiss."[123] In the next sentence, however, the court quoted *First Nationwide Bank v. Gelt Funding Corp.*[124] for the proposition that "when the plaintiff's loss coincides with a market-wide phenomenon causing comparable losses to other investors, the prospect that the plaintiff's loss was caused by the fraud decreases," and a plaintiff's claim fails when "it has not adequately [pled] facts which, if proven, would show that its loss was caused by the alleged misstatements as opposed to intervening events."[125]

As one district court has observed,

> [T]his passage lacks clarity. It provides no explanation for how "a general fall in the price of Internet stocks" is distinguishable from "a marketwide phenomenon causing comparable losses to other investors"—the former of which is a matter for proof at trial, while the latter can be a sufficient basis on which to dismiss a complaint.[126]

Thus, district courts have had unclear guidance as they grapple with issues of loss causation in the wake of the financial crisis.

b. Scienter: Tellabs, Inc. v. Makor Issues & Rights, Ltd.

In *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*,[127] the Supreme Court considered the then-extant split between the circuits on the level of

117. *Id.*
118. *See id.* at 175.
119. *See id.*
120. *See id.* at 174.
121. *Id.*
122. 343 F.3d 189 (2d Cir. 2003).
123. *See Lentell*, 396 F.3d at 174 (quoting *Emergent*, 343 F.3d at 197).
124. 27 F.3d 763 (2d Cir. 1994).
125. *See Lentell*, 396 F.3d at 174 (quoting *Gelt*, 27 F.3d at 772).
126. King Cnty., Wash. v. IKB Deutsche Industriebank AG, 708 F. Supp. 2d 334, 343 (S.D.N.Y. 2010).
127. 551 U.S. 308 (2007).

particularity required to give rise to a "strong inference" of scienter under the PSLRA.[128] Some courts permitted securities fraud plaintiffs to allege the requisite mental state simply by stating that it existed, while others required plaintiffs to allege with particularity facts giving rise to an inference of scienter.[129]

The Supreme Court framed its task as prescribing a "workable construction" of the "strong inference" standard, with an eye towards maintaining the twin goals of the PSLRA: curbing "frivolous, lawyer-driven litigation, while preserving investors' ability to recover on meritorious claims."[130] The Court set out three prescriptions. First, courts must, as in all motions to dismiss, accept all factual allegations in the complaint as true.[131] Second, courts must consider the complaint in its entirety, as well as other sources traditionally examined in ruling on a motion to dismiss, such as documents incorporated into the complaint by reference and matters amenable to judicial notice.[132] This inquiry is a holistic one: the question is whether all the facts collectively give rise to a strong inference of scienter, not whether any individual allegation does.[133] Finally, the inquiry has a comparative element; courts are required to "take into account plausible opposing inferences," and deny the motion to dismiss only if the inference of scienter is "at least as compelling as any opposing inference."[134]

While the surest route to scienter is to plead that the defendants possessed a pecuniary motive to commit fraud, the Court stated that the "absence of a motive allegation is not fatal."[135] Indeed, the Court noted without expressly deciding that every circuit court that has considered the issue has held that a plaintiff may allege scienter by showing that the defendant acted either intentionally or recklessly.[136] The Court held that to plead scienter adequately, the plaintiff must "plead facts rendering an inference of scienter *at least as likely as* any plausible opposing inference."[137] Meeting this standard has proven to be the major roadblock for plaintiffs in subprime securities suits to allow their 10b-5 claims to survive a motion to dismiss.[138]

A basic concept of particular import to pleading scienter successfully in the wake of financial collapse is the distinction between ex ante expectations and ex post losses. The *Tellabs* Court cited with approval[139] a

128. *Id.* at 319–20.
129. *Id.*
130. *Id.* at 322.
131. *See id.*
132. *See id.*
133. *See id.* at 322–23.
134. *See id.* at 323–24.
135. *Id.* at 325.
136. *See id.* at 319–20 & n.3.
137. *Id.* at 328.
138. *See infra* Part II.B.
139. *See Tellabs*, 551 U.S. at 320 (citing Shields v. Citytrust Bancorp, Inc., 25 F.3d 1124, 1129 (2d Cir. 1994)).

1978 case, *Denny v. Barber*.[140] *Denny* stands for the proposition that a plaintiff may not simply seize upon disclosures made in later reports and allege they should have been made sooner; this was termed "fraud by hindsight" by Judge Henry Friendly.[141] The plaintiffs had alleged that Chase Manhattan Bank had engaged in fraud, evidenced by inadequate disclosure of risky loans that eventually resulted in significant losses.[142] The court held that failure to predict events that contributed to the realization of those losses, including a drastic increase in petroleum prices, did not constitute fraud.[143] In the absence of allegations that the defendants perceived or were reckless in not perceiving these risks at the time they made their disclosures, plaintiffs did not adequately allege scienter.[144] Given the fact that the subprime mortgage meltdown and the ensuing credit crisis[145] were not predicted by many sophisticated parties,[146] it is not surprising that this distinction has featured prominently in many subprime securities suits.[147]

II. DISPOSITIONS OF MOTIONS TO DISMISS IN 10B-5 SUBPRIME SECURITIES SUITS

In this part, this Note surveys district court decisions involving 10b-5 suits stemming from the subprime mortgage collapse and credit crisis. First, this part provides an overview of the securities class actions filed during and after the crisis, and proceeds to analyze the dispositions of thirty-four decisions on motions to dismiss in subprime securities suits. In this sampling of cases, scienter was the most important factor in determining whether a complaint survives. Finally, this part discusses factual and legal issues that influenced whether a plaintiff's scienter allegations were held to be adequate.

A. Securities Litigation in the Wake of the Financial Crisis

As the subprime mortgage crisis of 2007 evolved into the global financial crisis of 2008, a wave of securities litigation followed. At the end of 2007, thirty-seven financial crisis-related cases had been filed in federal court,

140. 576 F.2d 465, 470 (2d Cir. 1978).
141. *Id.* at 470.
142. *See id.* at 469.
143. *See id.* at 470.
144. *See id.*
145. *See supra* Part I.A.
146. *See, e.g.*, Benjamin S. Bernanke, Chairman, Fed. Reserve, Speech at the Federal Reserve Bank of Chicago's 43rd Annual Conference on Bank Structure & Competition (May 17, 2007) ("[G]iven the fundamental factors in place that should support the demand for housing, we believe the effect of the troubles in the subprime sector on the broader housing market will likely be limited, and we do not expect significant spillovers from the subprime market to the rest of the economy or to the financial system."), *available at* http://www.federalreserve.gov/newsevents/speech/bernanke20070517a.htm.
147. *See infra* Part III.A.

thirty of which were filed in the last two quarters of that year.[148] While this accounted for only 22 percent of the 163 federal securities class action lawsuits filed in 2007,[149] that number would soon rise.

2008 saw ninety-nine financial crisis related class action lawsuits filed, making up 47 percent of the 210 securities class actions registered in that year.[150] The targets of these suits shifted from loan originators in 2007 to defendants involved in loan securitization in 2008, reflecting the spreading exposure of investment banks to the growing financial crisis.[151] Indeed, while the number of loan originators named as defendants in 2008 (twenty-two) remained steady compared to 2007 (nineteen), the percentage of financial crisis-related filings with loan originator defendants fell from 51 percent in 2007 to just 22 percent in 2008.[152]

The rate of new federal securities class action filings tapered off somewhat in 2009 with 155 new cases.[153] This drop was most likely attributable to the decline in financial crisis-related cases from ninety-nine in 2008 to fifty-one in 2009, representing approximately 33 percent of the total class actions filed in 2009.[154] One trend worth noting in 2009 was the length of time between the end of the class period and the filing date—at 218 days, this was almost double the annual average of 114 days in the years between the passage of the PSLRA in 1995 and 2009, and 71 percent higher than the average of 127 days observed in 2008.[155] This could suggest that plaintiffs' attorneys were refocusing on non-financial crisis matters.[156] Indeed, as of the end of 2010, the storm of filings seems to have subsided. Only nineteen financial crisis-related securities suits were filed, while the overall number of securities class action filings rose to 174.[157]

B. Overview of Subprime Securities Decisions Surveyed: Methodology and Dispositions

This section examines decisions on motions to dismiss in thirty-four securities class actions for losses stemming from the subprime mortgage

148. PRICEWATERHOUSECOOPERS LLP, 2008 SECURITIES LITIGATION STUDY 30 (2008), *available at* http://10b5.pwc.com/PDF/NY-09-0894%20SECURITIES%20LIT%20STUDY%20FINAL.PDF.

149. *See id.*; PRICEWATERHOUSECOOPERS LLP, 2009 SECURITIES LITIGATION STUDY 6 (2009), *available at* http://10b5.pwc.com/PDF/NY-10-0559%20SEC%20LIT%20STUDY_V7%20PRINT.PDF.

150. *See* PRICEWATERHOUSECOOPERS LLP, 2009 SECURITIES LITIGATION STUDY, *supra* note 149, at 7.

151. *See* PRICEWATERHOUSECOOPERS LLP, 2008 SECURITIES LITIGATION STUDY, *supra* note 148, at 34.

152. *Id.* at 31.

153. *See* 2009 SECURITIES LITIGATION STUDY, *supra* note 149, at 6–7.

154. *Id.*

155. *Id.*

156. *Id.*

157. PRICEWATERHOUSECOOPERS LLP, 2010 SECURITIES LITIGATION STUDY 7–9 (2010), *available at* http://10b5.pwc.com/PDF/NY-11-0484%20SEC%20LIT%20STUDY_V6BONLINE.PDF.

collapse and subsequent credit crisis.[158] Of these thirty-four decisions, twenty denied the defendants' motion to dismiss the plaintiff's 10b-5 claims at least in part.[159] Eleven granted dismissal in full.[160] Three dismissed the plaintiffs' 10b-5 claims, but allowed the plaintiffs' other claims to proceed.[161] Subsequent to the district court rulings, three dismissals have been affirmed by Circuit Courts of Appeals,[162] and one case proceeded to trial, resulting in a jury verdict for the plaintiff.[163]

Given the importance of lending practices to the overall financial collapse,[164] it is perhaps not surprising that the most common allegation levied by plaintiffs was that the defendants misrepresented the strength of their underwriting standards for issuing mortgage loans or insuring financial products with exposure to subprime. To use *In re New Century*[165] as an example, a defendant might describe its underwriting standards to investors as "improved" or "strict."[166] If the company's loan underwriting standards

158. *See* Table I. To identify these cases, this Note started with Kevin LaCroix's extraordinarily useful list of dispositions in credit crisis-related lawsuits. Kevin M. LaCroix, *The List: Subprime Lawsuit Dismissals and Denials Decisions* (Sept. 6, 2011), http://www.oakbridgeins.com/clients/blog/subprimeresolution.doc. As of July 16, 2011, LaCroix's list consisted of seventy-nine grants and fifty-nine denials of motions to dismiss. This Note used the following methodology to narrow the list to thirty-four decisions. First, multiple decisions in the same case and cases in which plaintiffs did not assert 10b-5 claims were removed. Next, to focus on subprime securities suits, this Note omitted cases that were not putative class actions, claims for losses unrelated to subprime (such as auction rate securities and student loans), and decisions other than on the merits, for example dismissals for lack of subject matter jurisdiction. There are certainly many other useful ways to analyze this data, and the question of whether a particular case does or does not qualify as "subprime-related" was often a close one. The goal of this Note is not to be exhaustive, but to analyze a representative sampling of decisions.

159. *See* Table I.

160. *Id.*

161. The other claims were under the '33 Act, which prohibits misleading statements made in connection with registration statements and prospectuses. *See In re* Wachovia Equity Sec. Litig., 753 F. Supp. 2d 326, 366–78 (S.D.N.Y. 2011) (dismissing 10b-5 claims but allowing '33 Act claims to proceed); *In re* Regions Morgan Keegan Sec., Derivative & ERISA Litig., 743 F. Supp. 2d 744, 762 (W.D. Tenn. 2010) (same); Local 295/Local 851 IBT Emp'r Grp. Pension Trust & Welfare Fund v. Fifth Third Bancorp, 731 F. Supp. 2d 689 (S.D. Ohio 2010) (same); *see also supra* note 58 and accompanying text. Because this Note focuses on the viability of 10b-5 claims at the motion to dismiss stage, these three decisions are considered dismissals for the remaining discussion.

