[University of Miami Business Law Review](https://repository.law.miami.edu/umblr)

Volume 29 | Issue 2 Article 10

Proving Economic Loss for In-And-Out Traders in Light of First Solar

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Abstract

Federal courts have grappled with the issue of whether or not to include in-and-out traders in federal securities class action lawsuits. One set of courts has excluded in-and-out traders on the grounds that they could not prove loss causation, while another set of courts has included in-and-out traders because of the possibility that they could prove that they had suffered a loss. In Mineworker's Pension Scheme versus First Solar, Inc., the Ninth Circuit recently addressed what should be the correct standard for loss causation. While the Ninth Circuit's decision resolved its own intra-circuit split, the Court's decision widened an already existing circuit split. Where some circuits have adopted a restrictive view of loss causation that requires a corrective disclosure revealing the fraud, the Ninth Circuit adopted the view that loss causation only requires that a plaintiff's economic loss be proximately caused by a defendant's misstatement. By embracing the Ninth Circuit's standard, this note argues that in-and-out traders can show economic loss in the absence of any corrective disclosures. Through proximate cause's intervening event pattern, it can be shown that an in-and-out trader has suffered a loss in the absence of a disclosure, obviating the need to show that a corrective statement was issued to the market.

"We are against fraud, aren't we?"

I. INTRODUCTION

Imagine it is February 27, 2020. COVID-19 has slowly taken hold in China, and the United States has remained unaffected. A few days prior, *Fraud Corporation* made a fraudulent public statement leading to an increase in the price of their stock. But now, people are realizing that, given the fraudulent information, COVID-19 will disrupt *Fraud Corporation's* ability to be profitable. This realization results in a sharp decline in the stock price. Seeing the sharp dip in the stock price, the purchaser, who had previously relied on *Fraud Corporation's* false statements, now sells the stock for a substantial loss.

If *Fraud Corporation* never made the false statement, the stock price would not have substantially dropped in value. Without the fraudulent statements, investor expectations would not have been hindered by an intervening event like the initial emergence of COVID-19. Realizing that the false statement was the cause of their loss, the purchaser attempts to sue *Fraud Corporation*; however, *Fraud Corporation* never made a corrective disclosure to the market before the purchaser sold the stock. Without that disclosure, courts will find that the purchaser's loss was not connected to the fraud.

In 2018, 403 federal securities class actions were filed.[1] Thirty-one percent of those class actions were filed in the Ninth Circuit.[2] By the middle of 2019, 198 new federal securities class actions were filed, and fifteen percent of those filings were located in the Ninth Circuit.[3] The Ninth Circuit has become a popular arena for plaintiffs seeking damages for a defendant's violation of Rule 10(b)-5, a rule targeting securities fraud. With its decision in *Mineworkers' Pension Scheme v. First Solar, Inc.*, the Ninth Circuit resolved an intra-circuit split and adopted a loss causation standard that will substantially affect where attorneys will file future securities class actions.

In *First Solar*, the Ninth Circuit held that the correct test for loss causation was a general proximate cause test.[4] According to the Ninth Circuit the ultimate issue in *First Solar* was "whether the defendant's misstatement, as opposed to some other fact, foreseeably caused the plaintiff's loss."[5] This note examines the Ninth Circuit's decision and whether in-and-out traders, traders who purchased and sold a corporation's shares before the fraud was revealed to the public, should be included in federal securities class actions. Although some federal courts have held that in-and-out traders should be excluded from class action litigation because they cannot show that they have suffered damages, other federal courts have included in-and-out traders because there was a possibility of showing damages. By utilizing an intervening cause pattern, this note argues that in-and-out traders can show they have suffered damages and, therefore, should be included in securities class actions.

Part II of this note provides background on securities litigation and Rule 10(b)-5 violations. This section looks at the history of loss causation and two recent Supreme Court decisions that have impacted loss causation litigation.

Part III of this note looks at how the different circuit courts have treated loss causation issues. This part is split into two different sections: (1) those circuit courts that hold that the market must learn and react to the disclosure of the fraud, and (2) those circuit courts that hold that the market must learn and react to the disclosure of the subject of the fraud.

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1 *Securities Class Action Filings: 2018 Year in Review*, CORNERSTONE RESEARCH (2019), https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2018-Year-in-Review.

2 *See id.*

3 Alexander Aganin & John Gould, *Securities Class Action Filings–2019 Midyear Assessment*, HARVARD LAW FORUM ON CORPORATE GOVERNANCE (Aug. 20, 2019), https://corpgov.law.harvard.edu/2019/08/20/securities-class-action-filings-2019-midyear-assessment/.

