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LOGIC OR PUBLIC POLICY: SHOULD “CONFIRMATORY
STATEMENTS” BE ACTIONABLE UNDER RULE 10b-5?

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NOTES

LOGIC OR PUBLIC POLICY: SHOULD “CONFIRMATORY STATEMENTS” BE ACTIONABLE UNDER RULE 10b-5?

*Sean Keegan**

ABSTRACT

The fraud-on-the-market theory, originating in the Ninth Circuit¹ and solidified by the Supreme Court in *Basic Inc. v. Levinson*,² was developed to be the solution to an overwhelming evidence problem. Securities class action suits under the famous Rule 10b-5 had previously required a showing of reliance put upon each individual class member. The proliferation of large corporations becoming publicly traded on efficient markets, coupled with the increase of fraudulent practices to meet Wall Street’s demands, created situations where thousands of plaintiffs had legitimate Rule 10b-5 claims. Of course, having common defendants, classes were formed and suits filed. This, however, left attorneys in a problematic place, since they were required to show reliance for each individual.

Recognizing the inefficiency of placing this burden on the plaintiff, courts began to develop the fraud-on-the-market theory in order to combat the problem. The theory gave plaintiffs a rebuttable presumption of reliance in class action Rule 10b-5 suits if the plaintiff could show that the defendant had made a public material misrepresentation, and that the

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¹ *Blackie v. Barrack*, 524 F.2d 891 (9th Cir. 1975).

² 485 U.S. 224 (1988).

defendant's shares were traded in an efficient market during a period in which the plaintiff traded those shares.³

Although the fraud-on-the-market theory repressed the evidentiary problem posed by class actions, a new issue has arisen more recently. In situations where a class period only covers misstatements that did not cause a fluctuation in the stock price, the Fifth Circuit has found those misstatements to be non-actionable.⁴ Since any misstatement that does not actually affect the market price is merely confirmatory, the Fifth Circuit has held that plaintiffs cannot actually be said to rely on the misstatement.⁵ Since reliance is an element of Rule 10b-5 claims, the suit fails. Ardently disagreeing with the Fifth Circuit, the Eleventh Circuit argued that allowing corporations to "prop up" stock prices with fraudulent statements was a major violation of public policy.⁶

This Note argues that in approving of the fraud-on-the-market theory in *Basic*, the Supreme Court should rely on considerations of public policy which, in securities fraud cases, strongly outweigh considerations of logic contained in the Fifth Circuit's strict reading of the law. Because of the rarity of ruling on this situation, the Supreme Court would be wise to adopt the Eleventh Circuit's view in order to prevent forum shopping and the spread of the Fifth Circuit's view.

I. INTRODUCTION: THE DEVELOPMENT OF RULE 10B-5 AND THE FRAUD-ON-THE-MARKET THEORY

The substantive rule against insider trader and other fraudulent securities activities is SEC Rule 10b-5, promulgated by the Securities and Exchange Commission, pursuant to congressional authority granted by Section 10(b) of The Securities Exchange Act of 1934.⁷ Section 10(b),

³ *Id.* at 247–48.

⁴ See *Greenberg v. Crossroads Sys., Inc.*, 364 F.3d 657 (5th Cir. 2004) (holding that confirmatory statements are not actionable in a fraud-on-the-market suit).

⁵ *Id.*

⁶ See *FindWhat Investors Grp. v. FindWhat.com*, 658 F.3d 1282 (11th Cir. 2011) (holding that confirmatory information that wrongfully prolongs a period during which stock is traded at inflated prices is actionable whether or not the level of inflation increases).

⁷ ROBERT W. HAMILTON ET AL., *CASES AND MATERIALS ON CORPORATIONS INCLUDING PARTNERSHIPS AND LIMITED LIABILITY COMPANIES* 805 (11th ed. 2010).

combined with Rule 10b-5, has been expanded to have a significant breadth and function concerning securities litigation. In fact, Rule 10b-5 is, “by a considerable margin, the most famous rule in securities law and probably in all of business law.”⁸

The first substantive case in which Rule 10b-5 was developed was *Kardon v. National Gypsum Co.*, in which the District Court for the Eastern District of Pennsylvania held that Rule 10b-5 could be the basis of a private suit seeking to rescind a securities transaction.⁹ Although Rule 10b-5 became famous in insider trading cases, it came to be relied upon in all cases involving “claims of securities fraud, deception, or trading in securities on the basis of undisclosed information in both publicly held and closely held corporations.”¹⁰ The rule was very flexible, and eventually, price fixing, or artificial inflation of a stock price or depression of a stock price through manipulation, became heavily litigated under Rule 10b-5.

Although courts began liberally construing both Section 10(b) and Rule 10b-5, limitations began to constrain the rule in 1975 when the Supreme Court adopted the Second Circuit rule from *Birnbaum v. Newport Steel Corp.*¹¹ In *Birnbaum*, the Second Circuit established that private plaintiffs had to be actual buyers or sellers of securities to bring a Rule 10b-5 action.¹² Although a defendant could still be charged with a Rule 10b-5 violation without buying or selling, the ruling began a series of actions making pleading more difficult for private plaintiffs.

Much of the litigation in private actions centered on whether a Rule 10b-5 action required *scienter* and whether aiding and abetting was actionable.¹³ Supreme Court decisions on insider trading suits, also created

⁸ *Id.*

⁹ 73 F. Supp. 798 (E.D. Pa. 1947).