162. *In re* HomeBanc Corp. Sec. Litig., 706 F. Supp. 2d 1336 (N.D. Ga. 2010), *aff'd sub nom.* Kadel v. Flood, No. 10-12220, 2011 WL 2015379 (11th Cir. May 24, 2011); Pittleman v. Impac Mortg. Holdings, Inc., No. SACV 07-0970, 2009 WL 648983 (C.D. Cal. Mar. 9, 2009), *aff'd sub nom.* Sharenow v. Impac Mortg. Holdings, Inc., 385 F. App'x 714 (9th Cir. 2010); *In re* 2007 Novastar Fin., Inc., Sec. Litig., 07-0139-CV, 2008 WL 2354367 (W.D. Mo. June 4, 2008), *aff'd*, 579 F.3d 878 (8th Cir. 2009).

163. *See* Hubbard v. BankAtlantic Bancorp, Inc., No. 07-61542-CIV, 2009 WL 3261941 (S.D. Fla. May 12, 2009); Nathan Koppel, *Jury Finds Bankers Misled Loan Risk*, WALL ST. J., Nov. 19, 2010, at C3. Trial verdicts in securities class actions are exceedingly rare: since the passage of the PSLRA in 1995, 3,400 securities class actions have been filed in federal court but only twenty-eight have gone to trial. *See* BUCKBERG ET AL., *supra* note 11, at 15.

164. *See supra* notes 34–49 and accompanying text.

165. 588 F. Supp. 2d 1206 (C.D. Cal. 2008).

166. *See id.* at 1225.

are actually lax, this may be an actionable misstatement.[167] If the defendant is aware or should be aware that the standards are lax, he has made the misstatement with scienter.[168] Twenty-three of the thirty-four decisions reviewed in this Note included allegations about underwriting standards: in thirteen of these decisions, 10b-5 claims survived the motion to dismiss,[169] while in ten the 10b-5 claims did not.[170] The plaintiffs in the remainder of the decisions alleged misrepresentations that included the scope of the defendant's exposure to subprime either directly[171] or indirectly through

167. *See id.* In the cases examined, district courts have split on whether statements portraying underwriting practices as "strong" may be material misstatements actionable as securities fraud. *Compare In re* Sec. Capital Assurance, Ltd. Sec. Litig., 729 F. Supp. 2d 569, 597 (S.D.N.Y. 2010) (holding statements about company's "conservative" underwriting approach to be "classic examples" of inactionable corporate puffery), *with In re* Ambac Fin. Grp., Inc. Sec. Litig., 693 F. Supp. 2d 241, 271–73 (S.D.N.Y. 2010) (holding statements about company's "conservative" underwriting approach actionable, because once a defendant "affirmatively characterizes management practices as . . . 'conservative,'" the subject is "in play" and the defendant is "bound to speak truthfully" (quoting Shapiro v. UJB Fin. Corp., 964 F.2d 272, 282 (3d Cir. 1992))), *and In re* CIT Grp., Inc. Sec. Litig., No. 08 Civ. 6613, 2010 WL 2365846 at *3 (S.D.N.Y. June 10, 2010) (holding that touting "conservative" lending practices puts the subject "in play" (citing *Ambac*, 693 F. Supp. 2d at 271)).

168. *See New Century*, 588 F. Supp. 2d at 1229–30.

169. *In re* Citigroup, Inc. Sec. Litig., 753 F. Supp. 2d 206, 240, 244–45 (S.D.N.Y. 2010) (dismissing allegations related to mortgage underwriting but allowing claims related to CDO exposure to proceed); *In re* Am. Int'l Grp., Inc. 2008 Sec. Litig., 741 F. Supp. 2d 511, 530–32 (S.D.N.Y. 2010); *In re CIT*, 2010 WL 2365846, at *2–3; Freudenberg v. E*Trade Fin. Corp., 712 F. Supp. 2d 171, 205 (S.D.N.Y. 2010); *In re* MBIA, Inc. Sec. Litig., 700 F. Supp. 2d 566, 586–87, 591 (S.D.N.Y. 2010) (dismissing underwriting allegations but allowing claims related to CDO exposure to continue); *Ambac* 693 F. Supp. 2d at 271; *In re* PMI Grp., Inc. Sec. Litig., No. C08-1405, 2009 WL 3681669, at *1–2 (N.D. Cal. Nov. 2, 2009); *In re* Wash. Mut., Inc. Sec., Derivative & ERISA Litig., 694 F. Supp. 2d 1192, 1206–07 (W.D. Wash. 2009); Hubbard v. BankAtlantic Bancorp, Inc., No. 07-61542-Civ, 2009 WL 3261941, at *1–2 (S.D. Fla. May 12, 2009); *In re* RAIT Fin. Trust Sec. Litig., 07-cv-03148, 2008 WL 5378164, at *4 (E.D. Pa. Dec. 22, 2008); *New Century*, 588 F. Supp. 2d at 1210; *In re* Countrywide Fin. Corp. Sec. Litig., 588 F. Supp. 2d 1132, 1145–47 (C.D. Cal. 2008); Atlas v. Accredited Home Lenders Holding Co., 556 F. Supp. 2d 1142, 1149–50 (S.D. Cal. 2008).

170. *In re* Wachovia Equity Sec. Litig., 753 F. Supp. 2d 326, 354 (S.D.N.Y. 2011); Local 295/Local 851 IBT Emp'r Grp. Pension Trust & Welfare Fund v. Fifth Third Bancorp, 731 F. Supp. 2d 689, 706–07, 717 (S.D. Ohio 2010) (dismissing 10b-5 claims but allowing other claims to proceed); *In re* HomeBanc Corp. Sec. Litig., 706 F. Supp. 2d 1336, 1343 (N.D. Ga. 2010), *aff'd sub nom.* Kadel v. Flood, No. 10–12220, 2011 WL 2015379 (11th Cir. May 24, 2011); *In re Sec. Capital Assurance*, 729 F. Supp. 2d at 580; N.Y. State Teachers' Ret. Sys. v. Fremont Gen. Corp., 07-CV-5756, 2010 WL 1473265, at *3 (C.D. Cal. Mar. 29, 2010); Fulton Cnty. Emps.' Ret. Sys. v. MGIC Inv. Corp., No. 08-C-0458, 2010 WL 601364, at *1 (E.D. Wis. Feb. 18, 2010); *In re* Downey Sec. Litig., No. CV 08-3261, 2009 WL 2767670, at *6 (C.D. Cal. Aug. 21, 2009); Pittleman v. Impac Mortg. Holdings, Inc., No. SACV 07-0970, 2009 WL 648983, at *3 (C.D. Cal. Mar. 9, 2009), *aff'd sub nom.* Sharenow v. Impac Mortg. Holdings, Inc., 385 F. App'x 714 (9th Cir. 2010); *In re* 2007 Novastar Fin., Inc. Sec. Litig., 07-0139-CV, 2008 WL 2354367, at *2 (W.D. Mo. June 4, 2008), *aff'd*, 579 F.3d 878 (8th Cir. 2009); Tripp v. Indymac Fin., Inc., No. CV 07-1635, 2007 WL 4591930, at *3 (C.D. Cal. Nov. 29, 2007).

171. *See, e.g.*, *In re* Thornburg Mortg., Inc. Sec. Litig., 695 F. Supp. 2d 1165, 1204–05 (D.N.M. 2010).

MBS and CDOs,[172] adequacy of internal controls and risk management,[173] and in one case, a rating agency's independence and methodology.[174]

These thirty-four decisions included defendants involved in all of the different stages of creating MBS and CDOs, from loan originators, to insurers of mortgages and financial products based on mortgages, to the broker-dealers and investment banks that traded in these products.[175] The type of defendant was not particularly predictive of the outcome of the motion to dismiss: for example, loan originators, who were the defendants in seventeen of the thirty-four decisions, succeeded in dismissing the 10b-5 claims against them in seven cases.[176] The majority of the decisions came from district courts in the Second and Ninth Circuits, which accounted for thirteen and nine of the decisions surveyed by this Note, respectively.[177] In this sampling, plaintiffs in the Second Circuit fared particularly well, surviving motions to dismiss in ten of thirteen cases.[178] The relatively small number of decisions discussed here, however, should caution against concluding that the Circuit in which the claim was brought was determinative of the outcome.

Rather, the question of whether or not the plaintiff adequately alleged scienter was dispositive in almost every case. One early examination of securities class actions in the wake of the financial collapse indicated that scienter was a "perfect predictor" of the outcome of motions to dismiss subprime securities suits.[179] This trend is apparent in the cases surveyed by this Note. Only one decision that found a plaintiff's scienter allegations sufficient went on to dismiss that case.[180] The importance of scienter is further underscored by the three cases in which the 10b-5 claims were dismissed but '33 Act claims were permitted to proceed: unlike 10b-5, actions under the '33 Act do not require scienter allegations.[181]

172. *See, e.g.*, *In re* Bear Stearns Cos. Sec., Derivative & ERISA Litig., 763 F. Supp. 2d 423 (S.D.N.Y. 2011); *Citigroup*, 753 F. Supp. 2d at 236–38; *In re* Regions Morgan Keegan Sec., Derivative & ERISA Litig., 743 F. Supp. 2d 744, 759–62 (W.D. Tenn. 2010) (dismissing 10b-5 claims but allowing other claims to proceed); Plumbers & Steamfitters Local 773 Pension Fund v. Can. Imperial Bank of Commerce, 694 F. Supp. 2d 287 (S.D.N.Y. 2010) (granting dismissal); Cornwell v. Credit Suisse Grp., 689 F. Supp. 2d 629 (S.D.N.Y. 2010) (denying dismissal); *In re* Huntington Bancshares, Inc. Sec. Litig., 674 F. Supp. 2d 951 (S.D. Ohio 2009) (granting dismissal); *In re* Moneygram Int'l, Inc. Sec. Litig., 626 F. Supp. 2d 947 (D. Minn. 2009) (denying dismissal).

173. *See, e.g.*, *In re* Fannie Mae 2008 Sec. Litig., 742 F. Supp. 2d 382 (S.D.N.Y. 2010).

174. *In re* Moody's Corp. Sec. Litig., 599 F. Supp. 2d 493 (S.D.N.Y. 2009).

175. *See* Table I.

176. *See id.*

177. *See id.*

178. *See id.*

179. Jonathan Eisenberg, *Subprime Securities Class Action Decisions: Who's Winning, Who's Losing and Why?*, 3 BLOOMBERG L. REP. CLASS ACTIONS, no. 1, 2010, *available at* http://www.skadden.com/content/Publications/Publications1962_0.pdf.

180. *See In re* Sec. Capital Assurance, Ltd. Sec. Litig., 729 F. Supp. 2d 569, 598–602 (S.D.N.Y. 2010) (finding misstatements made with scienter actionable but dismissing for failure to plead loss causation).

181. *See In re* Wachovia Equity Sec. Litig., 753 F. Supp. 2d 326, 366–78 (S.D.N.Y. 2011); *In re* Regions Morgan Keegan Sec., Derivative & ERISA Litig., 743 F. Supp. 2d 744,

Because properly alleging scienter has proved the biggest hurdle for plaintiffs in surviving motions to dismiss, an inquiry into the types of allegations that have been held to provide the required "strong inference" of scienter and those that have been held insufficient is warranted. The reader should bear in mind in the following discussion, however, that under *Tellabs* a district court must "consider the complaint in its entirety" in determining whether a strong inference of scienter is pleaded.[182] Thus no one type of fact or conduct alleged is by itself dispositive of scienter; rather, it is the combination of the totality of the allegations and circumstances that determines the outcome.