4 Mineworkers' Pension Scheme v. First Solar, 881 F.3d 750, 752 (9th Cir. 2018).

5 *Id.* at 754 (citing Lloyd v. CVB Fin. Corp., 811 F.3d 1200, 1210 (9th Cir. 2016)).

Part IV of this note explores how loss causation has developed in the Ninth Circuit post-*Dura*. This part is split up into two sections. The first section explores the inter-circuit split within the Ninth Circuit. The second part of this section analyzes the Ninth Circuit's decision in *Mineworkers' Pension Scheme v. First Solar, Inc.*

Part V of this note argues that the Ninth Circuit's decision in *First Solar* opens the door to victims who suffered an economic loss but are unable to bring a viable 10(b)-5 claim. The note concludes that the Ninth Circuit's reasoning allows for an in-and-out trader to recover without a market disclosure.

Part VI of this note argues that under an intervening cause pattern an in-and-out trader can show they have suffered an economic loss. The Supreme Court has misapplied the common law to require a revelation of fraud. However, the Supreme Court has also noted that the fraud must be the proximate cause of the loss. Utilizing the common law principles of proximate cause, this note proposes that loss can be shown, in the absence of a disclosure, through an intervening cause pattern.

Part VII argues that a new standard based off an intervening cause pattern would not be investor insurance. While courts are worried that they would be rewarding investors for losing money, this standard would only reach those who have actually suffered a loss and can prove it to the court.

II. History of Loss Causation

A. The Evolution of Securities Litigation and Loss Causation

In the wake of the Great Depression, Congress passed the Securities and Exchange Act of 1934 ("Exchange Act"). The Exchange Act is directed at "regulating all aspects of public trading of securities."[6] In other words, the Exchange Act was enacted "to protect investors against manipulation of stock prices."[7] As part of the Exchange Act, there is a general anti-fraud provision, Section 10(b). Under this section, it is unlawful "to use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."[8]

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6 Thomas Lee Hazen, LAW OF SECURITIES REGULATION § 1:18 (updated Dec. 2020), Westlaw.

7 Basic Inc. v. Levinson, 485 U.S. 224, 230 (1988) (citing S. Rep. No. 792, 73d Cong. 2d Sess., 1-5 (1934)).

8 15 U.S.C. § 78j(b).

In 1942, a few years after the enactment of the Exchange Act, the Securities and Exchange Commission ("the Commission") adopted Rule 10(b)-5.[9] This new rule was based on Section 17(a) of the Securities Act of 1933 ("Securities Act")[10]; however, the new rule expanded upon Section 17(a) by extending coverage to include "misstatements and omissions occurring in connection with either a purchase or sale of securities."[11] The Commission's intent was "to provide protection against investors being duped into purchasing or selling securities."[12]

Around the early 1980s, federal courts started to recognized that a "securities fraud plaintiff should be permitted to recover under § 10(b) and Rule 10b-5 only if the misrepresentation of omission of the defendant proximately caused the plaintiff's loss."[13] A leading case, *Huddleston v. Herman & MacLean*, has recognized that "[t]he plaintiff must prove not only that, had he known the truth, he would not have acted, but in addition that the untruth was in some reasonably direct, or proximate, way responsible for his loss."[14] Over time, federal courts have recognized "a private cause of action exists for a violation of § 10(b) and Rule 10b-5, and constitutes an essential tool for enforcement of the 1934 Act's requirements."[15]

B. Loss Causation and the Supreme Court

The Supreme Court has issued two opinions that have shaped the current loss causation jurisprudence. First, the Supreme Court held in *Basic v. Levinson* that plaintiffs can apply a presumption of reliance based on the fraud-on-the-market theory.[16] Then, in *Dura Pharmaceuticals, Inc. v. Broudo*, the Supreme Court held that an investor may not establish loss causation by pleading an inflated purchase price.[17] This part of the note explores the Supreme Court's decisions in these two cases and how those two cases have affected the loss causation inquiry.

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9 Thomas Lee Hazen, Treatise on the Law of Securities Regulation § 12:16 (updated Dec. 2020), Westlaw.

10 *See* 15 U.S.C. § 77q(a) (limiting anti-fraud coverage to the offer and sale of securities).

11 Thomas Lee Hazen, Treatise on the Law of Securities Regulation § 12:16 (updated Dec. 2020), Westlaw.

12 *Id.* (citing Popovice v. Milides, 11 F. Supp. 2d 638, 641-42 (E.D. Pa. 1998)).