¹⁰ HAMILTON, *supra* note 7, at 807.

¹¹ See *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975) (holding that a potential buyer failed to buy because of misleading statements could not use Rule 10b-5 because they weren't actual purchasers).

¹² See *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir. 1952).

¹³ See *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976) (holding that Rule 10b-5 applies only to activities that involve scienter); *In re Enron Corp. Sec., Derivative & ERISA Litig.*, 235 F. Supp. 2d 549 (S.D. Tex. 2002) (holding secondary actors acted with reckless disregard, and thus scienter was properly pleaded under a 10b-5 case).

several doctrines in which to control suits brought pursuant to Rule 10b-5.¹⁴ Through litigation, courts have manifested five elements needed to state a private securities fraud under Rule 10b-5. The plaintiff must allege, “in connection with a purchase or sale of securities, (1) a misstatement or an omission, (2) of material fact, (3) made with scienter, (4) *on which plaintiff relied*, (5) that proximately caused [the plaintiff’s] injury.”¹⁵

At common law, plaintiffs had to prove reliance, the fourth element, by showing that they *reasonably* relied on a material misstatement that induced the transaction.¹⁶ Reliance in securities fraud became known as “transaction causation,” which is essentially the same as “but-for” causation.¹⁷ As this standard became incorporated into Rule 10b-5 claims, difficulties arose. One such difficulty was proving individual reliance in a class action suit with potentially thousands of plaintiffs.

It became axiomatic that the court system needed to create a doctrine for class action Rule 10b-5 reliance. The Ninth Circuit is credited with spelling out a solution as it created the conceptual basis of fraud-on-the-market theory.¹⁸ The Ninth Circuit, in *Blackie v. Barrack*, held that common law reliance does not govern “the necessary nexus between the plaintiff’s injury and the defendant’s wrongful conduct.”¹⁹ The theory would solve the difficulty that proving reliance for members of a class action materialized, and today, “most federal securities class actions . . . rely on the ‘fraud-on-the-market’ theory.”²⁰

What the fraud-on-the-market theory, based on the efficient market hypothesis, actually manifests is “a rebuttable presumption that (1) misrepresentations by an issuer affect the price of securities traded in the open market, and (2) investors rely on the market price of securities as an accurate measure of their intrinsic value.”²¹ In other words, if the defendant’s misrepresentation or scheme to defraud targeted the entire

¹⁴ See, e.g., *United States v. O’Hagan*, 521 U.S. 642 (1997); *Chiarella v. United States*, 445 U.S. 222 (1980).

¹⁵ Greenberg, 364 F.3d at 661.

¹⁶ See RESTATEMENT (SECOND) OF TORTS § 525 (1977).

¹⁷ See *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 341–42 (2005).

¹⁸ Harold S. Bloomenthal, *Fraud on the Market*, 2 SECURITIES LAW HANDBOOK § 27:21 (2000).

¹⁹ *Blackie*, 485 U.S. at 243.

²⁰ Jonathan Eisenberg, *Beyond the Basics: Seventy-Five Defenses Securities Litigators Need to Know*, 62 BUS. LAW. 1281, 1323 (2007).

²¹ *Id.* (quoting *In re Initial Pub. Offering Sec. Litig.*, 471 F.3d 24, 42 (2d Cir. 2006)).

market, and not just an individual plaintiff, than the plaintiff did not have to prove individual transaction causation.²² The theory is thereby narrowed to encompass only potential class action suits. All a plaintiff is required to do is to plead under a fraud-on-the-market theory, and the transaction causation would be presumed, albeit rebuttable by the defendant. In doing so, a plaintiff is relying on the integrity of an open and well-developed market.²³

The most significant case in fraud-on-the-market is the Supreme Court case of *Basic Inc. v. Levinson*, which gave the fraud-on-the-market theory traction. Concisely put, the Supreme Court described the theory as:

based on the hypothesis that, in an open and developed securities market, the price of a company's stock is determined by the available material information regarding the company and its business. . . . Misleading statements will therefore defraud purchasers of stock even if the purchasers do not directly rely on the misstatements. . . . The causal connection between the defendants' fraud and the plaintiffs' purchase of stock in such a case is no less significant than in a case of direct reliance on misrepresentations.²⁴

In *Basic*, the petitioner, Basic Incorporated, publically denied, on three separate occasions, that meetings of a possible merger had taken place.²⁵ Former Basic shareholders alleged a violation of § 10(b) and Rule 10b-5, claiming that they sold their shares between the first public denial and suspension of trading in Basic stock just prior to the merger, and thus sold their shares at what was an artificially low price.²⁶ A Supreme Court plurality recognized that in a class action such as *Basic*, the plaintiffs had an unrealistic evidentiary burden if they were required to prove each and every class member's reliance.²⁷ Thus, the Court adopted the fraud-on-the-market theory which applied a presumption of reliance rather than requiring each class member to show direct reliance on the defendant's fraudulent statements.²⁸

²² See, e.g., *Fine v. Am. Solar King Corp.*, 919 F.2d 290, 298–99 (5th Cir. 1990).

²³ *Litton Indus., Inc. v. Lehman Bros. Kuhn Loeb Inc.*, 967 F.2d 742, 748 (2d Cir. 1994).

²⁴ *Basic*, 485 U.S. at 241–42 (quoting *Peil v. Speiser*, 806 F.2d 1154, 1160–61 (3d Cir. 1986)).