1. Confidential Witnesses

Plaintiffs in subprime securities suits have relied to a great extent on the testimony of confidential witnesses. Of the thirty-four decisions surveyed, all but three utilized confidential witnesses to support the plaintiff's scienter allegations.[183] The only suit that did not use confidential witnesses and survived motion practice was *In re Moody's Corporation Securities Litigation*.[184] There the plaintiffs had the luxury of relying upon transcripts from congressional hearings that included internal documents indicating that Moody's executives were aware of problems in the independence of their ratings.[185] In fact, in dismissing the complaint in *Canadian Imperial Bank of Commerce*,[186] the district court specifically noted the absence of confidential sources.[187]

With thirty-one of thirty-four decisions involving confidential witnesses, it is clear that they play a crucial role in subprime securities suits. With 10b-5 claims in twelve of these cases nevertheless dismissed, it is also clear that confidential witness statements do not ensure that a complaint will survive. Where the confidential witness statements failed to show what the defendants knew or how the confidential witnesses knew what the defendants knew, the courts dismissed the fraud claims. For example, in *New York State Teachers' Retirement Systems v. Fremont General Corp.*,[188] the statements of forty-two confidential witnesses concerning exceptions to underwriting standards were found insufficient to allege

759–62 (W.D. Tenn. 2010); Local 295/Local 851 IBT Emp'r Grp. Pension Trust & Welfare Fund v. Fifth Third Bancorp, 731 F. Supp. 2d 689, 704 (S.D. Ohio 2010).

182. Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 323 (2007). For a discussion of *Tellabs*, see *supra* notes 128–37 and accompanying text.

183. The three that did not mention confidential witnesses in the opinion or complaint are: *In re Regions Morgan Keegan*, 743 F. Supp. 2d 744 (dismissing 10b-5 claims but allowing Section 11 claims to proceed); Plumbers & Steamfitters Local 773 Pension Fund v. Can. Imperial Bank of Commerce, 694 F. Supp. 2d 287 (S.D.N.Y. 2010) (granting motion to dismiss); *In re* Moody's Corp. Sec. Litig., 599 F. Supp. 2d 493 (S.D.N.Y. 2009) (denying motion to dismiss).

184. 599 F. Supp. 2d 493.

185. *See id.* at 504, 515–17.

186. 694 F. Supp. 2d 287 (S.D.N.Y. 2010).

187. *See id.* at 299.

188. 07-cv-5756, 2009 WL 3112574 (C.D. Cal. Sept. 25, 2009).

scienter, because "the allegations do not establish that any of the confidential witnesses were in a position to gain personal knowledge of what Defendants saw, knew, or thought."[189] Similarly, the *In re Wachovia Equity Securities Litigation*[190] court rejected evidence from confidential witnesses where there was "no allegation that any [confidential witness] met the Individual Defendants, reported any concerns, received any instructions, or made any personal contact with them during the Class Period."[191]

Where plaintiffs describe confidential witnesses' positions in the company with particularity, however, their statements detailing knowledge of facts inconsistent with the company's public statements may show scienter. The success of the plaintiffs in *Hubbard v. BankAtlantic Bancorp, Inc.*[192] on their second complaint is one example—where initially the court rejected the confidential witness statements because of a lack of "specific information as to the confidential witnesses' positions in the Company, their employment duties, the foundation or basis for their knowledge,"[193] the court later concluded that the amended complaint fixed these deficiencies.[194] *In re PMI Group, Inc. Securities Litigation*[195] provides a similar example: initially, the court found inadequate a confidential witness statement that he prepared reports describing non-performing assets that PMI continued to insure, because the complaint did not describe the reports in detail, and also rejected a statement that PMI's exposure to bad loans was "widely recognized," because the complaint did not explain how the witness would know what was "widely recognized" at the company.[196] The court later held that the plaintiffs sufficiently alleged scienter in their amended complaint, where the confidential witness statements described the reports with more specificity, and new confidential witness statements specifically described the defendants' awareness of these reports.[197]

The reliance of plaintiffs on confidential witness statements comes in the midst of some uncertainty over what weight the statements of confidential sources should be afforded after *Tellabs*. Subsequent to *Tellabs*, the Seventh Circuit held that allegations from confidential witnesses must be discounted, because "[i]t is hard to see how information from anonymous sources could be deemed 'compelling' or how we could take account of

189. *Id.* at *11.

190. 753 F. Supp. 2d 326 (S.D.N.Y. 2011).

191. *Id*. at 352.

192. Hubbard v. BankAtlantic Bancorp, Inc., 625 F. Supp. 2d 1267 (S.D. Fla. 2008).

193. *Id.* at 1284. *See generally* Eisenberg, *supra* note 179.

194. Hubbard v. BankAtlantic Bancorp, Inc., No. 07-61542-Civ, 2009 WL 3261941, at *1 (S.D. Fla. May 12, 2009) ("In contrast, the Amended Complaint contains sufficient information regarding these confidential witnesses, including their employment duties, whether they were employed during the Class Period and how they obtained direct knowledge of the facts they were reporting."). The plaintiffs later won a jury verdict in their favor at trial. *See supra* note 163 and accompanying text.

195. No. C08-1405, 2009 WL 1916934 (N.D. Cal. July 1, 2009) (*PMI I*).

196. *See id.* at *8–9. *See generally* Eisenberg, *supra* note 179.

197. *In re* PMI Grp., Inc. Sec. Litig., No. C08-1405, 2009 WL 3681669, at *3 (N.D. Cal. Nov. 2, 2009).

plausible opposing inferences. Perhaps these confidential sources have axes to grind. Perhaps they are lying. Perhaps they don't even exist."[198] The Fifth Circuit has agreed,[199] while the Third[200] and the Eleventh[201] Circuits have issued opinions holding that anonymity itself does not undermine confidential witness statements so long as the basis of the source's knowledge is described with particularity. In the opinions surveyed by this Note, two district courts in the Southern District of New York[202] and one in the District of New Mexico[203] expressly noted this disagreement; absent guidance from their respective circuits to the contrary, each weighed whether sufficient detail was provided about the confidential source's basis of knowledge. The other opinions surveyed did not directly consider this burgeoning "split" in the circuits.

2. Position-Based Inferences

In twenty-seven of the thirty-four decisions examined in this Note—fifteen denials[204] and twelve grants[205] of motions to dismiss—plaintiffs

198. Higginbotham v. Baxter Int'l, Inc., 495 F.3d 753, 757 (7th Cir. 2007).

199. *See* Ind. Elec. Workers' Pension Trust Fund IBEW v. Shaw Grp., Inc., 537 F.3d 527, 535 (5th Cir. 2008) ("Following *Tellabs*, courts must discount allegations from confidential sources. Such sources afford no basis for drawing the plausible competing inferences required by *Tellabs*.") (citations omitted).

200. *See* Inst. Investors Grp. v. Avaya, Inc., 564 F.3d 242, 263 (3d Cir. 2009).

201. *See* Mizzaro v. Home Depot, Inc., 544 F.3d 1230, 1240 (11th Cir. 2008).

202. *See In re* MBIA, Inc. Sec. Litig., 700 F. Supp. 2d 566, 590 n.16 (S.D.N.Y. 2010); *In re* Ambac Fin. Grp., Inc. Sec. Litig., 693 F. Supp. 2d 241, 267 n.31 (S.D.N.Y. 2010).

203. *See In re* Thornburg Mortg., Inc. Sec. Litig., 695 F. Supp. 2d 1165, 1177 n.11 (D.N.M. 2010).

204. Local 703, I.B. of T. Grocery and Food Emp.'s Welfare Fund v. Regions Fin. Corp., CV: 10-2847, 2011 U.S. Dist. LEXIS 60761, at *27–30 (N.D. Ala. June 7, 2011); *In re* Citigroup, Inc. Sec. Litig., 753 F. Supp. 2d 206, 236–40 (S.D.N.Y. 2010); *In re* Am. Int'l Grp., Inc. 2008 Sec. Litig., 741 F. Supp. 2d 511, 533–34 (S.D.N.Y. 2010); Freudenberg v. E*Trade Fin. Corp., 712 F. Supp. 2d 171, 199 (S.D.N.Y. 2010); *In re MBIA*, 700 F. Supp. 2d at 588; *Ambac*, 693 F. Supp. 2d at 268–69; Cornwell v. Credit Suisse Grp., 689 F. Supp. 2d 629, 637–38 (S.D.N.Y. 2010); *In re Thornburg*, 695 F. Supp. 2d 1210–11; *In re* PMI Grp., Inc. Sec. Litig., No. C08-1405, 2009 WL 3681669, at *2–3 (N.D. Cal. Nov. 2, 2009); *In re* Wash. Mut., Inc., Sec., Derivative & ERISA Litig., 694 F. Supp. 2d 1192, 1209–20 (W.D. Wash. 2009); Hubbard v. BankAtlantic Bancorp, Inc., No. 07-61542-Civ, 2009 WL 3261941, at *1–3 (S.D. Fla. May 12, 2009); *In re* RAIT Fin. Trust Sec. Litig., 07-CV-03148, 2008 WL 5378164, at *12–13 (E.D. Pa. Dec. 22, 2008); *In re* New Century, 588 F. Supp. 2d 1206, 1229–31 (C.D. Cal. 2008); *In re* Countrywide Fin. Corp. Sec. Litig., 588 F. Supp. 2d 1132, 1189–96 (C.D. Cal. 2008); Atlas v. Accredited Home Lenders Holding Co., 556 F. Supp. 2d 1142, 1156–57 (S.D. Cal. 2008).

205. *In re* Wachovia Equity Sec. Litig., 753 F. Supp. 2d 326, 352–54 (S.D.N.Y. 2011); *In re* Regions Morgan Keegan Sec., Derivative & ERISA Litig., 743 F. Supp. 2d 744, 757–58 (W.D. Tenn. 2010); Local 295/Local 851 IBT Emp'r Grp. Pension Trust & Welfare Fund v. Fifth Third Bancorp, 731 F. Supp. 2d 689, 725–27 (S.D. Ohio 2010); *In re* Radian Sec. Litig., No. 07-3375, 2010 WL 1767195, at *4–5 (E.D. Pa. Apr. 30, 2010); *In re* Sec. Capital Assurance, Ltd. Sec. Litig., 729 F. Supp. 2d 569, 595 (S.D.N.Y. 2010); Plumbers & Steamfitters Local 773 Pension Fund v. Can. Imperial Bank of Commerce, 694 F. Supp. 2d 287, 299–300 (S.D.N.Y. 2010); *In re* Huntington Bancshares, Inc. Sec. Litig., 674 F. Supp. 2d 951, 970–71 (S.D. Ohio 2009); N.Y. State Teachers' Ret. Sys. v. Fremont Gen. Corp., 07-cv-5756, 2009 WL 3112574, at *10–11 (C.D. Cal. Sept. 25, 2009); *In re* Downey Sec. Litig., No. CV 08-3261, 2009 WL 2767670, at *9–11 (C.D. Cal. Aug. 21, 2009); Pittleman

sought to support their scienter allegations by attempting to attribute knowledge to senior officers at least in part by their positions in the corporation. Construed broadly, "position-based inferences" might include a plaintiff's attempts to attribute knowledge of, or recklessness to, false and misleading misstatements by pointing to the defendant's high rank, membership on committees, receipt of internal reports, or allegations of widespread internal knowledge at the corporation of which the defendants could not possibly be unaware.