13 Smilovits v. First Solar, Inc., 119 F. Supp. 3d 978, 986 (D. Ariz. 2015).

14 Huddleston v. Herman & MacLean, 640 F.2d 534, 549 (5th Cir. 1981), *aff'd in part, rev'd in part,* 459 U.S. 375 (1983).

15 Basic Inc. v. Levinson, 485 U.S. 224, 231 (1988) (citing Ernst & Ernst v. Hochfelder, 426 U.S. 185, 196 (1976); Blue Chips Stamps v. Manor Drug Stores, 421 U.S. 723, 730 (1975)).

16 *See Basic*, 485 U.S. at 250.

17 Dura Pharmaceuticals, Inc. v. Broudo, 544 U.S. 336, 338 (2005).

1. Basic's Presumption of Reliance

The Supreme Court's decision in *Basic* established a presumption of reliance grounded on the fraud-on-the-market theory.[18] The fraud-on-the-market theory is based on the hypothesis that the price of a company's stock reflects all materially relevant information regarding a company and its business.[19]

In *Basic*, the Respondents were former shareholders of Basic Incorporated who sold their shares after Basic Incorporated released a public statement denying that they were in talks to merge with Combustion Engineering, Inc., but before the New York Stock Exchange suspended trading of Basic shares.[20] The Respondents alleged that the defendants violated § 10(b) of the 1934 Act and Rule 10b-5 by issuing three false or misleading public statements and alleged "that they were injured by selling Basic shares at artificially depressed prices in a market affected by petitioner's misleading statements and in reliance thereon."[21] One of the issues considered by the Court was "whether a person who traded a corporation's shares on a securities exchange after the issuance of a materially misleading statement by the corporation may invoke a rebuttal presumption that, in trading, he relied on the integrity of the price set by the market."[22]

The Court found that applying "a presumption of reliance supported by the fraud-on-the market theory" was not inappropriate in securities litigation.[23] The *Basic* Court reasoned that "most publicly available information is reflected in [the] market price."[24] In the Court's view, "'it is hard to imagine that there ever is a buyer or seller who does not rely on market integrity.'"[25] The market performs a substantial part of the valuation process for the investor because the "market is interposed between the seller and buyer and, ideally, transmits information to the investor in the processed form of a market price."[26]

The *Basic* Court's establishment of a presumption of reliance based on fraud-on-the-market is important for loss causation because it provides an economic theory that must serve as the basis of a loss causation analysis. Without an efficient market, a plaintiff would fail to satisfy the

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18 *Basic*, 485 U.S. at 250.
19 *Id.* at 241-42 (citing Peil v. Speiser, 806 F.2d 1154, 1160-61 (3rd Cir. 1986)).
20 *Id.* at 227-28.
21 *Id.* at 228.
22 *Id.* at 226.
23 *Id.* at 250.
24 *Id.* at 247.
25 *Id.* at 246-47 (1987) (citing Schlanger v. Four-Phase Systems Inc., 555 F. Supp. 535, 538 (S.D.N.Y. 1982)).
26 *Id.* at 244.

transactional causation element and a court would not have to address loss causation. By linking reliance to market integrity, the Court recognizes that a buyer is unknowingly deceived when a stock's price reflects fraudulent information.

2. Dura Pharmaceuticals and the Heightened Pleadings Standard

Unlike the court in *Basic*, the *Dura* Court addressed the pleading requirements for loss causation. Specifically, whether "a plaintiff can satisfy this requirement–a requirement that courts call 'loss causation'–simply by alleging in the complaint and subsequently establishing that 'the price' of the security 'on the date of purchase was inflated because of misrepresentation.'"[27]

In *Dura*, the Respondents were individuals who purchased stock in Dura Pharmaceuticals, Inc., between April 15, 1997, and February 24, 1998.[28] In their complaint, Respondents alleged that Dura made false statements concerning drug profits and the future Food and Drug Administration (FDA) approval of a new asthma medicine.[29] Dura falsely stated that they expected drug sales to be profitable and that the FDA would approve their asthmatic spray device.[30] On February 24, 1998, Dura released a corrective statement that earnings would be lower than expected.[31] The next day, Dura's share price lost half of its value.[32] Eight months later, Dura announced that they would not receive FDA approval for their asthmatic spray device.[33] The most important part of the pleadings was Respondent's statement concerning economic losses attributable to the FDA misstatement: "'In reliance on the integrity of the market, [the plaintiffs] . . . paid artificially inflated prices for Dura securities' and the plaintiffs suffered 'damage[s]' thereby.[34] The Court granted Dura's petition for certiorari because of the Ninth Circuit's view that plaintiffs properly established loss causation by showing that the price on the date of purchase was inflated because of the misstatement.[35]