²⁵ *Id.* at 227.

²⁶ *Id.* at 228.

²⁷ *Id.* at 245.

²⁸ *Id.* at 250.

Although the petitioners in *Basic* worried that the fraud-on-the-market theory effectively eliminated the reliance requirement of Rule 10b-5, the Court reiterated that in a modern market, securities changed hands millions of times a day as compared to the early fraud “face-to-face” transactions, and, accordingly, the understanding of Rule 10b-5’s reliance requirement “must encompass these differences.”²⁹ The Court ultimately held that the presumption of reliance was supported by “common sense and probability,” ruling that “[a]n investor who trades stock at the price set by an impersonal market does so in reliance on the integrity of that price.”³⁰ The Court continued, “[b]ecause most publically available information is reflected in market price, an investor’s reliance on any public material misrepresentations . . . may be presumed for purposes of a Rule 10b-5 action.”³¹

Today, it is well-developed that if the plaintiff can show that the defendant made public material representations, that the defendant’s shares were traded in an efficient market, and that plaintiffs traded shares between the time the misrepresentations were made and the time that the truth was revealed, the plaintiff is then entitled to a rebuttable presumption of reliance. If the plaintiff does not have the burden, as they do with other 10(b) and Rule 10b-5 actions, they do not have to produce evidence sufficient to show that the defendant’s misstatements altered the market price of the subjective securities.³² Instead, “once the plaintiff has shown that materially misleading statements have been disseminated into a well-developed securities market, the burden shifts to the defendant to ‘sever the link’ between the misstatements and market price.”³³

II. THE DEVELOPMENT OF RULE 10B-5 CONCERNING FRAUD-ON-THE-MARKET AND CONFIRMATORY STATEMENTS

A circuit split has developed over the question of whether a confirmatory statement disseminated by a corporation in a fraud-on-the-

²⁹ *Basic*, 486 U.S. at 243–44.

³⁰ *Id.* at 246–47.

³¹ *Id.* at 247.

³² 9 CAUSES OF ACTION 2D, *Cause of Action for Securities Fraud Under Section 10(b) of the 1934 Securities Exchange Act and/or Rule 10b-5*, § 13 (1997).

³³ *Id.*

market Rule 10b-5 claim is actionable. When the issue does arise, the courts must ask whether a Rule 10b-5 action is proper, since the misstatement does not affect the market, for the market had already digested the information. The Fifth Circuit has held that a Rule 10b-5 action is improper in the case of confirmatory statements, and the Eleventh Circuit has strongly disagreed.

A. The Fifth Circuit's View: Confirmatory Statements Are Not Actionable

In 2001, the Fifth Circuit first set up the premise in *Nathenson v. Zonagen Inc.* that confirmatory statements may not be actionable under Rule 10b-5 fraud-on-the-market claims.³⁴ The court held that despite the loosening of the reliance requirement set out in *Basic*, “[i]f the market price was not *actually* affected by the statement, reliance on the market price [did] not *of itself* become reliance on the statement.”³⁵ Simply put, investors were required to show that the allegedly false misrepresentation actually affected the stock price. Therefore, an increase in the stock price after the release of false positive information or a decrease in price following disclosure of true negative information was required. If a percent drop or rise was not significant, the investors still had to show that an earlier false, non-confirmatory statement actually affected the price. Although the court set up a “special circumstances” exception,³⁶ the Fifth Circuit has been reluctant to apply it.

Greenberg v. Crossroads Systems, Inc. further clarified the *Nathenson* holding. In *Greenberg*, purchasers of Crossroads Systems, Inc. (“Crossroads”) stock filed a putative class action against Crossroads and three officers for securities fraud under Sections 10(b) and 20(a) of the Securities Exchange Act and Rule 10b-5.³⁷ Crossroads designed, manufactured, and sold storage routers.³⁸ On January 25, 2000, Crossroads announced that they were beginning to produce Third Generation routers, and continued to make additional statements concerning the routers for the

³⁴ *Nathenson v. Zonagen Inc.*, 267 F.3d 400 (5th Cir. 2001).

³⁵ *Id.* at 419.

³⁶ *Id.* The Eleventh Circuit cites this exception since it appears to conflict with the Fifth Circuit's view in *Nathenson*.

³⁷ *Greenberg*, 364 F.3d at 659.

³⁸ *Id.* at 660.

next several months.³⁹ On July 27, 2000, Crossroads disseminated a series of unfavorable news items, including the fact that they had stopped shipment on their products because of interoperability problems.⁴⁰ As a result, the price of Crossroads stock fell by approximately one-half.⁴¹

At issue in the case was the period from January 25, 2000 to August 24, 2000, in which the plaintiffs alleged that Crossroads had made several material public misrepresentations “overstating the interoperability and other capabilities of its router products that tended to inflate the price of the company’s stock.”⁴² As a result of these misrepresentations, the plaintiffs alleged securities fraud violations.⁴³

The plaintiffs argued that the rule of *Nathenson* allowed them “to benefit from the presumption of reliance if it can be shown that ‘special circumstances’ prevented the price from otherwise rising.”⁴⁴ The Fifth Circuit did not agree, holding that the example in *Nathenson* was merely an example showing that stock prices are not affected by confirmatory information.⁴⁵ The court went on to say “[i]t is the actual movement of stock price which must be shown by fraud-on-the-market plaintiffs, and a plaintiff cannot relieve himself of this obligation by referring to ‘special circumstances’ in an attempt to explain non-movement of the stock price.”⁴⁶

The plaintiffs also argued that the decline in stock price after the July 27, 2000 statement was evidence that Crossroads had inflated the price of stock with their earlier statements.⁴⁷ The court noted that “the main concern when determining whether a plaintiff is entitled to the presumption of reliance is the casual connection between the allegedly false statement and its effect on a company’s stock price.”⁴⁸ The court held that to establish the nexus that the plaintiffs had to show that the stock price was actually affected and this is ordinarily shown by an increase following the release of

³⁹ *Id.*

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² *Greenberg*, 364 F.3d at 660.

