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P R O C E E D I N G S

(10:33 a.m.)

JUSTICE STEVENS: The Court will now hear argument in Dura Pharmaceuticals against Broudo. We finally get to the arguments.

(Laughter.)

ORAL ARGUMENT OF WILLIAM F. SULLIVAN

ON BEHALF OF THE PETITIONERS

MR. SULLIVAN: Justice Stevens, and may it please the Court:

This case presents two disparate views of what kind of loss is necessary to sustain a claim for securities fraud under the Reform Act's loss causation requirement.

The minority view of artificial inflation articulated by the Ninth Circuit is illogical and equates loss with purchase, regardless of whether the investor has suffered any economic harm. An investor does not suffer any harm until some form of corrective disclosure occurs and the artificial inflation is removed from the stock. The two events must be related. There is no causal connection between the harm and the misrepresentation otherwise.

The majority rule correctly requires a causal connection between the misrepresentation and a decline in

1 value. The -- and the statute itself is expressed in
2 terms of causation that a plaintiff prove that the act of
3 the defendant caused the loss.

4 When we look at the statute of the Reform Act
5 and other provisions, we see supporting language. In
6 section 21D of the Reform Act, we see under the provision
7 that has been known as the look-back provision that the
8 Congress discussed the loss in terms of trading price
9 after a corrective disclosure.

10 Similarly in section 105 of the Reform Act,
11 although dealing with section 12 of the Securities Act,
12 the Reform Act, in its one place where it actually spoke
13 of loss causation and its definition, defined it in terms
14 of depreciation in value. And the -- the depreciation in
15 value of the security would be attributable to the fraud.

16 JUSTICE KENNEDY: Can -- can you tell me if --
17 if we had not granted certiorari in the case and the Ninth
18 Circuit's opinion became final, what would have happened
19 on remand? What would have happened in the trial court?

20 MR. SULLIVAN: At the trial court, the --

21 JUSTICE KENNEDY: And -- and wouldn't there have
22 been a -- a motion to make the pleadings more specific and
23 they would have then come up with a measure of damages, or
24 am I wrong about that?

25 MR. SULLIVAN: Well, the Ninth Circuit remanded

1 for specific reasons on repleading, which Your Honor has
2 articulated, and those would have occurred.

3 The other issues relating to loss raise
4 questions concerning whether some of the -- the claims
5 might be time barred and whether or not those claims could
6 be stated. So that would have raised a different issue.

7 In addition, throughout the pleadings of this
8 case -- we're now on the third complaint -- the -- the
9 plaintiffs have not raised that issue and have not sought
10 to plead causation consistent with the -- our view of the
11 world.

12 JUSTICE KENNEDY: Well, I mean, I -- I assume
13 you say that the trial judge and -- and defense counsel
14 and -- and the trial court would have had real problems
15 with this opinion. What -- what were those problems --

16 MR. SULLIVAN: Well --

17 JUSTICE KENNEDY: -- insofar as the measure of
18 loss is concerned?

19 MR. SULLIVAN: Well, the -- the real problems
20 that the trial court had and what we would continue to
21 espouse with this opinion is that it doesn't link the loss
22 with the misrepresentation. And in this case, the
23 misrepresentation offered occurred 9 months after the
24 price drop that is being sought.

25 I think when you -- when you carve it all back

1 and you look at what the real issue is, at the end of the
2 day, it's -- it becomes an issue of what -- what damages
3 does the plaintiffs' class seek.

4 JUSTICE KENNEDY: Under this opinion, how would
5 -- under the Ninth Circuit's opinion, how would the jury
6 have been instructed to come -- to calculate the loss? I
7 assume you have a problem with that and I want to know
8 what it is.

9 MR. SULLIVAN: The -- the problem is we wouldn't
10 have been able to -- to frame a clear jury instruction
11 that would have indicated whether or not the loss that the
12 jury should look at would be related to the disclosure
13 about Albuterol Spiros, which would have occurred in the
14 November time frame, or whether we would have had to step
15 back to the February time frame and -- and the loss that
16 was incurred then. And the issue would have not only
17 related to the -- the damages instructions but would have
18 related to the misrepresentation instruction.

19 And the -- the problem that -- that we continue
20 to have with the -- the case after the Ninth Circuit's
21 opinion is where do you look for the misrepresentation and
22 where do you look for the damage and how do you know that
23 there is a loss under the statute. You're looking at a --
24 at a --

25 JUSTICE O'CONNOR: What would have happened if

1 the disclosure about Albuterol was made before the company
2 announced revenue shortfalls?

3 MR. SULLIVAN: Well, I think that would have
4 been different. That would have been a disclosure prior
5 to the -- to the drop, and there -- I would expect under
6 pleading that the plaintiffs could have done, they could
7 have tied the two of them together and argued that the
8 cause of the loss was the combination of the two events in
9 the marketplace.

10 JUSTICE BREYER: Why is it difficult to figure
11 out what the Ninth Circuit was thinking? I -- I found it
12 -- am I right? I thought they said the -- the seller says
13 we found gold. The stock sells for \$60. They have loads
14 of experts who say in the absence of that statement, which
15 was a lie, we found gold, it would have sold for \$10. The
16 loss is \$50. I mean, I take it that's their theory.

17 MR. SULLIVAN: That -- that would be the theory
18 under the Ninth Circuit.

19 JUSTICE BREYER: All right. Now, what's wrong
20 with that theory?

21 MR. SULLIVAN: Well, the --

22 JUSTICE BREYER: It's clear. I mean, it's
23 certainly clear.

24 MR. SULLIVAN: The problem with -- with that
25 theory is that Congress has told us that the

1 misrepresentation has to have caused the loss and --

2 JUSTICE BREYER: Yes. They say it caused the
3 loss, \$50.

4 MR. SULLIVAN: And -- and what we would be
5 looking for is evidence that -- that such a actual loss
6 occurred in response to a corrective disclosure in the
7 marketplace.

8 JUSTICE SCALIA: Well, doesn't it depend on --
9 on what you -- what you consider to be the value of the
10 stock. Until the disclosure of the fact that they didn't
11 find gold is made, the stock is still worth \$60, isn't it?

12 MR. SULLIVAN: Yes, it is.

13 JUSTICE SCALIA: Because everybody else thinks
14 they found gold too. So you're still holding stock worth
15 \$60, if worth means its market value. Right?

16 MR. SULLIVAN: That is correct.

17 JUSTICE SCALIA: And we're dealing with a
18 special rule that looks to market value. Right? You
19 don't have to have the -- the representation made
20 explicitly to the plaintiff. It's a representation that
21 was made to the market at large which caused the market
22 value of the stock. Right?

23 MR. SULLIVAN: That is correct.

24 JUSTICE SCALIA: So he paid \$60, he got \$60.
25 There's no loss.

1 MR. SULLIVAN: And would have the ability to
2 continue to sell that stock for \$60 in the marketplace
3 until such time as there was a corrective disclosure.

4 JUSTICE BREYER: Is there any other problem?
5 I'm trying to get a list of what the problems are with the
6 simple theory. Now, I've heard one that you've ratified.

