

No. 03-932

In The  
Supreme Court of the United States

DUURA PHARMACEUTICALS, INC. *et al.*

*Petitioners*

MICHAEL PROUDO *et al.*

*Respondents*

On Writ Of Certiorari To The  
United States Court Of Appeals  
For The Ninth Circuit

BRIEF FOR AMICI CURIAE NATIONAL  
ASSOCIATION OF SHAREHOLDERS AND  
CONSUMER ATTORNEYS, AARP AND THE  
CONSUMER FEDERATION OF AMERICA IN  
SUPPORT OF RESPONDENTS

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## I. INTEREST OF *AMICI CURIAE*<sup>1</sup>

AARP is a nonprofit, non-partisan organization with more than 35 million members, dedicated to addressing the needs and interests of Americans aged 50 and older. As the largest membership organization representing the interests of older Americans, AARP is very concerned about fraudulent practices in the securities industry and our capital markets. Older people are frequent targets of fraud because they often have significant assets and are looking for investment opportunities to supplement the Social Security and pension benefits they will receive during retirement. As a result, AARP has made the need to combat securities fraud a high priority, and advocates the availability and enforcement of adequate federal and state statutory remedies to provide victims with financial redress.

The National Association of Shareholder and Consumer Attorneys (“NASCAT”) is a nonprofit membership organization founded in 1989. The member law firms represent investors (both individuals and institutions) and consumers in securities fraud and shareholder derivative cases throughout the United States. NASCAT and its members are devoted to representing victims of corporate abuse, fraudulent schemes, and so-called “white-collar” criminal activity in cases that have the potential for advancing the state of the law, educating the public, modifying corporate behavior, and improving access to

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<sup>1</sup> In accordance with Rule 37.6, counsel for AARP, NASCAT, and CFA represent that they authored this brief and that no person other than these *amici curiae* or their counsel made a monetary contribution to its preparation or submission. Petitioners and Respondents have consented to the filing of this brief.

justice and compensation for the wrongs inflicted upon victims. NASCAT advocates the principled interpretation and application of the federal securities laws – including the Securities Act of 1933 (the “1933 Act”), the Securities Exchange Act of 1934 (the “1934 Act”), and the Private Securities Litigation Reform Act of 1995 (the “PSLRA”) – to protect investors from manipulative, deceptive and fraudulent practices and to ensure that the nation’s securities markets operate fairly and efficiently.

The Consumer Federation of America (“CFA”) is a nonprofit association of 300 consumer groups that represent more than 50 million Americans. It was established in 1968 to advance the consumer’s interest through research, education, and advocacy. As increasing numbers of Americans have come to rely on the nation’s financial markets to fund their retirements and save for other long-term goals, CFA has made enhancing investor protections a top legislative and regulatory priority. CFA’s policies in this area are based on a fundamental belief that investors are entitled to a marketplace that provides them with a choice of appropriate investments and service providers, the information necessary to make informed choices, protection against fraud and abuse, and effective recourse when they are the victims of wrongdoing. To achieve that goal, CFA has for nearly two decades been actively involved in efforts to promote investor protection legislation and regulations, and to oppose efforts to weaken those protections, at the state and federal levels. Consistent with its belief that access to redress for wrongdoing is essential to maintaining investor faith in the integrity of our securities markets, CFA’s efforts have included opposition to measures that would limit the ability of defrauded investors to recover their losses in court.

AARP and NASCAT have previously filed *amicus curiae* briefs in this Court in cases involving the construction and application of the Federal securities laws.<sup>2</sup>

## II. INTRODUCTION

This case concerns the “loss causation” element of investors’ claims seeking to recover damages under Section 10(b) of the 1934 Act and Rule 10b-5 promulgated by the Securities and Exchange Commission (“SEC”). For the reasons stated above, AARP, NASCAT and CFA are qualified to advise this Court, as *amici curiae*, of the meaning and import of Section 21D(b)(4) of the PSLRA, which codified the “loss causation” elements of Section 10(b)/Rule 10b-5 claims recognized by the circuit courts two generations ago. We note that the courts below did not analyze the language or meaning of that statutory provision in this case; however, *amici* believe that when this Court examines the relevant statutory language and the record, it will agree that Respondents properly alleged the “loss causation” element of their securities fraud claims against Petitioners. Further, AARP, NASCAT and CFA believe that the Ninth Circuit’s ruling concerning the “loss causation” requirement is consistent with the important public policies underlying the federal securities laws, and that affirming the decision of the court below will further the