⁴³ *Id.* at 659.

⁴⁴ *Id.* at 663.

⁴⁵ *Id.*

⁴⁶ *Id.*

⁴⁷ *Greenberg*, 364 F.3d 657 at 665.

⁴⁸ *Id.*

positive information.⁴⁹ Plaintiffs could also make this showing following the release of the alleged truth of earlier misrepresentations.⁵⁰

The result of *Greenberg* was that some of the statements made were actionable, each time the court reiterated that the statements were “non-confirmatory and therefore actionable.”⁵¹ However, both the district court and the Fifth Circuit held that the statement made on February 7, 2000 was confirmatory and thus not actionable.⁵² The February 7, 2000 statement had been previously released to the market by Crossroad’s on January 25, 2000 and since “confirmatory information does not actually affect the stock price” it “cannot form the basis of the plaintiffs fraud-on-the-market claim.”⁵³ The court explained why the misrepresentation had to be non-confirmatory to be actionable:

Finally, it is necessary that the earlier positive misrepresentation not be confirmatory. As we noted in our example in *Nathenson*, confirmatory information has already been digested by the market and will not cause a change in stock price. Because the presumption of reliance is based upon *actual movement* of the stock price, confirmatory information cannot be the basis for a fraud-on-the-market claim.⁵⁴

Greenberg meant that the plaintiff had to demonstrate, following an allegedly true disclosure that caused a sharp decrease in stock price, that a stock’s price was *actually* affected. To do so the plaintiff had to show that “the negative truthful information causing the decrease in price [was] related to an allegedly false, non-confirmatory positive statement made earlier” and that it was “more probable than not that it was this negative statement and not other unrelated negative statements, that caused a significant amount of the decline.”⁵⁵ The Fifth Circuit had raised, or at least clarified, its proof requirements for application of the fraud-on-the-market presumption of reliance that no other Circuit had nor has.

Defendants within the Fifth Circuit subsequently began to argue that plaintiffs failed to show that any statement by them was anything but

⁴⁹ *Id.*

⁵⁰ *Id.*

⁵¹ *Id.* at 666.

⁵² *Id.* at 670.

⁵³ *Id.*

⁵⁴ *Greenberg*, 364 F. 3d 657 at 666–67.

⁵⁵ *Id.* at 666.

confirmatory under *Greenberg*.⁵⁶ It was an easy defense to label a fraudulent statement as “confirmatory.” The district courts adopted with this line of thinking; “[f]irst, as a matter of law, the alleged misrepresentations in the offering memoranda . . . [and] . . . filings are ‘confirmatory’ and cannot be the basis for a fraud-on-the-market presumption of reliance.”⁵⁷ One district court went as far as saying it was irrelevant if the defendants “knew of any fraudulent statements or were reckless in approving the offering memoranda” continuing that intent did not cure that problem of “confirmatory statements” which under *Greenberg* “cannot trigger the fraud-on-the-market presumption of reliance.”⁵⁸

In *Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*, the Fifth Circuit again held that the plaintiff was required to show that the misstatement actually moved the market.⁵⁹ The plaintiff had to establish “loss causation in order to trigger the fraud-on-the-market presumption.”⁶⁰ The court ruled that it wasn’t enough merely to show that the market price declined after a statement reporting negative news and that the “main concern when addressing the fraud-on-the-market presumption of reliance is whether allegedly false statements actually inflated the company’s stock price.”⁶¹ The plaintiffs were required to show that a loss occurred from the decline in stock price because the truth made its way into the marketplace rather than for some other reason, such as a changed investor expectations, or other independent factors.⁶² The court noted that the earlier positive misrepresentation must not be confirmatory, because that information was already known by the market, and those statements would not affect the stock price.⁶³

In sum, the *Archdiocese of Milwaukee* court held that the correct standard for the plaintiff’s burden was to present evidence that a fraudulent non-confirmatory statement caused the stock price to rise by showing that

⁵⁶ See *In re Enron Corp. Sec.*, 529 F. Supp. 2d 644, 663 (2006).

⁵⁷ *Id.* at 774.

⁵⁸ *Id.* at 775.

⁵⁹ *Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*, 597 F.3d 330, 335 (5th Cir. 2010), *vacated and remanded sub nom. Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179 (U.S. 2011).

⁶⁰ *Id.*

⁶¹ *Id.*

⁶² *Id.*

⁶³ *Id.* at 337.

“an alleged corrective disclosure causing the decrease in price is related to the false, non-confirmatory positive statement made earlier, and that it is more probable than not that it was this related corrective disclosure, and not any other unrelated negative statement, that caused the stock price decline.”⁶⁴ Ultimately the court held that the alleged misrepresentations and corrective disclosures failed to meet the requirement for proving loss causation at the class certification stage.⁶⁵ The case would be overturned by the Supreme Court⁶⁶ on a different issue, but the Supreme Court did not comment on anything past the formation of a class, rather remanding it to decide the remaining issues, including confirmatory statements. *Archdiocese of Milwaukee* does show that the Fifth Circuit, despite slight inconsistencies, still adheres to *Greenberg* as recently as 2010.