7 (Laughter.)

8 JUSTICE BREYER: And -- and is there any other?

9 MR. SULLIVAN: Thank you.

10 The -- the other is -- is I think an issue of
11 certainty as to the marketplace. Remember, we are
12 operating on a fraud-on-the-market theory context here in
13 this kind of action, and in that -- in that context, when
14 there is a disclosure in the marketplace, you have
15 certainty as to what the market actually valued the
16 decline to be as opposed to speculation that there was in
17 fact inflation at the -- at the time of purchase.

18 The Ninth Circuit's purchase time rule in the --
19 in the fraud-on-the-market context doesn't necessarily
20 identify the decline in the value of the stock which you
21 can get from the marketplace, and that I think is just
22 better -- a better indicator.

23 JUSTICE BREYER: Now, can we -- can they prove
24 this? \$60. \$50 is wrong, is inflated because of the
25 gold. It turns out that gold never existed and they knew

1 it. The stock is not selling for \$60 anymore. It's
2 selling for \$200. They found platinum. No one expected
3 it. All right. They want to prove maybe it is selling
4 for \$200, but if we had found gold as well, it would have
5 sold for \$250. Can they do it?

6 MR. SULLIVAN: The Congress has told us that we
7 should look for loss, and that --

8 JUSTICE BREYER: It's a loss. \$250 versus \$200.

9 MR. SULLIVAN: -- and that leads us to the --
10 the point that -- that whether the increase can actually
11 be pled. But if there is a disclosure that indicates that
12 the gold component was not part of the -- of the -- the
13 discoveries, and the plaintiffs can indicate that there
14 was an upward tick because of the platinum and a downward
15 movement in the stock because of the disclosure about
16 gold, then I think those two can be separated and pled
17 accordingly.

18 JUSTICE GINSBURG: And both would be all right
19 because what's the difference between not getting as much
20 appreciation as you would have gotten if the correct
21 information had been out there and getting less than you
22 would have gotten. I mean, in both cases the shareholder
23 is affected the same way. They didn't get as much in one
24 case. So you're not distinguishing between those. I
25 think you're agreeing that in both cases the -- the

1 discovery of platinum is the shares go up, but they would
2 have gone up much higher if there had been gold as well.
3 That shareholder has a claim under your theory, doesn't
4 she?

5 MR. SULLIVAN: Well, that shareholder -- it
6 would depend on what has happened in the marketplace. If
7 there has not been a disclosure about the absence of gold,
8 that stock would still reflect the -- the value of the
9 expectation of gold.

10 JUSTICE GINSBURG: Yes, but I'm assuming that --
11 that there is, and so the stock goes up but not as much as
12 it would have.

13 But on the point of disclosure, there is a
14 difference between your position and the Government's, and
15 I really would like you to tell me if that's genuine or
16 it's my misperception. Your view is there's the
17 disclosure of the bad news, the lie, and the price drops.
18 In the Government's presentation -- and I'm reading from
19 page 19 -- the fraud can be revealed by means other than a
20 corrective disclosure and a drop in the stock price may
21 not be a necessary condition for establishing loss
22 causation in every fraud on the marketplace.

23 MR. SULLIVAN: Our position is we believe that a
24 drop in the price is necessary to demonstrate the loss.

25 JUSTICE O'CONNOR: But the Government --

1 MR. SULLIVAN: They do.

2 JUSTICE SCALIA: It doesn't matter in this case,
3 does it? Is -- is that issue before us?

4 MR. SULLIVAN: In this case --

5 JUSTICE SCALIA: Do we have to decide that issue
6 here?

7 MR. SULLIVAN: We don't have to decide that
8 issue for this case.

9 JUSTICE SCALIA: And is it -- is it easy to
10 prove that -- that the price of this now valuable stock
11 because they found platinum would have been \$40 higher had
12 they found gold? I mean, the burden would be on the
13 plaintiff to prove that -- would -- I mean, if we adopted
14 that theory.

15 MR. SULLIVAN: The plaintiff has that burden --

16 JUSTICE SCALIA: It would be very hard to prove,
17 it seems to me.

18 MR. SULLIVAN: And -- and at the pleading stage,
19 I believe that they could be segregated and -- and an
20 upward movement in the stock could be distinguished from a
21 downward movement in the stock. But the downward movement
22 in stock would be the focus from our standpoint.

23 JUSTICE KENNEDY: In -- in your view, is the
24 plaintiff entitled to an expectancy measure of damage, or
25 is it more the traditional tort measure which is out-of-

1 pocket losses?

2 MR. SULLIVAN: We don't believe that they are
3 entitled to any expectation damages. It would be an out-
4 of-pocket loss calculation.

5 JUSTICE KENNEDY: Is the -- is the respondents'
6 position properly characterized as asking for expectancy
7 damages or is that too simplistic a view?

8 MR. SULLIVAN: I -- I think that it is perhaps
9 inclusive of expectancy. It really depends on how you
10 view that price inflation theory.

11 JUSTICE SCALIA: I think they'd be called
12 reliance damages. You know, I used to teach contract law.
13 We would call it reliance damages.

14 MR. SULLIVAN: And it gets back in our view to
15 the transaction causation distinction in the securities
16 cases that talk about the reliance transaction, price
17 inflation that occurs at the front end.

18 JUSTICE BREYER: If that's so then -- then on
19 the platinum/gold theory, you can't really recover what
20 would have happened if there had been gold because it
21 might be that the stock would have been worth \$400 if
22 there had been gold even though 15 years earlier when he
23 only paid \$50 for it, he's only out of pocket, at most,
24 \$50. But if there had been gold, because of the gold
25 market in the world, it would have been a lot more

1 valuable. And you're saying he can't do that? I don't
2 know. Maybe that question isn't in the case, but that
3 strikes me as a difficult question.

4 MR. SULLIVAN: Following your -- your suggestion
5 about the price of gold, it would depend on where that --
6 that disclosure occurred in connection with the price of
7 -- the price of gold, if that disclosure occurred, and if
8 there was an economic loss that could be -- could be tied
9 to it. The passage of time here is important only insofar
10 as it allows for the corrective disclosure and a chance
11 for the market to reflect an economic loss.

12 JUSTICE STEVENS: Mr. Sullivan, you refer to
13 the disclosure as being the key point and when you measure
14 the -- the loss and so forth. What if the information
15 leaks out and there's no specific one disclosure that does
16 it all and the stock gradually declines over a period of
17 six months?

18 MR. SULLIVAN: I think --

19 JUSTICE STEVENS: How would you handle that
20 case?

21 MR. SULLIVAN: I think that a plaintiff would be
22 able to handle that in -- in a pleading and they would
23 have to identify the leaks and if there are several,
24 identify each of them and identify them as --

25 JUSTICE STEVENS: Well, maybe they don't know

1 the leaks. The only thing they can prove is that there
2 was a gross false statement at the time they bought the
3 stock and they don't know what happened to the decline.
4 Later on they find out that it gradually leaked out. Do
5 they have to prove exactly how the information became
6 public?