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<sup>2</sup> See *SEC v. Edwards*, 540 U.S. 389 (2004) (AARP); *SEC v. Zandford*, 535 U.S. 813 (2002) (AARP-NASCAT); *Central Bank, N.A. v. First Interstate Bank, N.A.*, 511 U.S. 164 (1994) (NASCAT); *Musick, Peeler & Garrett v. Employers Ins.*, 508 U.S. 286 (1993) (NASCAT).

goal of protecting victims of investment fraud and help ensure they can obtain adequate recovery for their losses.

AARP, NASCAT and CFA submit that any reasoned analysis of the PSLRA's statutory provisions, and their application to the facts and circumstances of this case, must take into account the unprecedented wave of corporate scandals and schemes to violate the federal securities laws that have infected our securities markets over the past ten years. Well-publicized financial scandals at Enron, World-Com, Qwest, Global Crossing, Adelphia Communications, ImClone Systems, and Tyco International have cost shareholders *more than \$460 billion*.<sup>3</sup> These financial scandals caused investors to question the fundamentals of investing and corporate responsibility.<sup>4</sup> Investors' confidence in the U.S. stock market was so low that in June 2002, investors withdrew more than \$18 billion from stock funds, the third largest such withdrawal in history. Joseph F. Morrissey, *Catching the Culprits: Is Sarbanes-Oxley Enough?*, 2003 COLUM. BUS. L. REV. 801, 806 (2003). Professor Morrissey asserts that these corporate and accounting scandals

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<sup>3</sup> See John Paul Lucci, *Enron – The Bankruptcy Heard Around the World and the International Ricochet of Sarbanes-Oxley*, 67 ALB. L. REV. 211, 212 (2003). When filed, Enron's bankruptcy was the largest in U.S. history, and shareholders lost in excess of \$60 billion in market value of Enron's stock. Faith Stavelman Kahn, *Bombing Markets, Subverting the Rule of Law: Enron, Financial Fraud and September 11, 2001*, 76 TUL. L. REV. 1579 (2002); see also John C. Coffee, Jr., *What Caused Enron? A Capsule Social and Economic History of the 1990s*, 89 CORNELL L. REV. 269 (2004); Marianne M. Jennings, *A Primer on Enron: Lessons from a Perfect Storm of Financial Reporting, Corporate Governance and Ethical Culture Failures*, 39 CAL. W. L. REV. 163 (2003); Steven Schwarcz, *Some Thoughts on the Enron Bankruptcy*, 70 U. CIN. L. REV. 1309 (2002).

<sup>4</sup> Ethan G. Zelizer, *The Sarbanes-Oxley Act: Accounting for Corporate Corruption?*, 15 LOY. CONSUMER L. REV. 27, 27 (2002).

demonstrate that “corporate America and its industry insiders (including accountants, investment bankers, brokers and lawyers) seem to influence – if not make – the rules, but subsequently take liberties in complying with or ignoring these rules as they see fit.” *Id.* He also poses the following questions that this Court should consider in deciding this case:

Is there a rule of law in corporate America? Alternatively, have the professional and corporate managerial classes in America been participating in a scheme to present the investing world with a system that seems to be ruled by law but in fact is not? At the same time, the professional and managerial classes have enjoyed enormous profits while most investors have sat by with little recourse or compensation to redress their losses resulting from fraud in the securities markets. . . .

Any nation purporting to be governed by a rule of law must actually provide for mechanisms of enforcement against fraud and deception in its securities markets.

*Id.* at 806-07, 809 (footnotes omitted). As the Supreme Court of California has recognized, American business “depends on a national investment market” to support its industry. Effective remedies for fraud and market manipulation help ensure that the flow of capital necessary to the growth of American business will continue. *Diamond Multimedia Systems, Inc. v. Superior Court*, 968 P.2d 539, 557 (Cal. 1999).