A. The Eleventh Circuit Weighs In: Confirmatory Statements Are Actionable

The Eleventh Circuit explicitly disagreed with the Fifth Circuit concerning whether confirmatory statements could be actionable under Rule 10b-5 fraud-on-the-market suit:

While we agree with the Fifth Circuit that confirmatory information will not likely move the market price at the time of its release—because the market already digested the information when it was first released—we do not agree that such confirmatory information can never be actionable. If a company knowingly makes materially false representations with the purpose and effect of preventing the stock price from falling to the level that the truth would yield, the company is responsible for perpetuating inflation within the stock price.⁶⁷

In *FindWhat Investor Group v. FindWhat.com*, investors alleged, in a class action, securities fraud against an internet commerce company and three of its officers for making false and misleading statements and material omissions in order to inflate the company’s stock price.⁶⁸ The defendant, MIVA, Inc. (“MIVA”), provided a pay-per-click advertising service in which the advertisers pay MIVA each time an internet user clicks on their

⁶⁴ *Id.*

⁶⁵ *Id.* at 344.

⁶⁶ See *Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179 (2011).

⁶⁷ *FindWhat Investor Grp. v. FindWhat.com*, 658 F.3d 1282, 1314 (11th Cir. 2011).

⁶⁸ *Id.* at 1290.

ad.⁶⁹ The revenue was decided by the price that advertisers bid for a click on their ads, and the number of clicks generated on those ads.⁷⁰ In other words, the more clicks the better revenue for MIVA. However, the more advertiser-paid clicks that fail to translate into income for the advertiser, the lower the price the advertisers bid for the ad.⁷¹ Unfortunately, and at issue in the case, was practice of click fraud, which “refers to the practice of clicking on an Internet advertisement for the sole purpose of forcing the advertiser to pay for the click.”⁷² Click fraud uses spyware, browser hijacking software, and other bots or non-human clickers and can be very costly to advertisers that pay-per-click. It was therefore important to prevent for companies like MIVA because it led to lower conversion rates, and thus lower bids.⁷³

Plaintiffs in *FindWhat*, alleged that MIVA’s top revenue distribution partners, who were responsible for one-third of MIVA’s revenue, began to use click-fraud.⁷⁴ Although the clicks were high, MIVA began seeing lower bids from advertisers and lost some of its high quality distribution partners because they left due to decreasing revenues.⁷⁵ This meant that an even larger portion was being generated from click fraud. Since click-fraud, although eventually deleterious, ensured short term gains, and MIVA appeared to be doing well and continued to meet or exceed analyst’s growth expectations every year.⁷⁶ MIVA became “obsess[ed] with meeting Wall Street’s forecasts, these expectations were sometimes met by as little as penny.”⁷⁷

Eventually regulators began cracking down on click-fraud, and MIVA, trying to remain proactive, claimed in a company conference call that they had removed distribution partners with \$70,000 in revenue per day because they wanted higher quality traffic.⁷⁸ However, some evidence showed that no traffic was taken off line, and the click-fraud distributors were not

⁶⁹ *Id.* at 1291.

⁷⁰ *Id.*

⁷¹ *FindWhat*, 658 F.3d at 1291.

⁷² *Id.*

⁷³ *Id.* at 1292.

⁷⁴ *Id.*

⁷⁵ *FindWhat*, 658 F.3d at 1292.

⁷⁶ *Id.* at 1292–93.

⁷⁷ *Id.* at 1293.

⁷⁸ *Id.*

removed from the network, or that these were fraudulent statements. In a March 16, 2005 Form 10-K annual report filed with the SEC, MIVA again claimed that they were removing low-quality distributors.⁷⁹ On the same Form 10-K, MIVA asserted that they did not rely on spyware for any purpose and they had implemented screening policies to detect click-fraud.⁸⁰ On May 5, 2005, MIVA issued a press release announcing disappointing first quarter results, and that day the company revealed the click-fraud was responsible for some of MIVA's revenue, and that some distributors had not been adhering to MIVA standards. As a result, MIVA's share price dropped significantly, over 21 percent in one day.⁸¹

The district court, in granting MIVA's summary judgment motion, concluded that the plaintiffs did not show the elements of loss causation and damages related to two of the statements at issue.⁸² The March 16, 2005 SEC Form 10-K filing was merely a repetition of prior statements and did not "move the market up or down."⁸³ Since the price inflation of the stock, which was 26.44%, existed on February 24, 2004, and remained at that level after both the February 23, 2005 and March 16, 2005 statements, "the inflation in the stock price was caused by statements made prior to the class period in this case."⁸⁴ The district court held that although the particular statements were otherwise actionable, since the inflation level did not change as a result of the alleged misrepresentations they could not have caused the plaintiff's losses.

The Eleventh Circuit vehemently disagreed with the *MIVA* court calling the ruling "legal error."⁸⁵ Ultimately holding that:

The Defendants may be held liable for knowingly making materially false statements that continued to prop up the already inflated price of MIVA's stock and thereby caused losses to investors, regardless of whether MIVA's stock price was already inflated before the actionable statements were made.⁸⁶

⁷⁹ *FindWhat*, 658 F.3d at 1293.