7 MR. SULLIVAN: The key is that they have to
8 prove that the loss was connected to the misrepresentation
9 and that the drop in --

10 JUSTICE SCALIA: Well, they -- they wouldn't
11 have to prove how it came out. They would just have to
12 prove that the market knew the truth, no matter how the
13 market learned the truth. I mean, if it was published in
14 a -- in a column by some market reporter who doesn't
15 disclose how he found out. So long as the market knows
16 the truth, isn't that all they need?

17 MR. SULLIVAN: So I was distinguishing -- yes is
18 the answer to your question. I was distinguishing a
19 situation where the price just trickled down and no one
20 knew until later. And the -- the question that Justice
21 Scalia poses about the -- the leak coming out over time
22 but it is the -- the fact that the market becomes aware of
23 the reason for the misrepresentation, it is in fact
24 appropriate.

25 The -- the other point that I would like to

1 make, in addition to the statutory scheme, is -- is this
2 Court's decision in Basic v. Levinson creates a tension
3 here, and I -- and I think a conflict that is very
4 important to -- to discern. The -- Basic v. Levinson
5 presents the fraud-on-the-market theory, and from that
6 fraud-on-the-market theory we have a rebuttable
7 presumption of reliance for transaction causation.

8 The Ninth Circuit's view collapses the -- the
9 Ninth -- the Ninth Circuit's view of transaction causation
10 with loss causation and presents a conflict as it relates
11 to that presumption. The presumption, which is based on a
12 well- developed, efficient capital market that gets the
13 information out quickly and is easily digestible -- that
14 -- that presumption is at odds with the Reform Act's
15 requirement that there be a burden of proof. If you
16 collapse the transaction causation and the loss causation,
17 you've got a head-on collision between the rebuttable
18 presumption of reliance and the Congress' codification of
19 the Loss Causation Act and the Reform Act. And we think,
20 at the end of the day, the Ninth Circuit's decision really
21 renders that conflict apparent and makes the act of
22 Congress in the Reform Act one that was meaningless.

23 The -- I think the legislative history is also
24 supportive of our position so far as particularly the
25 Senate report is very important in the -- in the phrase

1 where it talks about the obligation of the plaintiff to
2 prove that the loss in the value of the stock was caused
3 by the section 10(b) violation and not by other factors.
4 That is a critical component here of the analysis and I
5 think very helpful from the standpoint of the legislative
6 history in identifying what we have.

7 Finally, I -- the last point I'd like to make is
8 that the Reform Act from Congress was designed to and
9 sought to establish uniform and fairly stringent pleading
10 guidelines, and this was to address congressional concerns
11 over frivolous suits. And Congress, in enacting the
12 Reform Act, was not signaling any intention to relax the
13 requirements of section 10(b), was -- rather, was enacting
14 a very specific loss causation requirement. And
15 historically there was a very clear and distinct body of
16 law at the time, the Huddleston case, the Bastian case,
17 and that was codified. And there was a very clear
18 perception that Congress was acting and not collapsing the
19 loss causation transaction rule into the loss -- the
20 transaction causation into the loss causation, which I
21 think creates this conflict.

22 If there are no further questions, Justice
23 Stevens, I'd like to reserve the balance of my time for
24 rebuttal.

25 JUSTICE STEVENS: You certainly may.

1 MR. SULLIVAN: Thank you.

2 JUSTICE STEVENS: Mr. Hungar.

3 ORAL ARGUMENT OF THOMAS G. HUNGAR

4 ON BEHALF OF THE UNITED STATES,

5 AS AMICUS CURIAE, SUPPORTING THE PETITIONERS

6 MR. HUNGAR: Thank you, Justice Stevens, and may
7 it please the Court:

8 In a fraud-on-the-market case, a plaintiff who
9 buys a security at an inflated price suffers no loss at
10 the time of purchase because the market continues to value
11 the security at the inflated price, and that's --

12 JUSTICE O'CONNOR: Would you tell us how you
13 differ with petitioner on what ought to happen here and
14 why?

15 MR. HUNGAR: Well, our view -- well, what ought
16 to happen in this case is that the judgment of the court
17 of appeals should be reversed because the court failed to
18 require loss causation. In effect, what the court said is
19 that transaction causation is sufficient. But what --

20 JUSTICE O'CONNOR: You agree with the bottom
21 line.

22 MR. HUNGAR: Yes.

23 JUSTICE O'CONNOR: Now, where do you disagree?

24 MR. HUNGAR: Well, I'm not sure that I can
25 accurately tell you petitioners' position, but I can tell

1 you our position, which is that in a fraud-on-the-market
2 case the plaintiff cannot -- has failed to plead loss
3 causation unless the plaintiff pleads that the -- the
4 inflation attributable to the misrepresentation or
5 omission has been removed or reduced from the price of the
6 stock through dissemination of corrective information of
7 some sort to the market. That does not mean that the
8 company must make an announcement or that there must be an
9 admission of fraud or that there must be really any
10 information, any -- any sort of formal disclosure. But if
11 the information is disseminated to the market such that
12 the market, in whole or in part, becomes aware of the
13 truth and adjusts the price accordingly, that price
14 adjustment is loss and the plaintiff has alleged loss
15 causation in an amount to be proven at trial.

16 JUSTICE O'CONNOR: Well, doesn't the general
17 rule 8 governing complaints -- isn't that adequate? You
18 have to plead under that every element of an affirmative
19 case.

20 MR. HUNGAR: That's right. Exactly right, Your
21 Honor.

22 JUSTICE O'CONNOR: Why is the Government
23 proposing that you have to follow rule 9 not 8 or some
24 other requirement?

25 MR. HUNGAR: Well, the -- I don't think the

1 question -- we cited rule 9(b) in our brief because fraud
2 must be pled with particularity and -- and that -- and
3 that rule applies to all the, quote, circumstances
4 constituting a fraud. But the Court doesn't need to
5 address the question because even under rule 8, the
6 plaintiff must allege all the elements of the cause of
7 action.

8 JUSTICE O'CONNOR: We don't have to get into
9 that.

10 MR. HUNGAR: That's correct. That's absolutely
11 right.

12 JUSTICE GINSBURG: But, Mr. Hungar, if you look
13 at the forms of what's proper pleading under the Federal
14 rules on causation, the sample pleadings say, for example,
15 for money lent, the defendant owes the plaintiff for money
16 lent. Period. Or for goods sold and delivered. Nothing
17 more. Just alleged causation. Defendant -- plaintiff
18 alleges I lost X amount and it was caused by defendant.

19 I thought you pointed to the 9(b) rule because
20 fraud must be pleaded with particularity, but causation
21 does not, not under the rules and not under the statute.

22 MR. HUNGAR: Well, as we said in our brief, we
23 think 9(b) applies here. Obviously, this is a fraud case.

24 JUSTICE GINSBURG: But that -- that's to the --
25 to the allegation of fraud, but not causation.

1 MR. HUNGAR: Well, Congress has made very clear
2 that loss causation is an element of the cause of action.
3 The elements must be pled. In a fraud case, they must be
4 pled with particularity, but even -- even in a -- in a
5 common law --

6 JUSTICE GINSBURG: It says -- but the fraud
7 must be pleaded with particularity, not all the elements
8 of a fraud claim.