One should not, however, simply look at the above tally of wins and losses and conclude that position-based inferences are a path to success for plaintiffs in surviving a motion to dismiss. On the contrary, those courts concluding that a plaintiff's scienter allegations rested solely on the high rank of the defendants did not hesitate to dismiss the complaint.[206] Similarly, mere attendance at meetings, even where adverse financial results were discussed, is insufficient.[207] Instead, the cases reveal that plaintiffs generally do not allege a strong inference of scienter by merely alleging that defendants had access to information because of their high rank; a more particularized showing of what information the defendants possessed is required. As one district court observed in dismissing the 10b-5 claims against Fifth Third Bancorp, "[t]here are no factual allegations, however, that Defendants actually read or reviewed information available . . . . Since the complaint relies entirely on Defendants' mere access to financial data, these allegations fail to support a strong inference of scienter."[208]

A good example of this requirement can be found in *Hubbard v. BankAtlantic Bancorp, Inc.*[209] Initially, the court granted the motion to dismiss, finding that allegations that defendants regularly received reports on exceptions to underwriting guidelines did not indicate "what these Defendants knew or should have known about the Company's lending practices . . . because there is no information about what the Exception Reports actually contained during that time."[210] The fact that the defendants sat on a major loan committee "may demonstrate negligence as to their monitoring of the Company's lending practices," but did not rise to the showing of recklessness required to demonstrate scienter.[211]

v. Impac Mortg. Holdings, Inc., No. SACV 07-0970, 2009 WL 648983, at *3 (C.D. Cal. Mar. 9, 2009), *aff'd sub nom.* Sharenow v. Impac Mortg. Holdings, Inc., 385 F. App'x 714 (9th Cir. 2010); *In re* 2007 Novastar Fin., Inc. Sec. Litig., 07-0139-CV, 2008 WL 2354367, at *4 (W.D. Mo. June 4, 2008), *aff'd*, 579 F.3d 878 (8th Cir. 2009); Tripp v. Indymac Fin., Inc., No. CV 07-1635, 2007 WL 4591930, at *4–5 (C.D. Cal. Nov. 29, 2007).

206. *See Fifth Third Bancorp*, 731 F. Supp. 2d at 725–27; *In re Sec. Capital Assurance*, 729 F. Supp. 2d at 595; *Can. Imperial Bank of Commerce*, 694 F. Supp. 2d at 299; *In re Huntington Bancshares*, 674 F. Supp. 2d at 971; *Fremont Gen. Corp.*, 2009 WL 3112574, at *14; *In re* Radian Sec. Litig., 612 F. Supp. 2d 594, 616 (E.D. Pa. 2009); *In re* Downey Sec. Litig., No. CV 08-3261, 2009 WL 736802, at *9 (C.D. Cal. Mar. 18, 2009).

207. *See, e.g.*, *In re Novastar*, 07-0139-CV, 2008 WL 2354367, at *4.

208. *Fifth Third Bancorp*, 731 F. Supp. 2d at 726.

209. 625 F. Supp. 2d 1267, 1287 (S.D. Fla. 2008) (*BankAtlantic I*).

210. *Id.*; *see supra* notes 193–94 and accompanying text.

211. *BankAtlantic I*, 625 F. Supp. 2d at 1287.

The plaintiff's amended complaint, however, survived the defendant's renewed motion to dismiss.[212] Where previously the plaintiff relied upon the defendants' high rank to infer their knowledge of risky loans, the amended complaint used confidential witnesses to put forth particularized allegations of the duties and responsibilities of the defendants at the company.[213] For example, instead of alleging that the Chief Financial Officer "must have known" of the company's inadequate loan loss reserves, the amended complaint alleged that the CFO was "responsible for determining, reviewing and monitoring loan loss reserves."[214] The amended complaint also contained particularized facts about the information contained in the exception reports, and specifically described meetings attended by the defendants at which these reports were circulated as agenda items.[215]

As with the use of confidential witnesses,[216] resolution of the plaintiffs' arguments centering on the defendants' positions at the company at the district court level touches upon an issue of some disagreement between the circuits. An alternative route for pleading scienter is the "core operations inference." In a nutshell, the "core operations inference" means "that knowledge of core activities of a business may be imputed to its highest officials in some circumstances."[217] The Third, Seventh, and Ninth Circuits have expressed willingness to consider the core operations inference.[218] Other circuits have not directly considered arguments related to a company's core business, but decisions from the Fifth and Eighth Circuits declining to impute knowledge to management based on the magnitude or nature of the alleged fraud indicate that these circuits might be reluctant to accept it.[219]

212. Hubbard v. BankAtlantic Bancorp, Inc. (*BankAtlantic II*), No. 07-61542-Civ, 2009 WL 3261941, at *1 (S.D. Fla. May 12, 2009).

213. *See id.* at *3; *see also supra* notes 193–94 and accompanying text.

214. *Id.* at *3 n.6.

215. *See id.* at *1–2 & n.4.

216. *See supra* notes 198–201 and accompanying text.

217. *In re* RAIT Fin. Trust Sec. Litig., No. 2:07-CV-03148, 2008 WL 5378164, at *12 (E.D. Pa. Dec. 22, 2008) (emphasis omitted); *see also* Bruce D. Angiolillo, *Establishing Scienter in Securities Fraud Actions Through Imputation of Knowledge*, *in* 42ND ANNUAL INSTITUTE ON SECURITIES REGULATION 325, 329 (PLI Corporate Law & Practice Course Handbook Ser., No. 24008, 2010), *available at* Westlaw, 1850 PLI/Corp 325; Gregory A. Markel & Martin L. Seidel, '*Core Operations' Doctrine May Undermine PSLRA*, N.Y. L.J., Apr. 29, 2010, *available at* http://www.cadwalader.com/assets/article/042910MarkelSeidelNYLJ.pdf.

218. *See* Inst. Investors Grp. v. Avaya, Inc., 564 F.3d 242, 269 (3d Cir. 2009) (considering the core operations inference as part of the totality of circumstances indicative of scienter); Zucco Partners, LLC v. Digimarc Corp., 552 F.3d 981, 1001 (9th Cir. 2009) (holding that scienter may be inferred from an officer's position alone when the falsity of the information is "patently obvious—where the facts [are] prominent enough that it would be absurd to suggest that top management was unaware of them") (internal quotations omitted); Makor Issues & Rights, Ltd. v. Tellabs Inc., 513 F.3d 702, 709 (7th Cir. 2008) (imputing knowledge of the lack of demand for the company's two most important products to its top senior management).

219. *See* Elam v. Neidorff, 544 F.3d 921, 929 (8th Cir. 2008) (declining to rule whether the core operations inference is viable, but rejecting plaintiffs' scienter allegations for failing

Nine of the district court decisions surveyed by this Note explicitly discussed the "core operations inference," with five denying[220] and four granting[221] the motions to dismiss. Unsurprisingly, all but three of these decisions have come from the Third or Ninth Circuits, which have expressly endorsed the core operations inference subsequent to *Tellabs*. The decisions suggest, however, a reluctance to find scienter based solely on the core operations inference. Indeed, in *PMI I*, the original complaint was dismissed when it attempted to rely on the core operations inference; it was only upon repleading, with further factual allegations from confidential witnesses, that plaintiffs were able to survive the 12(b)(6) motion to dismiss.[222] Similarly, in *Pittleman v. Impac Mortgage Holdings, Inc.*,[223] the court held that the plaintiff's factual allegations were insufficient to give rise to the "exceedingly rare" circumstance that would permit an inference of scienter solely from the fact that the alleged misstatements involved the defendant's core business.[224] In two other dismissals, *In re Huntington Bancshares, Inc. Securities Litigation*[225] and *In re Radian Securities Litigation*,[226] the courts both held that the plaintiffs' factual allegations were insufficient, and that the business activities in question were not actually "core operations" of the defendants.[227]

Moreover, even in *In re Countrywide Financial Corp. Securities Litigation*,[228] the decision that relied most heavily on the core operations inference to deny dismissal, the court emphasized that "position alone

to allege sufficient facts indicating knowledge at the company); Ind. Elec. Workers' Pension Trust Fund IBEW v. Shaw Grp. Inc., 537 F.3d 527, 535–36, 539–40 (5th Cir. 2008) (reversing district court's denial of motion to dismiss and declining to impute knowledge to management based on "massive" size of accounting irregularities and defendants' "hands-on" management style).

220. Freudenberg v. E*Trade Fin. Corp., 712 F. Supp. 2d 171, 201 (S.D.N.Y. 2010); *PMI I*, No. C08-1405, 2009 WL 1916934, at *9–10 (N.D. Cal. July 1, 2009); *In re RAIT*, 07-CV-03148, 2008 WL 5378164, at *12; *In re* New Century, 588 F. Supp. 2d 1206, 1227–29 (C.D. Cal. 2008); *In re* Countrywide Fin. Corp. Sec. Litig., 588 F. Supp. 2d 1132, 1189–90 (C.D. Cal. 2008).

221. *In re* Wachovia Equity Sec. Litig., 753 F. Supp. 2d 326, 352–53 (S.D.N.Y. 2011); *In re* Huntington Bancshares, Inc. Sec. Litig., 674 F. Supp. 2d 951, 970, 975–76 (S.D. Ohio 2009); *In re* Radian Sec. Litig., 612 F. Supp. 2d 594, 616 (E.D. Pa. 2009); Pittleman v. Impac Mortg. Holdings, Inc., No. SACV 07-0970, 2009 WL 648983, at *3 (C.D. Cal. Mar. 9, 2009), *aff'd sub nom.* Sharenow v. Impac Mortg. Holdings, Inc., 385 F. App'x 714 (9th Cir. 2010).

222. *See PMI I*, 2009 WL 1916934, at *9–10; *In re* PMI Grp., Inc., Sec. Litig., No. C08-1405, 2009 WL 3681669, at *2–3 (N.D. Cal. Nov. 2, 2009).

223. 2009 WL 648983.

224. *Id.* at *3.

225. 674 F. Supp. 2d 951.

226. 612 F. Supp. 2d 594.

227. *Id.* at 617–18 (holding that the complaint only established "that Radian's financial services segment as a whole [as opposed to the subsidiary whose operations were at issue] constituted 28% of Radian's net income in 2006, and 11% of its equity") (emphasis omitted); *Huntington Bancshares*, 674 F. Supp. 2d at 970 (noting that the operations at issue accounted for "just 3.9 percent of Huntington's total loans and leases and just 2.8 percent of Huntington's total assets, hardly bringing it into the territory of Huntington's core operations").

228. 588 F. Supp. 2d 1132 (C.D. Cal. 2008).

creates a strong inference of scienter only in the extraordinary case where it is 'absurd to suggest' that a defendant did not know."[229] The scienter allegations in that case were supported with confidential witnesses, who described underwriting problems at Countrywide of such breadth that if "the highly particularized allegations about Countrywide's core business operations give even a rough sketch" of Countrywide's business practices, many of the defendants' statements about those practices may well have been fraudulent.[230] Similarly, though the *In re RAIT Financial Trust Securities Litigation*[231] court found that the alleged misstatements about RAIT's underwriting standards had to do with the company's core business operations, it was also influenced by corroborating testimony of confidential witnesses indicating that the defendants had ample reason to know of the falsity of their statements.[232]

Two decisions included in this survey from the Southern District of New York are of particular note, as the Second Circuit has not endorsed the core operations inference subsequent to the passage of the PSLRA in 1995.[233] The *In re Wachovia Equity Securities Litigation*[234] court noted that the seminal core operations decision from the Second Circuit predated the PSLRA by six years.[235] After examining recent decisions in the district and concluding that those courts varied on the issue, the court "venture[d] to suggest that the future of the doctrine may be tenuous" and held that it would consider "'core operations' allegations to constitute supplementary but not independently sufficient means to plead scienter."[236] Meanwhile, the court in *Freudenberg v. E*Trade Financial Corp.*[237] accepted the core operations inference.[238] Citing the Seventh Circuit's decision in *Makor* and two pre-*Tellabs* decisions from the Southern District of New York, the *E*Trade* court found that the magnitude of E*Trade's mortgage business (and subsequent write-offs thereof) relative to its overall business operations made the inference of scienter compelling for misstatements about its underwriting practices.[239] The scienter allegations in *E*Trade* were buttressed, however, by sixteen confidential witnesses pointing to specific meetings and reports, serious accounting violations, and indications of insider trading.[240] Thus the *E*Trade* decision may be unusual only insofar as it explicitly applied the core operations label; for example, in another Southern District of New York case surveyed for this Note, *In re MBIA, Inc. Securities Litigation*,[241] the district court cited as evidence of

229. *Id.* at 1191.
230. *Id.* at 1192.
231. 07-cv-03148, 2008 WL 5378164 (E.D. Pa. Dec. 22, 2008).
232. *Id.* at *13–14.
233. *See supra* Part I.B.3.
234. 753 F. Supp. 2d 326 (S.D.N.Y. 2011).
235. *Id.* at 352–53 (citing Cosmas v. Hassett, 886 F.2d 8, 13 (2d Cir. 1989)).
236. *Id.*
237. 712 F. Supp. 2d 171 (S.D.N.Y. 2010).
238. *Id.* at 199.
239. *Id.*
240. *See id.* at 196–201.
241. 700 F. Supp. 2d 566 (S.D.N.Y. 2010).

scienter the importance of MBIA's credit rating to its business, and the importance of residential MBS (RMBS) to maintaining that credit rating.[242]

III. A FINANCIAL CRISIS DEFENSE?

This part examines the ways in which the financial crisis itself has played a role in the dispositions of motions to dismiss. First, it discusses the role the crisis has played in pleading scienter. Second, this part discusses the effect of the crisis on pleading loss causation.