When it enacted the PSLRA, Congress codified private securities actions as “an indispensable tool with which defrauded investors can recover their losses without having to rely upon government action.” H.R. Conf. Rep. No. 104-369, at 31 (1995), *reprinted in* 1995 U.S. CODE CONG. &

ADMIN. NEWS 730, 731. Lawmakers concluded in 1995 that class actions (like this case) are socially beneficial, both for compensating victims of securities fraud and for deterring future wrongdoing by corporate actors, thereby promoting confidence in the nation's securities markets. *Id.* at 31-32.<sup>6</sup> Private securities litigation “promotes public and global confidence in our capital markets and helps to deter wrongdoing and to guarantee that corporate officers, auditors, directors, lawyers, and others properly perform their jobs.” *Id.* at 31; see also Lisa L. Casey, *Reforming Securities Class Actions from the Bench: Judging Fiduciaries and Fiduciary Judging*, 2003 B.Y.U. L. REV. 1239, 1247-50 (2003). Over the past forty years, this Court has repeatedly recognized an implied private right of action to enforce the securities laws as a supplement to government regulatory efforts for the benefit of defrauded investors and the capital markets generally. See *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 315 (1985); *Deposit Guaranty Nat'l Bank v. Roper*, 445 U.S. 326, 339 (1980); *J. I. Case Co. v. Borak*, 377

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<sup>6</sup> More than a decade ago, then-SEC Chairman Richard Breeden told lawmakers that budgetary limitations meant that private class actions must “perform a critical role in preserving the integrity of our securities markets.” *Securities Investor Protection Act of 1991: Hearing on S. 1533 Before the Subcomm. on Sec. of the S. Comm. on Banking, Hous. & Urban Affairs*, 102nd Cong. 15-16 (1992) (testimony of then-SEC Chairman Richard C. Breeden). A few years later, Breeden's successor, Arthur Levitt, declared that private lawsuits, rather than government actions, had become “the primary vehicle for compensating defrauded investors.” *Common Sense Legal Reform Act: Hearing Before the Subcomm. on Telecomm. & Fin. of the House Comm. on Commerce*, 104th Cong. 1 (1995) (prepared statement of then-SEC Chairman Arthur Levitt) (“Private actions . . . provide a ‘necessary supplement’ to the [SEC’s] own enforcement activities by serving to deter securities law violations. Private actions are crucial to the integrity of our disclosure system because they provide a direct incentive for issuers and other market participants to meet their obligations under the securities laws.”) (footnote omitted).

U.S. 426, 432 (1964). The PSLRA has now made that implied right an explicit statutory right of action.

Petitioners and their *amici* ignore these important public policies, just as they ignore the express language of the PSLRA's "loss causation" provision at issue in this case. The briefs they filed in this Court fail to mention the ongoing corporate and accounting scandals that have robbed investors of their life savings and sapped their confidence in the securities markets. Needless to say, they also fail to acknowledge some of their own roles in causing billions of dollars in shareholder losses or their potential liability to investors when and if pending securities fraud actions are resolved against them. *See* note 26, *supra*. Their deliberately incorrect reading of the PSLRA would make it much more difficult – if not impossible – for the defrauded investors who lost hundreds of billions of dollars in recent corporate and accounting scandals to recover their losses. This unfortunate result cannot, and should not, be countenanced by this Court.

### III. ARGUMENT

#### A. SECTION 21D OF THE PSLRA DID NOT CHANGE THE TRADITIONAL PLEADING RULES CONCERNING THE "LOSS CAUSATION" ELEMENT OF SECURITIES FRAUD CLAIMS

To state a claim for securities fraud under Section 10(b) of the 1934 Act, 15 U.S.C. § 78j(b), and SEC Rule 10b-5, 17 C.F.R. § 240.10b-5, Respondents must allege that Petitioners (1) made a false statement or omission; (2) of a material fact; (3) with scienter; (4) in connection with the purchase or sale of securities; (5) upon which Respondents justifiably (or reasonably) relied; and (6) that Respondents'

reliance was the proximate cause of their injury. *See, e.g., Miller v. Asensio & Co.*, 364 F.3d 223, 227 (4th Cir. 2004); *In re K-Tel Int'l Sec. Litig.*, 300 F.3d 881, 888 (8th Cir. 2002); *Suez Equity Investors, L.P. v. Toronto-Dominion Bank*, 250 F.3d 87, 95 (2d Cir. 2001); *Semerenko v. Cendant Corp.*, 223 F.3d 165, 174 (3d Cir. 2000).