⁸⁰ *Id.*

⁸¹ *Id.*

⁸² *In re MIVA, Inc.*, No. 2:05-cv-201-FtM-29DNF, 2009 U.S. Dist. LEXIS 106842, at *16 (M.D. Fla. Nov. 16, 2009).

⁸³ *Id.* at *14.

⁸⁴ *Id.* at *15.

⁸⁵ *FindWhat*, 658 F.3d at 1307.

⁸⁶ *Id.*

The court's analysis, explained below, largely attacked *Greenberg* on the premise that defendants, if not for the fraudulent statements, may not have suffered loss if the truth was revealed at the onset of the class period.

Citing *Greenberg*, the Eleventh Circuit noted that confirmatory information will not change the stock price because the market had already "digested the information."⁸⁷ However, the court noted that the falsity keeps the stock fraudulently inflated and therefore taints the mix of public information, or in other words, it "props" the fraudulent stock price up. Again, the fraud-on-the-market case allows the reliance element of a Rule 10b-5 claim to be rebuttably presumed, so long as the statement was material and the market was informationally efficient. The court, quite simply, continued that everyone who relies on the market price, relies on the misrepresentation that is fed into the market.⁸⁸

Since proof of a fraudulently inflated purchase price only satisfies reliance; loss causation requires going a step further to supply the logical link between the inflated share purchase price and any later economic loss.⁸⁹ Since in this case, the inflation was caused by statements made prior to the class period, the court had to address the problem that *Greenberg* and the district court had proposed. Since the statements made by the defendants during the class period could not have caused the inflation, they therefore could not have caused the plaintiff's losses. A conclusion that seemed logical to the Fifth Circuit, and the *MIVA* district court.

The Eleventh Circuit held that the *Greenberg* and *MIVA* reasoning "misapprehends the nature of market fraud."⁹⁰ The court argued that to say that statements that had no immediate effect on an already inflated stock price could not cause harm was "erroneous."⁹¹ Continuing, the court ruled that the inflation level did not have to change for new investors to be harmed by a false statement, as the false statement prevented the stock price from falling and prolonged the period that it remained at the unduly high inflation price.⁹² Causing a stock price to remain inflated fraudulently

⁸⁷ *Id.* at 1310.

⁸⁸ *Id.* at 1311–12.

⁸⁹ *Dura Pharm.*, 544 U.S. at 342.

⁹⁰ *FindWhat*, 658 F.3d 1314.

⁹¹ *Id.*

⁹² *Id.* at 1314.

caused the defendant to be liable. Ignoring confirmatory statements would punish those whom had a class period outside of that initial fraudulent statement, as in *FindWhat*.⁹³ The longer inflation remains with the stock, the more buyers who stand to lose when the inflation dissipates. The court could not comprehend a “reason to draw a lega[l] distinction between fraudulent statements that wrongfully prolong the presence of inflation in a stock price and fraudulent statements that initially introduce that inflation.”⁹⁴

III. SHOULD THE SUPREME COURT DECIDE WHETHER CONFIRMATORY STATEMENTS ARE ACTIONABLE UNDER RULE 10B-5

Whether the Supreme Court should decide the actionable confirmatory information issue in a fraud-on-the-market class action suit depends on the expansion of Fifth Circuit view, including within the Fifth Circuit itself. Although the Fifth Circuit expressly held that confirmatory information cannot be actionable in *Greenberg*, certain opinions have questioned that rule. It seems unclear if they will stay consistent. Since no other circuit has held that confirmatory statements are not actionable, the circuit split may disappear. Inklings of opposition to a rule where confirmatory information is not actionable began with *Nathenson* and the “certain special circumstances” exception:

We also realize that in certain special circumstances public statements falsely stating information which is important to the value of a company’s stock traded on an efficient market may affect the price of the stock even though the stock’s market price does not soon thereafter change. For example, if the market believes the company will earn \$1.00 per share and this belief is reflected in the share price, then the share price may well not change when the company reports that it has indeed earned \$1.00 a share even though the report is false in that the company has actually lost money (presumably when that loss is disclosed the share price will fall).⁹⁵

⁹³ *Id.* at 1315. Other statements were thrown out for FED. R. CIV. P. 12(b)(6) reasons, shortening the class period.

⁹⁴ *Id.* at 1316.

⁹⁵ *Nathenson*, 267 F.3d 419.

The Eleventh Circuit has pointed to this paragraph as hole in the *Greenberg* argument.⁹⁶ *Nathenson* was frequently cited by *Greenberg* and it seemed the facts of *Greenberg* and the like would fit this “special circumstances” situation. Nevertheless, the Fifth Circuit did not apply this standard, instead drawing a bright-line rule that confirmatory statements are not actionable.