A. Scienter

In *Tellabs*, the Supreme Court held that a court should weigh the inference of fraud against alternative "cogent and compelling" explanations when determining whether a complaint adequately alleges scienter.[243] A court may also consider matters amenable to judicial notice.[244] It is therefore not surprising that many defendants have sought to attribute shareholder losses to the financial crisis, accusing plaintiffs of pleading fraud by hindsight.[245] At the same time, plaintiffs have attempted to use the crisis offensively, alleging that the defendant's knowledge of the growing crisis rendered their public statements fraudulent. Indeed, in affirming the dismissal of claims against Impac Mortgage Holdings, the Ninth Circuit noted that both parties agreed that the court should take judicial notice of the financial crisis, but for opposite purposes.[246]

1. Grants of Motions to Dismiss

In *Plumbers and Steamfitters Local 773 Pension Fund v. Canadian Imperial Bank of Commerce*,[247] the plaintiffs alleged that the defendants misled investors about their exposure to the growing subprime mortgage crisis.[248] Both parties attempted to use the financial crisis to aid them in the motion to dismiss: plaintiffs argued that the defendants "knew or should have known of the deteriorating market situation."[249] The defendants, meanwhile, referenced twenty-one exhibits, internet sources, and news articles about the financial crisis in their motion to dismiss.[250] Although

242. *Id.* at 593 & n.19 (citing *In re* IMAX Sec. Litig., 587 F. Supp. 2d 471, 473–75, 479 (S.D.N.Y. 2008) (applying core operations inference)).

243. *See* Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 323–24 (2007); *supra* notes 131–35 and accompanying text.

244. *See Tellabs*, 551 U.S. at 322.

245. *See supra* notes 140–47 and accompanying text.

246. *See* Sharenow v. Impac Mortg. Holdings, Inc., 385 F. App'x 714, 716 n.1 (9th Cir. 2010). The court declined to resolve the issue of whether it should take judicial notice of the financial crisis or its causes, as it held that plaintiffs had not adequately alleged scienter regardless of the economic downturn. *Id.*

247. 694 F. Supp. 2d 287 (S.D.N.Y. 2010).

248. *See id.* at 292.

249. *See id.* at 296.

250. *See id.* at 297 n.2; Memorandum of Law in Support of Defendants' Motion to Dismiss the Consolidated Amended Complaint at 1–4, Plumbers & Steamfitters Local 773

the court declined to consider the defendants' exhibits "except to the limited extent that they inform the competing inference analysis required by [*Tellabs*]," it took judicial notice of the financial crisis.[251] The court rejected the plaintiff's arguments, holding that even if the defendants had notice of the crisis, "knowledge of a general economic trend does not equate to harboring a mental state to deceive, manipulate, or defraud."[252] Under the *Tellabs* comparative inquiry, the inference of fraudulent intent was less compelling than the inference that the bank chose an incremental response in the face of "an unprecedented paralysis of the credit market and a global recession."[253]

Defendants in other cases have had success using the financial crisis as a defense to scienter. *In re Radian Securities Litigation*[254] is one example. There, plaintiffs alleged that defendants downplayed liquidity problems at a subsidiary that securitized subprime mortgages, misleading investors who were harmed when the revelation of the truth caused the share price to fall.[255] To support their scienter allegations, plaintiffs argued, among other things, that the adverse trends in the subprime industry should have put the defendants on notice that their statements would mislead investors.[256] The court rejected this argument, stating that the plaintiffs' allegations concerning the general state of the subprime industry did not constitute evidence that the defendants must have known that their actions posed a risk of misleading investors.[257] The court went further, suggesting that scienter is more difficult to demonstrate in the wake of the financial crisis. It cited the Second Circuit's "marketwide phenomenon" language from *First Nationwide Bank v. Gelt Funding Corp.* in stating that "attempts to hold defendants responsible for market forces out of their control—and outside of their realm of prediction—cannot succeed."[258]

2. Denials of Motions to Dismiss

Some courts have accepted plaintiffs' arguments that the knowledge of the financial crisis itself should be indicative of scienter. One particularly noteworthy example is the *In re Thornburg Mortgage, Inc. Securities Litigation*[259] decision denying dismissal of 10b-5 claims against

Pension Fund v. Can. Imperial Bank of Commerce, 694 F. Supp. 2d 287 (S.D.N.Y. 2010) (No. 08 CV 8143), 2009 WL 2043588.

251. *See Can. Imperial Bank of Commerce*, 694 F. Supp. 2d at 297 n.2.

252. *Id.* at 300. This language was subsequently cited in *In re* Sec. Capital Assurance, Ltd. Sec. Litig., 729 F. Supp. 2d 569, 596 (S.D.N.Y. 2010).

253. *Can. Imperial Bank of Commerce*, 694 F. Supp. 2d at 301; *see also In re* Wachovia Equity Sec. Litig., 753 F. Supp. 2d 326, 367 (S.D.N.Y. 2011) ("The more compelling inference . . . is that Defendants simply did not anticipate the full extent of the mortgage crisis. . . . Although a colossal blunder with grave consequences for many, such a failure is simply not enough to support a claim for securities fraud.").

254. 612 F. Supp. 2d 594 (E.D. Pa. 2009) (*Radian I*).

255. *Id.* at 606.

256. *See id.* at 617.

257. *Id.* at 619.

258. *See id.* at 620 n.25; *see also supra* notes 120–26 and accompanying text.

259. 695 F. Supp. 2d 1165 (D.N.M. 2010).

Thornburg's President and Chief Operating Officer.[260] The plaintiffs alleged that the defendants tried to conceal the company's financial woes from investors; the defendants, meanwhile, argued that the losses were caused by market forces beyond the control or prediction of the company's leadership.[261] In rejecting the defendants' arguments that insider purchases of Thornburg's stock by insiders during the class period undermined the inference of scienter, the court held that a desire to survive the mortgage meltdown might provide a motive for the defendants to make misleading statements.[262] This motivation alone was not enough to allege scienter—also important was confidential witness testimony that the President was so "deeply involved" in Thornburg's operations that he knew of Thornburg's exposure[263]—but the crisis itself was a factor contributing to the "mounting image of [Thornburg] as a company trying to shield its weakening infrastructure from the prying eyes of its investors."[264]

Two other cases, *In re MoneyGram International, Inc. Securities Litigation*[265] and *In re Citigroup, Inc. Securities Litigation*,[266] indicate that courts are more likely to accept allegations that defendants had knowledge of the brewing financial collapse when they are coupled with allegations of questionable internal practices. In *MoneyGram*, the plaintiffs cited external market indicators—including the decline in the market for MBS and ABSs, rating agency downgrades, and bankruptcies of subprime lenders—as evidence that the defendants should have been aware that their statements about the risks of the company's subprime portfolio were misleading.[267] As in *Thornburg*, these financial crisis allegations alone were not enough, but combined with suspicious violations of internal controls by *MoneyGram*, particularly in keeping its accounting ledger open throughout the class period, the court was persuaded that the plaintiff's narrative of scienter was at least as compelling as the defendants' competing narrative of unforeseeable market collapse.[268] Similarly, in *Citigroup*, the court was persuaded by the plaintiff's allegations that Citigroup took significant internal steps to mitigate the risks of its CDO portfolio while publicly proclaiming the portfolio's soundness.[269]

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260. *Id.* at 1225.
261. *See id.* at 1192.
262. *See id.* at 1194. The court stated:

> The economy in 2007 and early 2008 was a ferocious beast that devoured many mortgage lending companies. . . . [The Court could infer that] especially during the mortgage crisis period, the Thornburg Defendants—many of whom were already holders of a substantial interest in TMI and whose careers were intertwined with it—sought to infuse TMI with more cash in hopes of increasing public confidence and giving TMI the capital it needed to ride out the crisis.

Id.

263. *Id.* at 1211.
264. *Id.*
265. 626 F. Supp. 2d 947 (D. Minn. 2009).
266. 753 F. Supp. 2d 206 (S.D.N.Y. 2010).
267. *See Moneygram*, 626 F. Supp. 2d at 981–82.
268. *See id.* at 974, 982–83.
269. *See Citigroup*, 753 F. Supp. 2d at 237–38.

Some courts have also rejected efforts to use the financial crisis defensively. In *In re Ambac Financial Group, Inc. Securities Litigation*,[270] the court rejected the defendants' arguments that "[i]n light of the broader financial picture . . . the more compelling inference is that Ambac's officers could not predict the economic collapse and consequently the company's modeling tools failed to value accurately the risk of loss underlying its CDO portfolio."[271] While the defendants presented one inference that could be drawn from the facts alleged, the court also considered the plaintiff's narrative, which portrayed a "vast gap" between the way Ambac publicly portrayed itself as a company that had retained its conservative underwriting standards, and its undisclosed lowering of those standards.[272] The court went so far as to state that Ambac's arguments were "premised on a convenient confusion of cause and effect. The conduct that plaintiffs allege, if true, would make Ambac an active participant in the collapse of their own business, and of the financial markets in general, rather than merely a passive victim."[273] This language was subsequently cited in rejecting similar arguments for dismissal in the suit brought against Bear Stearns.[274]

B. Loss Causation

Scienter has been the major hurdle for plaintiffs in financial crisis-related suits under section 10b and Rule 10b-5: in the cases examined, only one court that found the plaintiff's scienter allegations sufficient ultimately dismissed the complaint for failure to plead loss causation.[275] This dearth of dispositions on loss causation grounds is not for a lack of effort on the part of defendants. Defendants in sixteen of the decisions surveyed cited the "marketwide phenomenon" language[276] from *Gelt* and *Lentell* in their motion to challenge plaintiffs' loss causation allegations in light of the financial crisis.[277] In ten decisions, these arguments were rejected and the

270. 693 F. Supp. 2d 241 (S.D.N.Y. 2010).
271. *Id.* at 269.
272. *See id.*
273. *Id.* at 270. Similar language can be found in other decisions denying motions to dismiss. *See, e.g.*, Freudenberg v. E*Trade Fin. Corp., 712 F. Supp. 2d 171, 192 (S.D.N.Y. 2010) ("The 'current financial crisis' is not necessarily an absolute defense if it is alleged that defendants have misled the public as to the quality of their holdings.").
274. *See In re* Bear Stearns Cos. Sec., Derivative & ERISA Litig., 763 F. Supp. 2d 423, 504–05 (S.D.N.Y. 2011).
275. *See supra* notes 179–80 and accompanying text.
276. *See supra* notes 120–26 and accompanying text for discussion of this passage.
277. *See In re Bear Stearns*, 763 F. Supp. 2d at 506–08; *Radian I*, 612 F. Supp. 2d 594, 619 n.25 (E.D. Pa. 2009); Memorandum of Law in Support of Defendant's Motion to Dismiss the Amended Complaint at 24, Local 703, I.B. of T. Grocery and Food Emp.'s Welfare Fund v. Regions Fin. Corp., 2011 U.S. Dist. LEXIS 60761 (N.D. Ala. June 7, 2011) (CV: 10-2847), 2011 U.S. Dist. Ct. Motions LEXIS 2167; Consolidated Memorandum of Law in Support of the Wachovia Defendants' Motions to Dismiss the Amended Consolidated Class Action Complaints at 81–82, *In re* Wachovia Equity Sec. Litig., 753 F. Supp. 2d 326 (S.D.N.Y. 2011) (Nos. 08 Civ. 6171, 09 Civ. 6351), 2010 WL 4020397; Defendants' Memorandum of Law in Support of Their Motion to Dismiss the Consolidated Amended Complaint at 67, *In re* Citigroup, Inc. Sec. Litig., 753 F. Supp. 2d 206 (S.D.N.Y.

motion to dismiss denied.[278] In four decisions, the 10b-5 claims were dismissed on scienter grounds and the court did not reach the question of loss causation.[279] The argument was only adopted by the district court in two cases, *In re Security Capital Assurance, Ltd. Securities Litigation*[280] and *In re Homebanc Securities Litigation*.[281] In *Homebanc*, the court also found the shortcomings of the plaintiff's scienter arguments to be an independent ground for dismissal.[282] Thus *Security Capital Assurance* is the only case surveyed by this Note in which loss causation was the dispositive issue.