The Question Presented addresses only the *causation* requirement of a Section 10(b)/Rule 10b-5 claim, which has two components: Respondents must allege and prove at trial (a) that Petitioners' violations of the securities laws caused Respondents to engage in their stock transactions ("transaction causation") and (b) that the misrepresentations, omissions, or other violations caused Respondents' harm ("loss causation"). *See Castellano v. Young & Rubicam, Inc.*, 257 F.3d 171, 179 (2d Cir. 2001). "Transaction causation" is the causal connection between a securities fraud defendant's fraud and plaintiff's entering in the transaction in question. *Schlick v. Penn-Dixie Cement Corp.*, 507 F.2d 374, 380 (2d Cir. 1974); *see also Ambassador Hotel Co. v. Wei-Chuan Inv.*, 189 F.3d 1017, 1027 (9th Cir. 1999) (establishing transaction causation requires the plaintiff to prove that "but for the fraud, the plaintiff would not have engaged in the transaction at issue"). "[T]ransaction causation is generally understood as reliance." *Castellano*, 257 F.3d at 186. Under *Basic Inc. v. Levinson*, 485 U.S. 224, 241-42 (1988), a rebuttable presumption of "transaction causation" is established under the "fraud on the market" theory, even if Respondents were unaware of the fraudulent conduct at the time of their purchases of Dura's common stock.<sup>6</sup> But the

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<sup>6</sup> Under the "fraud on the market" doctrine, the trial court must presume that (a) the market price of Dura's common stock actually  
(Continued on following page)

“transaction causation” component of securities fraud causation is *not* an issue in this case.<sup>7</sup>

Contrary to Petitioners’ assertion, nothing in the PSLRA heightened the pleading requirements for the “loss causation” element of Section 10(b)/Rule 10b-5 claims. Rather, as codified in Section 21D(b)(4) of the PSLRA, Respondents have the “burden of **proving** that the act or omission of the [Petitioners] . . . caused the loss for which the [Respondents] seek[] to recover damages.” 15 U.S.C. § 78u-4(b)(4) (emphasis added). In a misguided effort to convince this Court to impose a heightened pleading burden, Petitioners and their *amici* misstate the express

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incorporated Petitioners’ alleged misrepresentations; (b) Respondents actually relied on the market price of those securities as an indicator of their value; and (c) Respondents acted reasonably in relying on the market price of Dura’s stock. *Id.* Paragraphs 37, 48, 51, 55, 85, 111, 128, 138 and 174 of Respondents’ Second Amended Complaint allege the necessary facts: Dura’s common stock traded in an efficient market on the NASDAQ National Market System; the company filed periodic public reports with the SEC; and Respondents and Class members purchased stock during the Class Period. These allegations are sufficient to establish reliance. *See, e.g., In re Ravisent Techs., Inc. Sec. Litig.*, 2004 U.S. Dist. LEXIS 13255, at \*45-46, 2004 WL 1563024 (E.D. Pa. July 12, 2004); *Fogarazzo v. Lehman Bros., Inc.*, 2004 U.S. Dist. LEXIS 9193, at \*29, 2004 WL 1151542 (S.D.N.Y. May 21, 2004); *In re Initial Pub. Offering Sec. Litig.*, 297 F. Supp. 2d 668, 670 (S.D.N.Y. 2003).

<sup>7</sup> Citing *Basic*, 485 U.S. at 247, some courts recognize a presumption of “loss causation,” asserting that in “fraud-on-the-market” cases, “[c]ausation lies in the fact that the plaintiff relied on the market price of the security as an indicator of the future value of the stock. To the extent that the defendant’s misrepresentations artificially altered the price of the stock and defrauded the market, causation is presumed.” *In re Control Data Corp. Sec. Litig.*, 933 F.2d 616, 619-20 (8th Cir. 1991); accord *DeMarco v. Robertson Stephens, Inc.*, 318 F. Supp. 2d 110, 124-25 (S.D.N.Y. 2004) (collecting cases).