9 MR. HUNGAR: Well, with respect, Your Honor, we
10 think circumstances -- it does not constitute fraud if
11 there is no loss causation. At least it certainly doesn't
12 constitute securities fraud under this statute, and if the
13 complaint does not plead loss causation, it hasn't pled
14 fraud. So we submit that --

15 JUSTICE STEVENS: That's not correct I don't
16 think. I think there could be a completely fraudulent
17 statement but no -- no damages as a result of it. There
18 would still be fraud.

19 MR. HUNGAR: Yes, but in a -- in a private
20 action for securities fraud, loss causation is an element
21 of the cause of action. It's not an element in every
22 fraud case.

23 JUSTICE STEVENS: It's not an element of the
24 fraud. It's an element of the cause -- cause of action.

25 MR. HUNGAR: Well, it may be a semantic

1 question. That's --

2 JUSTICE STEVENS: Well, that's what Justice
3 Ginsburg's point --

4 MR. HUNGAR: But there -- I mean, there are
5 cases in the -- in the courts of appeals saying that --
6 that rule 9(b) applies to all the elements, and we're not
7 aware of cases -- the -- the -- one of the amicus briefs
8 cites cases which focus on the nature of the
9 representation, and that's certainly where 9(b) issues are
10 generally fought out because in a -- in a typical
11 securities case, loss causation is not a difficult issue
12 because the -- the bad news is -- is announced, the stock
13 drops, and the plaintiff pleads loss causation as a matter
14 of course. It -- it's -- it's not a difficult burden to
15 satisfy in your run-of-the-mill securities case.

16 JUSTICE SOUTER: Well --

17 JUSTICE SCALIA: In any event, the difference
18 between getting the -- the complaint dismissed on the
19 pleadings or having to wait for a -- a 12(b)(6) motion
20 because as soon as you, you know, ask for the -- the proof
21 of the elements of the cause of action, you're entitled to
22 have, if -- if your analysis of the case is correct,
23 you're entitled to have the drop in -- in the value of the
24 stock shown.

25 MR. HUNGAR: Well, as a -- as a practical

1 matter, Your Honor, there's a huge difference in how these
2 cases are litigated because it's the difference between
3 spending millions of dollars on discovery, literally
4 millions of dollars on discovery, or not. If -- if the
5 plaintiff has failed to allege loss causation and for some
6 reason feels unable to allege it, the -- the case is going
7 to be dismissed. If the court doesn't require loss
8 causation, as the Ninth Circuit did -- did here, that
9 means the case is going to go to discovery and the
10 defendant is going to have to either spend millions of
11 dollars on their own lawyers or spend millions of dollars
12 to settle even in a case that -- where the plaintiff might
13 be unable to establish loss causation. That's why --

14 JUSTICE SOUTER: Is -- is the --

15 MR. HUNGAR: -- Congress did what it did in
16 1995.

17 JUSTICE SOUTER: Is the reason -- is there a
18 further reason that they've got to -- to plead loss
19 causation? And that is, by reading (e)(2), in effect, as
20 -- as making -- as -- as saying that if you were going to
21 recover on a fraud-on-the-market theory, you in effect
22 have -- have got to prove your loss in a certain way. And
23 you're saying if you're going to -- if you're going to sue
24 on a fraud-on-the-market theory, you've got to allege all
25 the elements of fraud on the market. And if you allege

1 all the elements of fraud on the market, you're going to
2 allege exactly what you've just been saying is required.

3 So it's not so the -- I -- I guess what I'm --
4 I'm getting at is maybe what -- maybe the nub of the
5 answer is not necessarily that there's -- that there's
6 fraud involved, but there is a fraud-on-the-market theory
7 as the basis for the cause of action, and if that is the
8 basis, it's got to be disclosed in the pleadings as an
9 element.

10 MR. HUNGAR: I think that's -- that's a helpful
11 way to look at it, Justice Souter, because it's -- in --
12 in a fraud-on-the-market case, by definition the plaintiff
13 is alleging that there was an efficient national market
14 and that is what makes the difference. If this were the
15 -- you -- you buy a gold mine, like the -- the old common
16 law cases that respondents cite, there's no efficient
17 national market on which the -- the plaintiff can turn
18 around and sell it at the same price until the information
19 has been disclosed. But when it is an -- a national,
20 active stock market, the market continues to reflect the
21 inflation, and so -- so the plaintiff has not been
22 injured, and the allegation that it was an efficient
23 market and I bought it at an inflated price does not
24 support an inference of -- of injury. And the -- and so
25 because it is a fraud-on-the-market case, that's exactly

1 right. The additional information must be pled in the
2 complaint or else no injury has been -- been pled and the
3 complaint must be dismissed.

4 JUSTICE SOUTER: Do you -- do you take the
5 position that the phrase in (e)(2), if the plaintiff --
6 I'm sorry. Let me find it.

7 MR. HUNGAR: You're referring to section 12(b)
8 or?

9 JUSTICE SOUTER: No. I'm trying to find a
10 phrase in (e)(2).

11 If the plaintiff seeks to establish damages by
12 reference to the market price of a security, do you take
13 that phrase as -- as referring to a fraud-on-the-market
14 theory or as being broader than a fraud-on-the -- on-the-
15 market theory.

16 MR. HUNGAR: Well, I suppose a plaintiff in --

17 JUSTICE SOUTER: It certainly includes it.
18 There's no question about that. Does --

19 MR. HUNGAR: I think what that encompasses is a
20 -- is a case in which the plaintiff purchased the stock on
21 the market -- on -- on a open market, which will typically
22 be in practice a fraud-on-the-market case. I suppose a
23 plaintiff, in an unusual case, might not allege -- might
24 not choose to plead it as fraud-on-the-market case if they
25 have some specific evidence or reliance that they view is

1 stronger, but --

2 JUSTICE SOUTER: If -- if it's not confined to
3 fraud-on-the-market, then there's the argument on the
4 other side that all -- all (2) is really doing is saying
5 that if you are going to establish your damages by
6 reference to market price, this is the way you've got to
7 do it. You've got to go through this mean price analysis
8 and so on. But they are saying we are not simply trying
9 to establish our damages by reference to the market, and
10 therefore we're not bound by -- and therefore, (e)(2), in
11 effect, is -- is irrelevant. What -- what is your
12 answer?

13 MR. HUNGAR: Well, I think they -- they
14 unquestionably are trying to establish their damages. The
15 Ninth Circuit's damage theory or -- or injury theory
16 establishes damages by reference to the market price.

17 JUSTICE SOUTER: To the -- to the purchase
18 price.

19 MR. HUNGAR: The plaintiffs alleged they
20 purchased at the market price in this fraud-on-the-market
21 case, and -- and the damages are the difference between
22 what they paid at that market price and what it should
23 have been. That is in our view an attempt to establish
24 damages by reference.