2010) (No. 07 Civ. 9901), 2009 WL 773441; Memorandum of Law in Support of Fannie Mae's Motion to Dismiss Claims Under the Securities Exchange Act of 1934 at 41, *In re* Fannie Mae 2008 Sec. Litig., 742 F. Supp. 2d 382 (S.D.N.Y. 2010) (08 Civ. 7831), 2009 WL 5251511; Defendant American International Group, Inc.'s Memorandum of Law in Support of Its Motion to Dismiss the Consolidated Class Action Complaint at 72, *In re* Am. Int'l Grp., Inc. 2008 Sec. Litig., 741 F. Supp. 2d 511 (S.D.N.Y. 2010) (08 Civ. 4772), 2009 WL 2446763; Defendants' Motion to Dismiss Plaintiffs' Consolidated Class Action Complaint with Memorandum in Support at 87, Local 295/Local 851 IBT Emp'r Grp. Pension Trust & Welfare Fund v. Fifth Third Bancorp, 731 F. Supp. 2d 689 (S.D. Ohio 2010) (No. 1:08-CV-421), 2009 WL 2869446; Memorandum of Law in Support of Defendants' Motion to Dismiss at 39, *Freudenberg*, 712 F. Supp. 2d 171 (No. 07 Civ. 8538), 2009 WL 1635591; Memorandum of Law in Support of Motion by Defendants Patrick S. Flood & Kevin D. Race to Dismiss the Consolidated Amended Class Action Complaint at 31, *In re* HomeBanc Corp. Sec. Litig., 706 F. Supp. 2d 1336 (N.D. Ga. 2010) (No. 1:08-CV-1461), 2009 WL 5109723, *aff'd sub nom.* Kadel v. Flood, No. 10–12220, 2011 WL 2015379 (11th Cir. May 24, 2011); Memorandum of Law in Support of Motion to Dismiss at 43, *In re* MBIA, Inc. Sec. Litig., 700 F. Supp. 2d 566 (S.D.N.Y. 2010) (No. 08-CV-264), 2009 WL 1635641; XL Defendants' Memorandum in Support of Motion to Dismiss the First Amended Consolidated Class Action Complaint at 19, *In re* Sec. Capital Assurance, Ltd. Sec. Litig., 729 F. Supp. 2d 569 (S.D.N.Y. 2010) (No. 07 Civ. 11086), 2010 WL 4898813; Memorandum in Support of Ambac & Individual Defendants' Motion to Dismiss the Consolidated Amended Class Action Complaint at 31, *Ambac*, 693 F. Supp. 2d 241 (No. 08 Civ. 411), 2008 WL 5372693; Defendants' Memorandum of Law in Support of Their Motion to Dismiss the Consolidated Amended Complaint at 20, *In re* Moody's Corp. Sec. Litig., 599 F. Supp. 2d 493 (S.D.N.Y. 2009) (No. 07 CV. 8375), 2008 WL 5372580; Countrywide Defendants' Notice of Motion & Motion to Dismiss the Consolidated Amended Class Action Complaint for Violation of the Federal Securities Laws at 53 n.25, *In re* Countrywide Fin. Corp. Sec. Litig., 588 F. Supp. 2d 1132 (C.D. Cal. 2008) (No. CV-07-05295), 2008 WL 2725371; Defendants' Suggestions in Support of Motion to Dismiss Consolidated Class Action Complaint at 37, *In re* 2007 Novastar Fin., Inc. Sec. Litig., 2008 WL 2354367 (W.D. Mo. June 4, 2008) (07-0139-CV), 2007 WL 4688210.

278. *See Regions Fin. Corp.*, 2011 U.S. Dist. LEXIS 60761, at *31–34; *In re Bear Stearns*, 763 F. Supp 2d at 506–08; *Citigroup*, 753 F. Supp. 2d at 236; *Am. Int'l Grp.*, 741 F. Supp. 2d at 534; *Fannie Mae*, 742 F. Supp. 2d at 414; *E*trade*, 712 F. Supp. 2d at 202; *MBIA*, 700 F. Supp. 2d at 596 & n.22; *Ambac*, 693 F. Supp. 2d at 273–74; *Moody's*, 599 F. Supp. 2d at 513–14; *Countrywide*, 588 F. Supp. 2d at 1174.

279. *In re Wachovia*, 753 F. Supp. 2d at 367; *Fifth Third Bancorp*, 731 F. Supp. 2d at 717; *Radian I*, 612 F. Supp. 2d at 608; *Novastar*, 2008 WL 2354367, at *4.

280. 729 F. Supp. 2d 569 (S.D.N.Y. 2010).

281. *In re Sec. Capital Assurance*, 729 F. Supp. 2d at 599; *HomeBanc*, 706 F. Supp. 2d at 1360–61.

282. *HomeBanc*, 706 F. Supp. 2d at 1360.

1. Grants of Motions to Dismiss

Security Capital Assurance, Ltd. (SCA) was a financial guaranty insurer, a company that promises to pay the holder of a security in the event that an issuer defaults. The plaintiffs, led by the Employees' Retirement System of the State of Rhode Island, alleged that SCA made false and misleading statements about its ABS and CDO exposure as well as about its monitoring of this exposure, which caused the plaintiffs to suffer loss when the truth was revealed.[283]

The claims that survived the court's scienter inquiry were dismissed for failure to plead loss causation adequately.[284] The plaintiffs did not allege that a single announcement of previously undisclosed information caused a sharp drop in SCA's share price; rather, they alleged a "slow, steady decline" in the value of SCA's stock resulting from the "gradual revelation of the truth" of SCA's exposure to the subprime crisis.[285]

The district court traced SCA's stock price throughout the class period.[286] At the outset, the court noted that "though Plaintiffs are not expected to conduct an event study on a Motion to Dismiss, event study methodology is instructive here" and that the plaintiffs' wide event window "made it difficult to isolate the impact of Defendants' alleged misrepresentations" from other market events.[287]

Throughout its discussion of the stock price during the class period, the court noted the plaintiffs' failure to address and exclude possible intervening causes of drops in share prices or to explain rises in the stock price at certain points.[288] For example, the court noted that in November 2007 the rating agency Fitch announced downgrades of a large number of CDO tranches, including the three insured by SCA, and that the plaintiffs had not alleged facts suggesting that the decline in SCA's stock value was caused by the defendants' misrepresentations, rather than Fitch's downgrades.[289] The court held that the plaintiffs had not "effectively shown that it was the incremental revelation of Defendants' fraudulent misrepresentations, and not the actions of third parties or other circumstances of the market, that caused the decline in SCA's share price

283. *See id.* at 574–78.

284. *See id.* at 602.

285. *See id.* at 599.

286. *See In re Sec. Capital Assurance*, 729 F. Supp. 2d at 599–602. The court began by quoting the marketwide phenomenon language from *Lentell*. *See supra* notes 120–26 and accompanying text.

287. *See id.* at 600 & n.5. An event study is a statistical technique that attempts to separate the effects of firm-specific information and information that is likely to affect stock prices market-wide. The first step is to select an event window, the period when the firm-specific information becomes available to the market and may affect the price. The longer the event window, the more likely it includes all new information about the event, but longer event windows also make it difficult to isolate the impact of the event from other information that might affect the stock price. *See* Mark L. Mitchell & Jeffry M. Netter, *The Role of Financial Economics in Securities Fraud Cases: Applications at the Securities and Exchange Commission*, 49 BUS. LAW. 545, 556–58 (1994).

288. *See In re Sec. Capital Assurance*, 729 F. Supp. 2d at 600–01.

289. *See id.* at 601.

over the Class Period."[290] Indeed, the district court found that the events of the financial crisis so overwhelmed the Plaintiff's loss causation allegations that in granting leave to replead, it stated that it was unlikely that the plaintiffs would be able to attribute their losses to specific misrepresentations by individuals at SCA, only one of hundreds of companies brought down by RMBS and CDOs.[291]

The court in *HomeBanc* did not engage in nearly so searching an analysis. There, the court noted that the plaintiffs did not allege that the information allegedly concealed from investors was revealed, subsequently causing a stock drop.[292] The plaintiffs' speculation that the drop in HomeBanc's stock "must have been caused by fraudulent conduct" was unpersuasive in light of the stock's steady decline throughout the class period, similar to the declines of HomeBanc's competitors.[293] While the court noted that causation issues are usually not resolved at the motion to dismiss stage, the plaintiffs had failed to make any allegation allowing the court to distinguish losses caused by the defendants' misrepresentation and the general market downturn.[294]

2. Denials of Motions to Dismiss

Perhaps the most striking thing about the decisions that rejected the defendants' arguments that the financial crisis was an intervening cause is the brevity of the analysis employed in many of them. In *Citigroup*, for example, the loss causation analysis occupied just four sentences of the forty-five page decision.[295] This is perhaps less surprising in those cases, like *Citigroup*, where the plaintiff was able to identify corrective disclosures closely correlated with drops in share price.[296]

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290. *Id.* at 602.

291. *See id.* at 603.

292. *In re* HomeBanc Corp. Sec. Litig., 706 F. Supp. 2d 1336, 1361 (N.D. Ga. 2010).

293. *Id.*

294. *Id.* (citing Lentell v. Merrill Lynch & Co., 396 F.3d 161, 174 (2d Cir. 2005)).

295. *See In re* Citigroup, Inc. Sec. Litig., 753 F. Supp. 2d 206, 236 (S.D.N.Y. 2010). The court stated:

> Further, [plaintiffs] have adequately pled loss causation. Plaintiffs have identified several corrective disclosures that allegedly demonstrated the falsity of defendants' previous statements, and plaintiffs have also alleged that the value of their securities declined following the corrective disclosures. Plaintiffs' allegations are sufficient at this early stage of the litigation. Whether the alleged omissions and false statements actually caused plaintiffs' losses cannot be determined at this stage of the litigation.

Id. (internal citations omitted).

296. *See id.*; *see also* Local 703, I.B. of T. Grocery and Food Emp.'s Welfare Fund v. Regions Fin. Corp., CV: 10-2847, 2011 U.S. Dist. LEXIS 60761, at *31–33 (N.D. Ala. June 7, 2011); *In re* Bear Stearns Cos. Sec., Derivative, & ERISA Litig., 763 F. Supp. 2d 423, 508 (S.D.N.Y. 2011); *In re* Am. Int'l Grp., Inc. 2008 Sec. Litig., 741 F. Supp. 2d 511, 534 (S.D.N.Y. 2010); *In re* Ambac Fin. Grp., Inc. Sec. Litig., 693 F. Supp. 2d 241, 273–74 (S.D.N.Y. 2010); *In re* Moody's Corp. Sec. Litig., 599 F. Supp. 2d 493, 512–13 (S.D.N.Y. 2009).