Also questioning the bright-line rule was a concurring Circuit Judge of the Fifth Circuit in *Regents of University of California v. Credit Suisse First Boston, Inc.*⁹⁷ In *Regents*, the defendant investment banks, claimed the district court erred by failing to apply *Greenberg*, and holding that the misrepresentations made were non-confirmatory and therefore non-actionable.⁹⁸ The Fifth Circuit majority disallowed the formation of a class because they failed to get the required presumption of reliance based on a lack of duty.⁹⁹ The concurring Circuit Judge Dennis returned to the district court holding and held that indeed they wouldn’t use *Greenberg* to relieve the defendants of the burden.¹⁰⁰ He rationalized this by citing to *Basic*’s “unmistakably clear” statement that the defendant had the burden of rebutting the presumption of reliance.¹⁰¹ This presumption arose out of consideration of “fairness, public policy, and probability, as well as judicial economy.”¹⁰² The concurrence noted that the Fifth Circuit had correctly applied *Basic* previously in *Fine v. American Solar* when they recognized that the defendant could rebut *Basic*’s presumption of reliance only “by showing the nondisclosures did not affect the market price;” or that the plaintiffs “would have purchased the stock at the same price had they known the information that was not disclosed;” or “that the plaintiff actually knew the information that was not disclosed to the market.”¹⁰³ However, the concurrence felt that the *Greenberg* panel changed course unjustifiably and held that it was actually the plaintiff’s burden to show that

⁹⁶ *FindWhat*, 658 F.3d 1314 n.33.

⁹⁷ 482 F.3d 372, 401–02 (5th Cir. 2007) (Dennis, J., concurring).

⁹⁸ *Id.* at 401.

⁹⁹ *Regents*, 482 F.3d 372, 384 (5th Cir. 2007).

¹⁰⁰ *Id.* at 401 (Dennis, J., concurring).

¹⁰¹ *Id.*

¹⁰² *Regents*, 482 F.3d at 402 (citing *Basic*, 485 U.S. at 245).

¹⁰³ *Id.*

the defendant's misrepresentation actually moved the market price of the stock.¹⁰⁴

The concurring judge in *Regents* followed the same line as the Eleventh Circuit would subsequently; "*Greenberg* appears to have mistakenly relied on this court's earlier decision in *Nathenson*."¹⁰⁵ Continuing that *Nathenson* merely determined that the district court had not erred when it ruled that the "allegations of the plaintiffs' complaint affirmatively demonstrated that the misrepresentations in question did not affect the price of the issuer's stock."¹⁰⁶ In other words, just because the plaintiffs in *Nathenson* affirmatively pleaded themselves out of the fraud-on-the-market presumption lent "no support to the view that securities plaintiffs can invoke the fraud-on-the-market presumption only if they first affirmatively demonstrate that the market moved in response to the alleged misrepresentation."¹⁰⁷ The concurrence ended this issue with; "[b]ecause the *Greenberg* panel's decision to reallocate the burdens in fraud-on-the-market cases conflicts not only with *Basic*, but also with earlier decisions of this court, such as *Fine*, I would follow those decisions and hold that the defendant retains the burden of rebutting *Basic*'s presumption of reliance."¹⁰⁸

Nevertheless, currently it appears that the Fifth Circuit still adheres to the non-actionability of confirmatory statements in Rule 10b-5 class actions. The most recent ruling on the issue was 2010's *Archdiocese of Milwaukee*, in which the court made no mistake in assuring that confirmatory statements were non-actionable.¹⁰⁹ Also, there is no telling if district courts, such as in *MIVA*, will arise and use similar doctrine, which does have roots in logic.

On the opposite end, the Eleventh Circuit pointed to several jurisdictions that do not follow the *Greenberg* principles.¹¹⁰ However, they

¹⁰⁴ *Id.* at 402.

¹⁰⁵ *Id.*

¹⁰⁶ *Id.* at 403.

¹⁰⁷ *Id.*

¹⁰⁸ *Id.*

¹⁰⁹ *Archdiocese of Milwaukee Supporting Fund, Inc. v. Haliburton Co.*, 597 F.3d 330, 338 (5th Cir. 2010).

¹¹⁰ *See In re Cooper Sec. Litig.*, 691 F. Supp. 2d 1105, 1116 (C.D. Cal. 2010) (denying summary judgment to defendants on loss causation grounds on the basis that "it [was] disputed as to whether the [defendants'] statements caused artificial inflation to continue to be incorporated into the stock price, as

to fail to point to another circuit court that wholly agrees with them, instead citing district courts. Although one could argue that the circuit court did not correct the district courts, it is well settled that the Supreme Court's or a circuit court's decision to deny an appeal "does not in any sense constitute a ruling on the merits of the case in which the writ is sought."¹¹¹ This split is a real issue, and for the time being will remain one.

Despite some inconsistencies in the Fifth Circuit, with the amount of litigation surrounding securities because of economic failures and unprecedented fraudulent behavior of securities investors, it seems important for the Supreme Court to rule on the issue. Because many of the defendants are large corporations that may be sued in different jurisdictions, forum shopping will no doubt occur. The Fifth Circuit will be avoided by classes whose class period doesn't cover initial statements that caused inflation. At the same token, if plaintiffs are entrapped in the Fifth Circuit, law that the Supreme Court may deem unfair will be applied, just as defendants sued in the Eleventh Circuit may be subject to law that is deemed unfair. The gravity of the cases yearns for national consistency, as they usually are multi-million dollar affairs.

IV. PUBLIC POLICY OR LOGIC; WHICH MAKES MORE SENSE?

Logically, the *Greenberg* view does have strong roots. Although the terms are often complicated, what plaintiffs need to prove to establish reliance in securities cases is but-for causation.¹¹² *Basic* essentially held that if the market was efficient then the courts could presume but-for causation

opposed to revealing the truth, which allegedly would have caused the stock price to fall" (emphasis added); *In re Scientific Atlanta, Inc. Sec. Litig.*, 754 F. Supp. 2d 1339, 1380 n.12 (N.D. Ga. 2010) ("Plaintiffs argue persuasively that the class period inflation includes . . . the pre-class period inflation that would have been removed from the stock price had [the company] accurately provided information about [the relevant truth at the start of the class period]."); *In re Bristol-Myers Squibb Sec. Litig.*, No. Civ.A. 00-1990 (SRC), 2005 WL 2007004, at *17 (D.N.J. Aug. 17, 2005) (stating, in the materiality context, that "it is conceivable that [an affirmative] misstatement could serve to maintain the stock price at an artificially inflated level without also causing the price to increase further").