25 JUSTICE SCALIA: But they paid -- they paid

1 whether it was a market price or not. I mean --

2 MR. HUNGAR: Well, they -- they alleged they
3 purchased on the market. If -- if they weren't purchasing
4 on the market --

5 JUSTICE SCALIA: Well, what they paid happens to
6 be the market price, but -- but you can't really say that
7 the Ninth Circuit was referring to the market price as
8 part of its -- its damages. Its damages are what they
9 paid. Whether that -- if they paid above market, it would
10 be the same.

11 MR. HUNGAR: Well, in any event, we interpret it
12 to refer to -- I mean, by definition they are, in a fraud-
13 on-the-market case, alleging that they have purchased at
14 the market price, and that's exactly what this statute
15 would be encompassing. But beyond that, as -- as Mr.
16 Sullivan identified, Congress' explanation of how it
17 understood loss causation, when it -- when it enacted
18 section 12(b) as part of the Reform Act, is entirely
19 consistent with our position, and the common law is
20 entirely consistent with our position.

21 Thank you.

22 JUSTICE STEVENS: Thank you, Mr. Hungar.

23 Mr. Coughlin.

24 ORAL ARGUMENT OF PATRICK J. COUGHLIN

25 ON BEHALF OF THE RESPONDENTS

1 petitioners is that it -- conceptually, at least with the
2 Government, the right framework is to analyze did the
3 inflation come out of the stock. And our quarrel here is
4 how can the inflation come out of the stock? Does there
5 have to be a corrective disclosure? And we say no. Time
6 itself can take inflation out of the stock.

7 Company-specific information is our biggest
8 concern. If somebody walks a stock down, so to speak,
9 they give out information lowering expectations because
10 stock prices are based on cash flow. If they walk it down
11 and say, hey, our -- we're going to have a revenue miss,
12 but they don't announce their problems with AlSpiros at
13 the time, or we're closing some factories, or we're taking
14 a significant write-off, that stock drops. We believe
15 that lowers inflation.

16 I think a good case to take a look at to
17 illustrate this is the Wool v. Tandem case out of the
18 Ninth Circuit. In that case, Tandem was shipping to its
19 own warehouses for 2 years, lying about its revenues.
20 Wool went out and bought the stock. The stock was
21 inflated. The Wall Street Journal, subsequent to that,
22 reported we don't see how Tandem can continue to book
23 these revenues, and then the company itself lowered
24 expectations in one of their SEC filings saying, hey,
25 lower than expected revenues coming up. The stock has

1 dropped and now Wool sells. And now then after that, it's
2 admitted that there was a fraud. Does -- and the stock
3 barely drops hardly at all because the expectations in
4 that stock have already been taken out.

5 JUSTICE SCALIA: Why? I don't understand. I
6 mean, there would be even more expectation taken out after
7 the fraud is announced. I mean, it's just like saying,
8 you know, besides -- besides fact that our CEO just died,
9 there's no gold there. Don't you think it would go down
10 still further?

11 MR. COUGHLIN: Maybe and maybe not much. It
12 depends on what's your cash in the bank. In this case,
13 they had gone to the market and gotten \$400 million of
14 cash in the bank. So as the expectations were lowered
15 with the Ceclor CD sales here not once but twice and the
16 sales force inadequacy, before it was ever announced, they
17 knew when the FDA was coming out.

18 This is not the perfect situation. You're
19 right. We could have just taken this out and --

20 JUSTICE BREYER: But it sounds to me as if the
21 things you're saying now are matters for proof, and I -- I
22 think the wiggle room in the Government's position was it
23 said it has to be disclosed to the market in some form or
24 other. Well, if you're prepared to be broad and turn
25 those over to the experts for the proof, you end up with

1 your theory. The -- the inflation comes out and it comes
2 out because they didn't get the earnings that they would
3 have had or there may be many reasons.

4 MR. COUGHLIN: There's no doubt, Your Honor.
5 And if we have to do it at the pleading stage, it would be
6 impossible.

7 JUSTICE BREYER: Well, you just have to say at
8 the pleading stage what your theory is.

9 MR. COUGHLIN: And -- and I think we did that.
10 We said the stock was inflated and there was damage, and
11 we could have done a better job. Absolutely --

12 JUSTICE GINSBURG: I thought your theory was, at
13 least as I read your brief, that your loss occurs at the
14 moment of purchase, not at some later time, that when you
15 bought the stock, the price was inflated and that's when
16 you suffered your loss, on the day of the purchase, not at
17 a later time.

18 MR. COUGHLIN: That's absolutely correct. We
19 believe that you suffer your loss and damages on the date
20 you make the purchase. On the day --

21 JUSTICE SCALIA: How can you reconcile that with
22 your concession that if the person who -- who buys it at
23 an inflated price turns around 2 days later and sells it
24 at that same inflated price, he cannot bring suit? You
25 would not allow recovery in that situation.

1 MR. COUGHLIN: Would not allow recovery in
2 that --

3 JUSTICE SCALIA: How -- how can you reconcile
4 that --

5 MR. COUGHLIN: Because those --

6 JUSTICE SCALIA: -- with the notion that the
7 loss occurred at the time your purchased?

8 MR. COUGHLIN: Justice Scalia, because those are
9 -- what we're talking about are recoverable damages, and
10 then there's a limitation from section 28. In other
11 words, all the cause of action was satisfied on the date
12 you overpay. The day you pay \$100 for a stock that's
13 worth \$50, you're out the \$50, the economy is out the \$50
14 because it's not working -- it's working a fraudulent
15 market. But you cannot recover, we would agree, until
16 later.

17 And the problem with analyzing that at the
18 pleading stage is that is the -- that is expert analysis
19 and discovery to connect up how -- how the losses came out
20 and what you can recover. So I agree with you that you
21 cannot recover that.

22 JUSTICE SCALIA: They're saying there's no
23 losses. I mean, that's -- it's inconsistent how the
24 losses come out. You just told us the loss occurs, bang,
25 when you buy it. You've gotten stock that really isn't

1 worth what you paid for it, the notion of -- of worth as
2 some -- you know, some objective thing rather than what --
3 what people are willing to pay.

4 MR. COUGHLIN: Well, that's --

5 JUSTICE SCALIA: But that's your theory and it
6 seems to me you're stuck with it. And if that theory is
7 true, then it shouldn't matter that you later sell it to
8 some other poor, unsuspecting individual for the same
9 amount you bought it for.

10 MR. COUGHLIN: It doesn't matter for that
11 plaintiff if they sell it to a poor -- somebody
12 unexpected. For example, Fannie Mae just publicly, a
13 couple of weeks ago, found out they bought \$300 million
14 worth of bonds, and they -- they found out about a fraud.
15 They sold it and got fined by the Government because they
16 heard about the fraud and sold it back into the market to
17 recoup their losses or back through their broker. That's
18 -- that's not okay. That's just one outrageous example.