Yet even in cases where the plaintiff alleged a series of partial disclosures[297] or a materialization of the concealed risk,[298] the defendants' arguments often proved unpersuasive, and the court reserved the question of intervening causation for a later stage in the litigation.[299] For example, in *Countrywide*, defendants argued that the complaint did not sufficiently identify corrective disclosures, or distinguish the effect of the alleged misrepresentations from the decline in the market in general and among mortgage lenders in particular.[300] The defendants noted that share prices of Countrywide's competitors also dropped precipitously during the same period.[301] The court was not swayed by the fact that the alleged corrective disclosures were piecemeal, holding that "loss causation is not precluded by a series of disclosures; serial disclosures just make it more difficult for plaintiffs as a practical matter."[302] The court noted that "the price of Countrywide securities dropped as the disclosures accumulated," with many drops in share price tightly correlated with the disclosures.[303]

The court also addressed Countrywide's macroeconomic arguments.[304] The court noted that the financial collapse would raise complicated issues on damages, but held that it would be the fact-finders' job to apportion the losses proximately caused by Countrywide's misrepresentations.[305] In fact, the court noted, the complaint indicated that "Countrywide's deteriorating lending standards were causally linked to at least some of the macroeconomic shifts of [the financial crisis]."[306] Thus, far from holding that the intervening cause of the economic downturn rendered the plaintiff's loss causations allegations insufficient, the court suggested that Countrywide was at least partially responsible for the downturn itself.

297. *See* Freudenberg v. E*Trade Fin. Corp., 712 F. Supp. 2d 171, 202–03 (S.D.N.Y. 2010); *In re* MBIA, Inc. Sec. Litig., 700 F. Supp. 2d 566, 596 (S.D.N.Y. 2010); *In re* Countrywide Fin. Corp. Sec. Litig., 588 F. Supp. 2d 1132, 1200–01 (C.D. Cal. 2008).

298. *See In re* Fannie Mae 2008 Sec. Litig., 742 F. Supp. 2d 382, 414 (S.D.N.Y. 2010).

299. *See, e.g.*, *id.* (noting that "[a]lthough it may be likely that a significant portion, if not all, of Plaintiffs' losses were actually the result of the housing market downturn and not these alleged misstatements, at this stage of pleading" plaintiff's allegations were sufficient); *Am. Int'l Grp.*, 741 F. Supp. 2d at 534 (holding that "[a]lthough Defendants may ultimately demonstrate that some or all of Plaintiffs' losses are attributable to forces other than AIG and the Section 10(b) Defendants' material misstatements and omissions," the existence of intervening events is a matter for proof at trial (citing Emergent Capital Inv. Mgmt., LLC v. Stonepath Grp., Inc., 343 F.3d 189, 197 (2d Cir. 2003))). For a discussion of *Emergent* and *Lentell*, see *supra* notes 120–26 and accompanying text.

300. *See* Countrywide Defendants' Notice of Motion & Motion to Dismiss the Consolidated Amended Class Action Complaint for Violation of the Federal Securities Laws at 50–55, *In re* Countrywide Fin. Corp. Sec. Litig., 588 F. Supp. 2d 1132 (C.D. Cal. 2005) (No. CV-07-05295), 2008 WL 2725371.

301. *See id.* at 53.

302. *Countrywide*, 588 F. Supp. 2d at 1200.

303. *Id.* at 1201.

304. *Id.* at 1173–74 ("For the past year, almost all Defendants have recited—at hearings and in their papers—that an 'unprecedented' external 'liquidity crisis' caused . . . Countrywide's decline.").

305. *See id.* at 1174.

306. *Id.*

There is, however, one outlier in the cases reviewed by this Note. In *In re Moody's Corporation Securities Litigation*,[307] the district court also rejected the defendant's financial crisis defense to loss causation, but its analysis was far different than that of other courts.[308] Moody's, a ratings agency, and its officers were alleged to have made misstatements and omissions regarding its business, independence, the method and meaning of its credit ratings, and the manner in which it had generated financial results and growth.[309] Defendants moved to dismiss, arguing that the financial collapse was the "direct intervening cause" of the drop in Moody's share prices, and therefore of the plaintiffs' losses.[310] The defendants relied on *Gelt* to argue that the plaintiffs had not adequately alleged facts to show that the loss was caused by the misrepresentations, and not the intervening events.[311]

The district court denied the motion to dismiss and held that loss causation was adequately pled.[312] Significantly, however, the court did not rest its decision on the basis of the plaintiff pleading facts that demonstrated their losses were caused by the misrepresentation instead of the financial collapse.[313] Instead, the court began by citing *Lentell* for the proposition that the question of an intervening event is reserved for trial.[314] Further relying on *Lentell*, the court stated that "[w]here there is a market-wide downturn in a particular industry," a plaintiff must show that their loss was caused by the fraud.[315] The court thus framed its task as determining whether there was a market-wide downturn in the credit ratings industry at the time of the drop in stock price.[316] The court compared the stock prices of Moody's to those of its biggest competitor, the rating agency Standard & Poors, and found that S&P's stock rose during the class period.[317] The court thus held that it could not conclude that there was a market-wide downturn in the credit ratings industry, and reserved the question of the effect of intervening events on loss causation for trial.[318]

IV. LESSONS FROM SUBPRIME SECURITIES LITIGATION

This part attempts to draw some conclusions about subprime securities litigation from the foregoing analysis of this sampling of cases. First, this part provides conclusions about the factors influencing the resolution of

307. 599 F. Supp. 2d 493 (S.D.N.Y. 2009).
308. *See id.* at 512–15.
309. *See id.* at 499–501.
310. Defendant's Memorandum of Law in Support of Their Motion to Dismiss the Consolidated Amended Complaint at 19, *In re Moody's*, 599 F. Supp. 2d 493 (S.D.N.Y. 2009) (No. 07-CV-8375), 2008 WL 5372580.
311. *Id.* at 20.
312. *See Moody's*, 599 F. Supp. 2d at 512.
313. *See id.* at 513–14.
314. *See id.* at 513.
315. *Id.*
316. *See id.*
317. *See id.*
318. *See id.* at 513–14.

subprime securities cases discussed in Part II. Next, this part offers conclusions about the effect of the financial crisis on the cases reviewed.

A. Dispositions

In Part II, this Note examined the cases and determined that adequately pleading scienter has been the key factor in determining whether or not a subprime securities suit would survive dismissal.[319] The plaintiffs in the subprime securities suits surveyed relied to an extraordinary degree on confidential witnesses.[320] While not a guarantee of success, when the confidential witnesses were described with enough particularity to allow the court to determine their bases of knowledge, the complaint was likely to survive the motion to dismiss, while failure to do so was likely to result in dismissal.[321]

Similarly, position-based inferences could aid a plaintiff in pleading scienter, but only insofar as such inferences were supported by particularized facts pointing to knowledge on the part of the defendants.[322] Allegations based solely on a defendant's high rank were rejected.[323] The required particularized facts were often themselves provided by confidential witnesses.[324]

Finally, Part II discussed two points of divergence between the Circuit Courts of Appeals that surfaced in the district court decisions surveyed by this Note.[325] Yet neither played a particularly important role in determining the outcome of the cases examined. Those courts that noted the disagreement on confidential witnesses analyzed the witness statements for particularity without the disregard espoused by the Seventh Circuit, while most district courts did not acknowledge this disagreement at all.[326] Given the importance of confidential witnesses to securities plaintiffs, and the ability that district courts have shown to discern their reliability, courts should be hesitant to undercut witness utilization. Moreover, the concerns cited by the Seventh Circuit—that the confidential witnesses may have "axes to grind" or may not even exist[327]—could apply equally to named witnesses at the motion to dismiss phase, where the court must accept all the plaintiff's allegations as true and refrain from deciding disputed issues of fact.[328] The instruction in *Tellabs* to consider competing inferences should not change the basic inquiry on a motion to dismiss.

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319. *See supra* notes 179–81 and accompanying text.
320. *See supra* Part II.B.1.a.
321. *See supra* notes 183–97 and accompanying text.
322. *See supra* Part II.B.1.b.
323. *See supra* notes 206–08 and accompanying text.
324. *See supra* notes 210–15 and accompanying text.
325. *See supra* notes 198–203 (discussing disagreement between the circuits on the use of confidential witnesses) and notes 217–42 (discussing core operations inference) and accompanying text.
326. *See supra* note 203 and accompanying text.
327. *See supra* note 198 and accompanying text.
328. *See supra* note 131 and accompanying text.

Additionally, while the core operations inference aided plaintiffs in some cases, it was usually not enough in and of itself to plead scienter without the support of other particularized facts.[329] Even in *Countrywide*, the court took pains to emphasize the "extraordinary" nature of that situation.[330] If the use of the core operations inference spreads to other circuits, as decisions in the Southern District of New York suggest it may,[331] the doctrine should remain limited to extraordinary cases lest the scienter inquiry become too focused on a defendant's position at the company, rather than his knowledge of facts belying his public statements.

B. The Financial Crisis and 10b-5 Securities Litigation

One might have expected the unique situation of the financial crisis to dominate the litigation that followed in its wake. But in this sampling of cases, the factors examined in Part II of this Note played a more important role in determining the outcome of subprime securities suits than did the crisis itself. Still, some lessons can be gleaned that may help guide the way forward as courts attempt to deal with the flood of litigation stemming from the collapse.

1. Scienter

In dealing with the aftermath of a financial catastrophe, it is entirely proper for courts to decline to hold defendants responsible for failing to predict the unpredictable. This effort to avoid hindsight bias, however, should not translate into a free pass for defendants to escape otherwise meritorious claims. Simply put, there is no principled reason why it should be any easier or more difficult to plead scienter in the wake of a market-wide downturn: properly applied, the inquiry should focus on what facts were known to the defendants at the time of the alleged misrepresentations.

The *In re Radian* decision thus contains some questionable reasoning that courts should avoid.[332] The district court there relied upon the Second Circuit's decision in *Gelt* for its much-cited proposition that "when the plaintiff's loss coincides with a marketwide phenomenon causing comparable losses to other investors, the prospect that the plaintiff's loss was caused by the fraud decreases."[333] Contrary to its usage by the *Radian* court, the *Gelt* decision concerned loss causation, not scienter. This is not to say that the court necessarily reached the wrong result in granting dismissal, but its analysis was flawed on this point. Unlike loss causation, which is directly affected by the company's stock price, scienter is not inextricably intertwined with the conditions of the market; thus the analysis

329. *See supra* notes 217–42 and accompanying text.
330. *See supra* notes 229–30 and accompanying text.
331. *See supra* notes 239–42 and accompanying text.
332. *See supra* notes 255–58 and accompanying text.
333. First Nationwide Bank v. Gelt Funding Corp., 27 F.3d 763, 772 (2d Cir. 1994); *see supra* notes 120–26 and accompanying text.

of whether scienter is adequately pled should remain limited to what the defendants knew and when they knew it.

On the other hand, the approach in *Thornburg* should also be avoided.[334] The motive cited by the court—survival of the financial collapse—is one that every defendant in a management position would possess.[335] Taken to an extreme, every defendant in a management position could face liability following a market downturn. Thus, considering such vague motives as "survival" to be facts indicative of a strong inference of scienter would undermine the main goal of the PSLRA: preventing strike suits.[336]

In the end, courts attempting to ascertain whether a plaintiff has pleaded a strong inference of scienter in the wake of financial catastrophe should walk a middle path. The financial crisis should serve only to provide context to the plaintiff's factual allegations, whether as an element of the plaintiff's allegations or as a competing inference to be considered under *Tellabs*. Where, as in *Canadian Imperial Bank of Commerce*, those factual allegations are found to be sparse and conclusory, it is entirely appropriate to dismiss, as mere knowledge of a general economic trend should not suffice to allege scienter.[337] This does not mean, however, that such knowledge may never contribute to a successful pleading of scienter: where, as in *Citigroup* and *MoneyGram*,[338] that knowledge is demonstrated by particularized facts belying the defendant's public statements, the claims should be allowed to proceed.