¹¹¹ *Bethley v. Louisiana*, 520 U.S. 1259, 1259 (1997).

¹¹² Keith A. Rowley, *Cause of Action for Securities Fraud Under Section 10(b) of the 1934 Securities Exchange Act and/or Rule 10b-5*, 9 CAUSES OF ACTION 2D 271, § 11 (originally published in 1997).

or reliance on a misstatement.¹¹³ *Basic* made sure to note that this was a rebuttable presumption of reliance and “[any] showing that severs the link between the alleged misrepresentation and . . . the price received (or paid) by the plaintiff” could successfully rebut the presumption.¹¹⁴ This burden was “staggering” and makes rebuttal “virtually impossible in all but the most extraordinary case.”¹¹⁵ “In order to demonstrate absence of impact, a defendant, essentially, must prove a negative.”¹¹⁶

However, holding that a misstatement that did not affect the stock price could not be actionable makes sense as a prerequisite to getting a presumption of reliance. A plaintiff suing on a misstatement that did not change the stock price for better or worse, cannot be said to have “but for” relied on that particular statement. With no “transactional causation” the buyer perhaps should not be entitled to a presumption of reliance. The buyer was going to buy at that particular fraudulent price, whether or not a later misstatement was made. This view by no means diminishes the fact that the misstatement that actually caused the inflation is actionable and plaintiffs are entitled to a presumption of reliance. The view instead suggests that later misstatements that had no effect on the market price cannot be “relied” upon in any circumstance.

Although the above is quite logical, it creates a severe injustice on plaintiffs such as those in *FindWhat*. Plaintiffs which have had their class period shortened, often for various reasons,¹¹⁷ may have no choice but to use confirmatory statements to file securities fraud. By allowing the defendant corporations to just point to fact that their fraudulent statements didn’t move the market to essentially win the case, is unfair to plaintiffs and against public policy. This is certainly the view the Eleventh Circuit had:

We decline to erect a per se rule that, once a market is already misinformed about a particular truth, corporations are free to knowingly and intentionally reinforce material misconceptions by repeating falsehoods with impunity.

¹¹³ *Basic, Inc. v. Levinson*, 485 U.S. 224, 250 (1988).

¹¹⁴ *Id.* at 248.

¹¹⁵ *Id.* at 256 n.7 (White, J., dissenting).

¹¹⁶ Rowley, *supra* note 112.

¹¹⁷ Often due to pleading, such as 12(b)(6) problems, or because the original inflating statement was not actionable because of lack of duty, or was a leaked non-public statement.

Defendants who commit fraud to prop up an already inflated stock price do not get an automatic free pass under the securities laws.¹¹⁸

Whether a court uses public policy to determine an issue is a tough line to draw. However, the Supreme Court said in *Basic* that presumptions are effective to allocate the burdens of proof and are created “out of considerations of fairness, public policy, and probability, as well as judicial economy.”¹¹⁹ The presumption was also created out of “common sense and probability.”¹²⁰ A result allowing material misstatements to be non-actionable because they repeat fraudulent information the market has already absorbed, is not adhere to the *Basic* principles of “fairness” and “public policy.”

If the Fifth Circuit view is adopted it could have a lasting effect on commerce. Corporations with an inflated stock price would have an incentive to keep their stock price “propped” up as to induce as many traders to buy the stock, and maintain “good times” until they get caught. Immunizing defendants who disseminate fraudulent material just because the market already believed the information does not take the perspective of the trader who bought the fraudulently high stock into consideration. For if the corporation was honest during instead of making confirmatory statements, the trader would not have bought the stock in the first place. This not only brings unsuspecting traders into unwanted law suits to just recover their money, but also stifles trade in general by leaving no incentive for a corporation to correct a fraudulent statement and telling the public it is “okay” to keep market prices fraudulently high.

This is a classic case of logic creating an unfair result, the very situation in which public policy should be used to override it. The Eleventh Circuit does not want fraudulent statements to continually be repeated with no penalty, and perhaps harm to innocent plaintiffs. The Supreme Court should agree, seeing as how *Basic* adopted the fraud-on-the-market doctrine with public policy resonating in their minds.

¹¹⁸ FindWhat Investor Grp. v. FindWhat.com, 658 F.3d 1282, 1317 (11th Cir. 2011).

¹¹⁹ *Basic*, 485 U.S. at 245.

¹²⁰ *Id.* at 246.

V. CONCLUSION

The Fifth Circuit's holding in *Greenberg*, that confirmatory misstatements are non-actionable in fraud-on-the-market Rule 10b-5 suits, may have a basis in logic, but completely disregards public policy. The Supreme Court should hear the issue to prevent forum shopping and undue results from happening in the Fifth Circuit and other potential places where the *Greenberg* view may arise. The Court, on the basis of *Basic*, should adopt the Eleventh Circuit view, which relies on public policy, and put an end to the circuit split.