19 But somebody ends up with that stock that's
20 inflated. Okay? And when you make the purchase. We
21 agree we have to show the inflation come out before
22 recovery, and -- and 90 percent of the time --

23 JUSTICE SCALIA: You have to show what before
24 recovery? You have to show?

25 MR. COUGHLIN: The inflation came out of the

1 stock. In other words, if you pay \$100 for a stock that's
2 worth \$50, it's inflated by \$50. You don't recover that
3 \$50 until you show that \$50 inflation came out of the
4 stock.

5 It can come out a number of ways. Let's say,
6 for example, that somebody announced a competitive
7 product. Well, that would take some of the inflation.
8 That would be a market factor that would take some of the
9 inflation out of your false statement that you had a
10 product, the AlSpiros product. There are different ways
11 inflation can come out besides a corrective disclosure.

12 JUSTICE SOUTER: Yes, but if you've got to show
13 the inflation, then you don't have a complete cause of
14 action the day after you buy the stock if there's no loss.
15 I mean, if you've got to show the -- the drop following
16 the inflation, you don't have the complete cause of action
17 if there's no drop the day after you buy the stock.

18 JUSTICE SCALIA: That's what they're saying.

19 MR. COUGHLIN: You can only recover --

20 JUSTICE SCALIA: To me your -- your --

21 MR. COUGHLIN: You can only recover if that
22 inflation is taken out of the stock. Those are
23 recoverable damages under Ninth Circuit law.

24 JUSTICE SOUTER: No, but I -- I thought you were
25 conceding that you -- you, in fact, do not have a -- a

1 loss -- forget what you can recover -- that you don't have
2 a loss until the inflation is followed by a drop. And if
3 there's no drop at the -- at time of purchase plus 1
4 minute, then I don't see how there is even the element of
5 a cause of action.

6 MR. COUGHLIN: I -- I believe that the day you
7 overpay something, just like in the Sigafus, just in the
8 -- in the Bolles case, both of them had to do with gold
9 mines --

10 JUSTICE SOUTER: Then you're talking about a
11 cause of action without damages.

12 MR. COUGHLIN: You may not have recoverable
13 damages. That is true.

14 JUSTICE SOUTER: If you have no damages, you
15 have no cause -- I mean, on normal tort theory, you have
16 no cause of action.

17 MR. COUGHLIN: I understand, and I think you
18 have \$50 worth of damages right there. And our concern is
19 what you have to prove --

20 JUSTICE O'CONNOR: Well, that's exactly what
21 we're debating, I suppose, that very point. And -- and
22 it's hard to justify, under this statute, finding a cause
23 of action before there's any damage or if there isn't any.
24 That's -- that's just very hard to understand.

25 MR. COUGHLIN: In the most complex frauds, a --

1 a company is reporting revenue and earnings and their
2 stock is, let's say, trading at \$60 a share. Perhaps,
3 because of fraud, it's overstated by \$30. There are
4 people in the market buying that stock at \$60. That
5 company starts to lower those expectations.

6 This happens to be a real world example,
7 Worldcom. They say we're going to miss revenues by \$172
8 million. The stock starts dropping down. The inflation
9 that was in that stock because of what they lied about
10 starts coming out. Nobody knows there's fraud. Nobody
11 understands that. In fact, it's not until that stock goes
12 down at 80 cents that there was an admission of fraud.

13 JUSTICE BREYER: All right. But then you're not
14 saying what I think Justice Scalia and I actually thought
15 you were going to say which is that the minute he pays \$60
16 for a stock that should be worth \$30 but is \$60 because of
17 the lie, at that instant he suffered a loss. After
18 listening to you, I now think you're saying -- but I'm not
19 sure because I've heard you say things that are -- both --
20 I now think you're saying, no, he has not suffered a loss
21 until later on when that \$30 comes out of the price of the
22 stock.

23 JUSTICE SCALIA: And that's worrying me too.

24 JUSTICE BREYER: It might come out in many
25 different ways. It could come out because he announces

1 I'm a liar.

2 JUSTICE SCALIA: Right.

3 JUSTICE BREYER: It could come out because he
4 doesn't say anything but it sort of oozes out as earning
5 reports come in, but it has to come out.

6 Now, if you're saying that, then I find what
7 you're saying consistent what I think Judge Posner said.
8 And that's really what I'm interested in because I read
9 what he said. It seemed to me right. Now --

10 MR. COUGHLIN: I certainly don't want to be
11 disagreeing with Judge Posner. So I --

12 (Laughter.)

13 MR. COUGHLIN: The other --

14 JUSTICE SCALIA: I think -- I think you're -- I
15 think you're agreeing with the petitioners. I think this
16 -- this whole thing is a great misunderstanding. You --
17 you didn't --

18 (Laughter.)

19 MR. COUGHLIN: I would agree with that, Your
20 Honor. That's just -- we come to the same conclusion.
21 There is no doubt about that. We come to the same
22 conclusion. We have to prove that that inflation was in
23 there when we prove it. And what we're talking about is
24 what the burden is going to be on us at the pleading, and
25 that's what we're concerned about.

1 JUSTICE BREYER: When we have this happy
2 agreement and if you'll agree, you at least have to prove
3 what you -- you have to plead what you intend to do, that
4 is, you have to plead and there was a loss and this is my
5 theory. I would like to know -- maybe we won't get beyond
6 this, but in looking at this, I wondered now suppose that
7 the stock goes up in value because of extraneous things.
8 Can you recover because it would have been still higher?

9 MR. COUGHLIN: Justice Breyer, I think the
10 Government says that we can recover. We believe that we
11 could recover. In other words, it didn't go up as high.
12 I think it is -- as Justice Ginsburg said, it's the same
13 difference. You lost \$50 whether you lost it --

14 JUSTICE BREYER: What happens with the
15 transaction causation? Because I think you'd probably say
16 with your transaction causation in the -- in the case that
17 the -- that the lie wasn't there, we wouldn't have bought
18 the stock.

19 MR. COUGHLIN: Right.

20 JUSTICE BREYER: All right. If you say that,
21 they come along and say, okay, you wouldn't have bought
22 the stock. I'll tell you, here's one bad thing happened.
23 You lost your \$30. But there were six good things that
24 happened that you never thought of, and so the stocks were
25 four times what it would have been and you'd never have

1 later?

2 MR. COUGHLIN: If -- if we move to the proof
3 stage, the people that purchased in the class period and
4 sold before that announcement will not be able to recover
5 that 20 cent drop at the end. People who purchased during
6 the class period and held until all of the inflation was
7 taken out by either final announcement from the FDA or
8 when they announced they were abandoning the product would
9 be able to recover from that inflation because all of the
10 inflation was taken out as to AlSpiros.

11 JUSTICE GINSBURG: I -- I thought that you were
12 trying to pick up on the drop that seemed to be
13 attributable to the other --

14 MR. COUGHLIN: Product, Ceclor?

15 JUSTICE GINSBURG: Yes, and that's what -- well,
16 there -- there are two frauds going on. The first one is
17 discovered and the price drops substantially. And I
18 thought you were trying to attribute that drop to the
19 other product.