2. Loss Causation

As for loss causation in the wake of the financial collapse, two conclusions may be drawn. First, the financial crisis defense against loss causation simply has not proved persuasive where plaintiffs have adequately pleaded the other elements of a 10b-5 action.[339] Second, it is clear that circuit courts should provide district courts with more guidance with respect to how a plaintiff must account for intervening causes when pleading loss causation. In the sampling of decisions reviewed by this Note, loss causation has not proved as important as scienter. Nevertheless, the contrast between the in-depth analysis conducted by the district court in *In re Security Capital Assurance, Ltd., Securities Litigation*[340] and the comparatively superficial analysis conducted by other courts indicates a lack of clarity.[341] This guidance should first come from the Second Circuit, whose unclear passage in *Lentell v. Merrill Lynch & Co.*[342] has been widely

334. *See supra* notes 260–64 and accompanying text.
335. *See supra* note 262 and accompanying text.
336. *See supra* note 96 and accompanying text.
337. *See supra* note 252 and accompanying text.
338. *See supra* notes 265–69 and accompanying text.
339. *See supra* notes 276–83 and accompanying text.
340. *See supra* notes 283–91 and accompanying text.
341. *See supra* notes 295–306 and accompanying text.
342. *See supra* notes 120–26 and accompanying text.

cited by defendants and district courts around the country as they attempt to resolve the effect of the financial crisis on pleading loss causation.[343]

Whatever form this guidance may take, it should not follow the reasoning of *In re Moody's*.[344] The analysis adopted by the district court in that case is questionable in a number of respects. First, the methodology adopted—comparing the stock price of the defendant to that of the defendant's competitors to determine if there was a downturn in a particular industry—finds little support in *Lentell*.[345] The relevant language in *Lentell* states that an "an intervening event, like a general fall in the price of internet stocks . . . is a matter of proof at trial and not to be decided on a Rule 12(b)(6) motion to dismiss," while a "marketwide phenomenon causing similar losses to other investors" decreases the chances the plaintiff's losses were caused by the fraud.[346] The *Moody's* court, however, held that a downturn in a particular industry would require plaintiffs to rule out intervening events in order to survive a motion to dismiss.[347] While *Lentell* is certainly unclear, it is difficult to see how a downturn in a particular industry can constitute a marketwide phenomenon.[348]

Moreover, even if the language can be stretched to support such a reading, applying this comparative methodology would be bad policy. Fraud may be committed by one company in an industry that happens to suffer a downturn, or by every company in that industry—indeed, one might argue that this aptly describes the demise of the subprime lending industry.[349] Under the analysis adopted by the *Moody's* court, the plaintiffs in *Countrywide* may not have been able to survive the motion to dismiss despite well-pleaded allegations of large-scale fraud; all other mortgage lenders were also hit hard by the crisis.[350] Additionally, defining what constitutes a "particular industry" is difficult; this is evident in *Moody's* itself, where the court compared Moody's stock price with just one competitor.[351]

In weighing the effect an intervening cause has on loss causation, district courts should remember that the question on a motion to dismiss is whether the defendant's misdeeds caused a loss, not how much of a loss the defendant may have caused.[352] While the Supreme Court in *Dura* required that a plaintiff distinguish the loss caused by the misrepresentation from the "tangle of other factors" affecting the price, it also noted that pleading loss causation should not prove a great burden on plaintiffs.[353] Thus, while

343. *See supra* notes 277–82 and accompanying text.
344. *See supra* notes 308–18 and accompanying text.
345. *See supra* note 317 and accompanying text.
346. Lentell v. Merrill Lynch, 396 F.3d 161, 174 (2d Cir. 2005); s*ee supra* notes 120–26 and accompanying text.
347. *See supra* note 317 and accompanying text.
348. *See supra* notes 120–26 and accompanying text.
349. *See supra* note 36 and accompanying text (discussing the role of fraud in subprime defaults).
350. *See supra* note 300 and accompanying text.
351. *See supra* note 317 and accompanying text.
352. *See supra* Part I.B.4.a.i.
353. *See supra* notes 106–10 and accompanying text.

dismissal may be appropriate in cases like *HomeBanc* where plaintiffs utterly failed to provide the court with facts allowing the court to apportion the loss caused by the defendants' misstatements,[354] plaintiffs should not have to hire expert witnesses to conduct complicated analyses at the motion to dismiss phase.

CONCLUSION

Motions to dismiss are only the first chapter in securities litigation arising out of the financial collapse, a chapter not yet fully written. The cases surveyed in this Note highlight the legal issues that will influence the resolution of 10b-5 claims for subprime securities losses as investors continue to seek recompense for the harm they suffered in the subprime mortgage meltdown and ensuing credit crisis. Indeed, as Circuit Courts of Appeals begin to weigh in, the issues arising out of subprime securities suits may ultimately shape the contours of the private 10b-5 action as it continues to evolve from its origins in the Great Depression.

354. *See supra* notes 292–94 and accompanying text.

TABLE I

Case Name	***Motion to Dismiss (NB: considered a denial if any 10b-5 claims survive)***	***Citation***	***District***	***Circuit***	***Date of Decision***	***Type of Defendant***	***Subsequent History***
Atlas v. Accredited Home Lenders Holding Co.	Denied	556 F. Supp. 2d 1142	S.D. Cal.	9th	1/4/2008	Loan Originator	
Cornwell v. Credit Suisse Grp.	Denied	689 F. Supp. 2d 629 (Initially Granted: 666 F. Supp. 2d 381)	S.D.N.Y.	2d	2/11/2010	Investment Bank Exposed to Subprime	
Freudenberg v. E*Trade Fin. Corp.	Denied	712 F. Supp. 2d 171	S.D.N.Y.	2d	5/11/2010	Loan Originator/ Purchaser	
Fulton Cnty. Emps.' Ret. Sys. v. MGIC Inv. Corp.	Granted	2010 WL 601364	E.D. Wis.	7th	2/18/2010	Insurer	
Hubbard v. BankAtlantic Bancorp, Inc.	Denied	2009 WL 3261941 (Initially Granted: 625 F. Supp. 2d 1267)	S.D. Fla.	11th	5/12/2009	Loan Originator	Verdict for Plaintiffs at Trial. *See supra* note 163 and accompanying text.
In re 2007 Novastar Fin. Litig.	Granted	2008 WL 2354367	W.D. Mo.	8th	6/4/2008	Loan Originator	*aff'd*, 579 F.3d 878 (8th Cir. 2009)
In re Am. Int'l Grp., Inc. 2008 Sec. Litig.	Denied	741 F. Supp. 2d 511	S.D.N.Y.	2d	9/24/2010	Insurer	
In re Ambac Fin. Grp., Inc. Sec. Litig.	Denied	693 F. Supp. 2d 241	S.D.N.Y.	2d	2/22/2010	Insurer	
In re Bear Stearns Cos., Inc. Sec., Derivative, and ERISA Litig.	Denied	763 F. Supp. 2d 423	S.D.N.Y.	2d	1/19/2011	Investment Bank Exposed to Subprime	

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Case Name	***Motion to Dismiss (NB: considered a denial if any 10b-5 claims survive)***	***Citation***	***District***	***Circuit***	***Date of Decision***	***Type of Defendant***	***Subsequent History***
In re CIT Grp., Inc. Sec. Litig.	Denied	2010 WL 2365846	S.D.N.Y.	2d	6/10/2010	Loan Originator	
In re Citigroup Inc., Sec. Litig.	Denied	2010 WL 4484650	S.D.N.Y.	2d	11/9/2010	Bank Exposed to Subprime; Loan Originator.	
In re Countrywide Fin. Corp. Sec. Litig.	Denied	588 F. Supp. 2d 1132	C.D. Cal.	9th	12/1/2008	Loan Originator	
In re Downey Sec. Litig.	Granted	2009 WL 2767670 (Initially Granted: 2009 WL 736802)	C.D. Cal.	9th	8/21/2009	Loan Originator	
In re Fannie Mae 2008 Sec. Litig.	Denied	742 F. Supp. 2d 382	S.D.N.Y.	2d	9/30/2010	Government Sponsored Enterprise	
In re HomeBanc Corp. Sec. Litig.	Granted	706 F. Supp. 2d 1336	N.D. Ga.	11th	4/13/2010	Loan Originator	*aff'd sub nom.* Kadel v. Flood, No. 10–12220, 2011 WL 2015379 (11th Cir. May 24, 2011)
In re Huntington Bancshares Inc. Sec. Litig.	Granted	674 F. Supp. 2d 951	S.D. Ohio	6th	12/4/2009	Financial Holding Company	
In re MBIA, Inc., Sec. Litig.	Denied	700 F. Supp. 2d 566	S.D.N.Y.	2d	3/31/2010	Insurer	
In re MoneyGram Int'l, Inc. Sec. Litig.	Denied	626 F. Supp. 2d 947	D. Minn.	8th	5/20/2009	Investor Exposed to Subprime (MBS, CDOs)	
In re Moody's Corp. Sec. Litig.	Denied	599 F. Supp. 2d 493	S.D.N.Y.	2d	2/23/2009	Rating Agency	

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In re New Century	Denied	588 F. Supp. 2d 1206	C.D. Cal.	9th	12/3/2008	Loan Originator	
In re PMI Grp., Inc. Sec. Litig.	Denied	2009 WL 3681669 (Initially Granted: 2009 WL 1916934)	N.D. Cal.	9th	11/2/2009	Insurer	
In re Radian Sec. Litig.	Granted	2010 WL 1767195 (Initially Granted: 612 F. Supp. 2d 594)	E.D. Pa.	3d	4/30/2010	Insurer	
In re RAIT Fin. Trust Sec. Litig.	Denied	2008 WL 5378164	E.D. Pa.	3d	12/22/2008	Real Estate Investment Trust (REIT)	
In re Regions Morgan Keegan Sec., Derivative, & ERISA Litig.	Granted for 10b-5 Claims, Denied for 1933 Act Claims	743 F. Supp. 2d 744	W.D. Tenn.	6th	9/30/2010	Broker/ Dealer, Investment Advisor	
In re Sec. Capital Assurance, Ltd. Sec. Litig.	Granted	729 F. Supp. 2d 569	S.D.N.Y.	2d	3/31/2010	Insurer	
In re Thornburg Mortg., Inc. Sec. Litig.	Denied	695 F. Supp. 2d 1165	D. N.M.	10th	1/27/2010	Loan Originator	
In re Wachovia Equity Sec. Litig.	Granted for 10b-5 Claims, Denied for '33 Act Claims	753 F. Supp. 2d 326	S.D.N.Y.	2d	3/31/2011	Bank Exposed to Subprime; Loan Originator	
In re Washington Mut., Inc. Sec., Derivative & ERISA Litig.	Denied	694 F. Supp. 2d 1192 (Initially Granted: 259 F.R.D. 490)	W.D. Wash.	9th	10/27/2009	Loan Originator	

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Case Name	***Motion to Dismiss (NB: considered a denial if any 10b-5 claims survive)***	***Citation***	***District***	***Circuit***	***Date of Decision***	***Type of Defendant***	***Subsequent History***
Local 295/Local 851 IBT Emp' Grp. Pension Trust and Welfare Fund v. Fifth Third Bancorp	Granted for 10b-5 Claims, Denied for '33 Act Claims	731 F. Supp. 2d 689	S.D. Ohio	6th	8/10/2010	Loan Originator	
Local 703, I.B. of T. Grocery and Food Emp.'s Welfare Fund v. Regions Fin. Corp.	Denied	2011 U.S. Dist. Lexis 60761	N.D. Ala.	11th	6/7/2011	Bank	
N.Y. State Teachers' Ret. Sys. v. Fremont General Corp.	Granted	2010 WL 1473265 (Initially Granted Twice: 2008 WL 4812021; 2009 WL 3112574)	C.D. Cal.	9th	3/29/2010	Loan Originator	
Pittleman v. Impac Mortg. Holdings, Inc.	Granted	2009 WL 648983 (Initially Granted: 2008 WL 4809962)	C.D. Cal.	9th	3/9/2009	Loan Originator	*aff'd sub nom.* Sharenow v. Impac Mortg. Holdings, Inc., 385 F. App'x 714 (9th Cir. 2010)
Plumbers & Steamfitters Local 773 Pension Fund v. Can. Imperial Bank of Commerce	Granted	694 F. Supp. 2d 287	S.D.N.Y.	2d	3/17/2010	Bank Exposed to Subprime	
Tripp v. Indymac Fin. Inc.	Granted	2007 WL 4591930	C.D. Cal.	9th	11/29/2007	Loan Originator	