20 MR. COUGHLIN: There -- there are some things in
21 that drop attributable to the other product. The sales
22 force insufficiency, as well as management integrity, and
23 there are some other things that weren't pleaded well.

24 First of all, we were being conservative when we
25 pled this and we pled the rises. We pled the insider

1 sales. We pled the stock offerings. And all the
2 statements were in that earlier period. They make the
3 announcement. The stock starts down, 50 percent drop.
4 It's walked down another 40 percent after that. Finally,
5 you get the FDA announcement.

6 And we certainly could have, and -- and maybe
7 should have, taken that period out right then. The
8 district court ended up having problems with it. The
9 Ninth Circuit, in their questionings -- Judge Reinhardt
10 had problems with the -- with that. And they gave us
11 leave to replead, and we told them at that time if that's
12 what we need to do, is tie that in also, if that's a loss
13 that we intend to recover for or seek recovery for, then
14 we'll do that and we'll go back to replead. If there are
15 statute of limitations, that's a different issue, but we
16 can plead that and could have.

17 JUSTICE GINSBURG: Well, one of the problems for
18 me is the Ninth Circuit seems to think that it has a
19 theory -- and it is the theory of your complaint -- that's
20 different from, say, the Third Circuit. The Ninth Circuit
21 says we recognize that the loss is you bought it at an
22 inflated price, and the Ninth Circuit thinks that's
23 different from a circuit that says you don't have any loss
24 until somehow the bad news comes out and there's a drop in
25 price as a result.

1 JUSTICE KENNEDY: All right.

2 MR. COUGHLIN: That's absolutely correct.

3 JUSTICE KENNEDY: That's not what the Ninth
4 Circuit said in this case.

5 MR. COUGHLIN: The Ninth Circuit didn't -- it
6 cited -- it cited the Green v. Occidental opinion and the
7 Blackie I believe.

8 JUSTICE KENNEDY: But I'm submitting it cited it
9 for the wrong conclusion.

10 MR. COUGHLIN: I -- I think it -- I think it --

11 JUSTICE SCALIA: It cited -- I thought cited
12 Knapp and -- which, in turn, cited Gray or -- or --

13 MR. COUGHLIN: There are all the appendants.
14 There's -- there's the three that started off. Knapp is
15 the ATV case that we tried, and that was Judge Wallace and
16 he relied on Gray. All of them are the same in that you
17 have to -- to get by the pleading stage, that you have to
18 plead the inflation and identify the causes for it. It's
19 for proof and expert testimony and discovery to see if you
20 have recoverable damages.

21 If this Court were to say, no, we want
22 identifiable drops, then we could do that. You know, if
23 this Court were to say, listen, you've got to identify the
24 drops, whether they -- whether you can connect them up to
25 the fraud at this time, we want a full theory in the

1 complaint -- and we can do that. If that's what the -- if
2 that's what this Court directs us to do, then we'll do
3 that and we'll put in all the losses, as well as the
4 rises, as well as identifying the causes. You know, we'll
5 do that in -- in the complaints.

6 Sometimes what -- what we're saying and where we
7 differ a little bit from the Government is it's hard to
8 necessarily tie one of those innocuous disclosures that
9 may be taking the inflation out back to the
10 misrepresentation, and yet the stock is dropping and
11 inflation is coming out. And that's what we're worried
12 about. And there are other market forces that may take it
13 out. So at the pleading stage, we're worried about the
14 burden that almost puts us in -- in the position of having
15 an expert come in, and we think that's for a later time
16 for summary judgment or trial.

17 JUSTICE SCALIA: I mean, if you're worried about
18 it, why aren't you worried about it later, as well as
19 earlier? I mean, if that's going to be a problem, we
20 should know it sooner rather than later, rather than --
21 you know. If you say that's terribly difficult to prove,
22 we can hardly ever prove it, well, good. Then let's get
23 rid of this -- rid of the case earlier.

24 MR. COUGHLIN: I don't think I said --

25 JUSTICE SCALIA: I don't -- I don't know why --

1 somebody coming in and saying, hey, you paid \$60 for a
2 stock that was really worth \$30. When you brought suit,
3 the stock was down at \$10. Do you get to pay -- do you
4 get \$50? And Judge Sneed said no. You only get the
5 overpayment on the date.

6 Admittedly in up or down markets, what
7 petitioners and the Government would suggest might move
8 the damages up or down. In an up market -- you know,
9 we're talking about something that was going down here.
10 In an up market, you might get a bigger drop.

11 JUSTICE BREYER: But that's a --

12 JUSTICE O'CONNOR: That's why the term loss
13 causation is used because under the statute it's -- it's a
14 loss experienced by the plaintiff caused by the
15 misrepresentation.

16 MR. COUGHLIN: Justice O'Connor, I -- I couldn't
17 agree more, and that's why it goes to proof. It says this
18 is a proof statute --

19 JUSTICE O'CONNOR: Well --

20 JUSTICE SOUTER: No.

21 MR. COUGHLIN: I agree. It has to be alleged.

22 JUSTICE O'CONNOR: The Government said you don't
23 want unnecessary discovery. You have to put out pleadings
24 that make clear what your theory is --

25 MR. COUGHLIN: There's no doubt.

1 JUSTICE O'CONNOR: -- which yours don't do.

2 MR. COUGHLIN: They don't do well enough in this
3 case.

4 JUSTICE SOUTER: No, but what -- it seems to me
5 that what Judge Sneed's theory boils down to is this. You
6 cannot recover any loss except the loss that was caused by
7 the fraud in question. In theory, that limit is
8 established by the inflation at the time you purchase. So
9 that is the limit of your recovery, but it does not follow
10 from that that you have anything to recover for until you
11 have your actual loss if you're pleading a -- a fraud-on-
12 the-market theory. Isn't that fair to say?

13 MR. COUGHLIN: That's fair to say.

14 JUSTICE SOUTER: Okay.

15 MR. COUGHLIN: I agree with that, Your Honor.
16 That is -- that's exactly what -- that's exactly what
17 Judge Sneed did. And when we were talking about this
18 statute here, it talks about us proving those -- that loss
19 causation and tying it to the actual omissions.

20 And it follows two sections that deal with
21 pleading, material -- deal with particularized pleading as
22 to falsity and as to scienter. And this statute says that
23 if you don't plead one or two with the particularity
24 required, then the complaint shall be dismissed.

25 This section here --

1 JUSTICE SCALIA: So -- so -- I'm not sure I
2 understand what -- I'm -- I'm really coming to believe
3 that this is a misunderstanding. It seems to me you're
4 now saying that the loss does not occur when you make the
5 purchase. It is just that that is the limit on your loss,
6 the difference between what the stock would have cost you
7 had the -- the absence of gold been known and what you
8 actually paid.

9 MR. COUGHLIN: It's the limit on your loss.

10 JUSTICE SCALIA: But that is not your loss.
11 You're saying now the loss has to occur later when the
12 price goes down and you're thereby harmed. Is that it?

13 MR. COUGHLIN: No. I apologize if I haven't
14 been clear. The loss occurs at the time you purchase, but
15 you cannot recover any portion of the loss until the
16 inflation is taken out.

17 JUSTICE SOUTER: But the -- let's approach it a
18 different way. On a fraud-on-the-market theory, there are
19 two facts I think that can be assumed. Number one, there
20 was no misrepresentation that was made peculiarly to you.
21 The misrepresentation was to the broad market and was
22 reflected in the broad market price.

23 MR. COUGHLIN: Correct.

24 JUSTICE SOUTER: Number two, you as a purchaser
25 do not know about the fraud until the market finds out

1 about the fraud.

2 MR. COUGHLIN: Correct.

3 JUSTICE SOUTER: If that is the case, then I
4 don't see that it makes any sense at all to talk about
5 your having a cause of action the day after you purchase
6 before the market has found out and before the fraud is
7 known. I mean, this -- this strikes me as an exercise in
8 -- in an inconsistent theory.

9 MR. COUGHLIN: And here's why it matters, if I
10 might, is that what petitioners and perhaps the Government
11 would say is that you're right. You don't find out about
12 the fraud until the whole market finds out. But before
13 you find out about the fraud, there can be terrific drops
14 in the stock, which we think we could prove are related to
15 the fraud. Okay? Because we've had certainly a market
16 loss to what we paid. The stock has dropped down. We
17 don't know about fraud yet. All of a sudden, there's a
18 disclosure of fraud, and we all learn about it.

19 JUSTICE SCALIA: You don't know about it, but
20 the market knows about it. That's -- that's why the stock
21 has gone down.

22 MR. COUGHLIN: Not necessarily, Your Honor. In
23 other words, you can lower expectations by lower revenue
24 numbers. Other market forces like a competitor coming out
25 with a product. There are other things that can lower

1 that. I'm sorry. And when it gets down there, the rule
2 that we fear is being urged is that you only get the drop
3 from either the admission of the fraud or the full
4 disclosure of the fraud, and in the complex cases, the
5 Enrons, the Worldcoms, the Healthsouths of the world, that
6 didn't happen even until long after they were in
7 bankruptcy. And if we only get the drop, the \$3 drop at
8 the end, or the 80 cents to 50 cents that the Government
9 just returned \$750 million to in the Worldcom, with every
10 large institution in the country already out of that
11 stock, well, then those that were sought to be protected
12 by the Reform Act aren't.

13 We have to be able to plead certainly -- and --
14 and we can -- the -- the market moving down. And then
15 that's at the pleading stage, a plain 8(a) statement. And
16 then we have to prove and tie that back up to get damages.

17 JUSTICE GINSBURG: I thought that that's what
18 the Government was getting at in the passage I read
19 earlier where they don't make it -- there must be a
20 statement by the issuer of the correction. They have more
21 leeway.

22 But you -- the Ninth Circuit -- the litany that
23 it's using, the -- the set of cases -- for example,
24 plaintiffs were harmed when they paid more for the stock
25 than it was worth. The -- the notion that's repeated,

1 that your loss is established on the day you purchase the
2 price, that's just wrong, and I think we would have to at
3 a minimum say that.

4 MR. COUGHLIN: I -- I don't agree with that,
5 Your Honor. I agree with the Ninth Circuit that you
6 suffer the loss of overpayment. You have something in
7 your hand that's worth half as much as its true value.

8 JUSTICE GINSBURG: You -- you seem --

9 MR. COUGHLIN: Can you recover? Is it like the
10 UCC where you've got to mitigate your damages? You cannot
11 recover those damages even though you've suffered them.
12 You have a stock certificate that's worth half of what
13 it's worth even in an efficient market. And when the
14 truth comes out, that's true, you'll be damaged, and if
15 you sell it before then, you get no recovery.

16 JUSTICE SOUTER: But aren't -- aren't you --
17 aren't you, in -- in effect, equating two different
18 things: one, a loss that you suffer which you say occurs
19 immediately upon purchase of the inflated stock; and on
20 the other hand, a limit on the loss that is attributable
21 to the fraud? Those are two different things. I
22 understand the limit on the loss. I don't understand the
23 -- the suffering of the loss in fact.

24 MR. COUGHLIN: Well, Your Honor, I think that
25 that's an interesting statement because if the limit is --

1 let's say for a \$100 stock that's worth \$50 and you
2 overpay by \$50, let's say that's the limit of our loss,
3 even if the stock --

4 JUSTICE STEVENS: Mr. -- Mr. Coughlin, I'm
5 afraid you've had a full opportunity to explain this very
6 difficult case. You'll have to -- your time is up.

7 MR. COUGHLIN: Thank you, Justice Stevens.

8 JUSTICE STEVENS: Mr. Sullivan, you have 2
9 minutes.

10 REBUTTAL ARGUMENT OF WILLIAM F. SULLIVAN

11 ON BEHALF OF THE PETITIONERS

12 MR. SULLIVAN: Justice Stevens, and may it
13 please the Court:

14 One point I think I want to focus upon for the
15 -- for the Court is -- is the comment in the Senate report
16 which said that the damages had to be a result of the
17 cause -- the -- the misrepresentation, not other factors.
18 I think what we've just heard about, in terms of the
19 decline in the market value, is -- is a look at a number
20 of the other factors. And there are disclosures that are
21 related to fraud and there are disclosures that are not
22 related to fraud. And if there was a misrepresentation in
23 the marketplace, that -- that is one thing. If a new
24 competitor comes out with a new product, that's not --

25 JUSTICE BREYER: What's the problem here? He --

1 I mean, well, you heard what he said. And it sounded to
2 me that he agrees with you he has to prove that in fact
3 the fraud not only led to the overpayment, but that also
4 later on the client who bought the stock lost money
5 because the market went down, and that default, which cost
6 him the money, is caused by the fraud.

7 MR. SULLIVAN: And -- and --

8 JUSTICE BREYER: When it comes out, it just
9 comes out in subtle ways as well as direct ways.

10 Now, do you agree with that? If they -- if you
11 do, it seems to me there's no case here.

12 MR. SULLIVAN: I would -- I would agree with you
13 and -- and I would just --

14 JUSTICE BREYER: Where do you disagree?

15 MR. SULLIVAN: -- I would just add -- I don't
16 disagree. I would add that the cause is not by other
17 factors because I think when we heard the discussion about
18 the -- the reduction of inflation, we were hearing about
19 factors other than that.

20 I just want to close by saying the loss
21 causation codification in the Reform Act was meaningful
22 and was part of the Reform Act. And that really indicates
23 that this is a pleading standard that we -- we -- we're
24 dealing with, that the cause of action for a securities
25 fraud has to be stated at the time. And that's consistent

1 with what the Reform Act was trying to achieve which is to
2 give the defendants a chance to respond and actually have
3 the motion to dismiss serve as a meaningful screen in
4 dealing with those cases.

5 Thank you.

6 JUSTICE STEVENS: Thank you, Mr. Sullivan.

7 The case is submitted.

8 (Whereupon, at 11:34 a.m., the case in the
9 above-entitled matter was submitted.)

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