The *Dura* Court held that merely alleging an inflated purchase price on the date of purchase was not enough to satisfy the Private Securities Litigation Reform Act of 1995 (PSLRA) requirement that loss causation

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27 Dura Pharmaceuticals, Inc. v. Broudo, 544 U.S. 336, 338 (2005).
28 *Id.* at 339.
29 *Id.*
30 *Id.*
31 *Id.*
32 *Id.*
33 *Id.*
34 *Id.* at 339-40.
35 *Id.* at 340.

be plead with particularity.[36] The Court stated, "the statute expressly imposes on plaintiffs 'the burden of proving' that the defendant's misrepresentations 'caused the loss for which the plaintiff seeks to recover.'"[37] The Court's reasoning was that an intervening event could break the causal chain:

> [A]s a matter of pure logic, at the moment the transaction takes place, the plaintiff has suffered no loss; the inflated purchase payment is offset by ownership of a share that at that instant possesses equivalent value. Moreover, the logical link between the inflated share purchase price and any later economic loss is not invariably strong. Shares are normally purchased with an eye toward a later sale. But if, say, the purchaser sells the shares quickly before the relevant truth begins to leak out, the misrepresentation will not have led to any loss. If the purchaser sells the shares quickly before the relevant truth begins to leak out, the misrepresentation will not have led to any loss. If the purchaser sells later after the truth makes its way into the marketplace, an initially inflated purchase price might mean a later loss. But that is far from inevitably so. When the purchaser subsequently resells such shares, even at a lower price, that lower price may reflect, not the earlier misrepresentation, but changed economic circumstances, changed investor expectations, new industry-specific or firm-specific facts, conditions, or other events, which taken separately or together account for some or all of that lower price.[38]

The effect of the *Dura* holding is that a plaintiff has a heightened pleading requirement for loss causation. Plaintiffs need to plead with particularity to "prove the defendant's misrepresentation (or other fraudulent conduct) proximately caused the plaintiff's economic loss."[39]

III. LOSS CAUSATION CIRCUIT SPLIT

The circuits have been split over what is the correct test for loss causation. Currently, there is a two-way split among the circuits over how to prove loss causation. However, all circuits agree that "a plaintiff must

36 *Id.* at 345-46.
37 *Id.* (citing 15 U.S.C. § 78u-4(b)(4)).
38 *Id.* at 342-43.
39 *Id.* at 346.

show a 'causal connection' between the 'loss and the misrepresentation.'"[40] The First, Fourth, Fifth, Seventh, Tenth and Eleventh Circuits have each held that the market must learn and react to the revelation of fraud. The Second, Third, and Sixth have each held that there must be a connection between the *subject* of a fraudulent disclosure and the economic loss. Before *First Solar*, the Ninth Circuit had an intra-circuit split, utilizing both approaches.

A. Majority Standard

The majority standard upheld by the First, Fourth, Fifth, Seventh, Tenth and Eleventh Circuits requires that the defendant's fraudulent conduct be revealed to the market and that the market reacts to that information. The Supreme Court endorsed the majority standard in *Erica P. John Fund Inc. versus Halliburton Co*.[41]

The Tenth Circuit has held that "[t]he plaintiff bears the burden of showing that his losses were attributable to the revelation of the fraud and not the myriad other factors that affect a company's stock price. Without showing a causal connection that specifically links losses to misrepresentations, he cannot succeed."[42] Thus, in *In re Williams Securities Litigation*, the Tenth Circuit reasoned that "[u]ntil the fraud is revealed the purchasers actually benefit from the inflation and therefore have no legally compensable injury." [43]

The Fifth Circuit[44] and the Eleventh Circuit[45] use the following framework to assess whether a plaintiff can show loss causation:

> (1) Identifying a "corrective disclosure" (a release of information that reveals to the market the pertinent truth that was previously concealed or obscured by the company's fraud); (2) showing that the stock price dropped soon after the corrective disclosure; and (3) eliminating other possible explanations for this price drop, so that the factfinder can infer that it is *more*

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40 *Id.* at 347.

41 *See* Erica P. John Fund, Inc. v. Halliburton Co., 563 U.S. 804, 811 (2011) ("It is common ground, for example, that plaintiffs must demonstrate that the alleged misrepresentations were publicly known (else how would the market take them into account?), that the stock traded in an efficient market, and that the relevant transaction took place 'between the time the misrepresentations were made and the time the truth was revealed.'").

42 *In re* Williams Sec. Litig., 558 F.3d 1130, 1137 (10th Cir. 2009).

43 *Id.* at 1139.

44 Pub. Emp.'s Ret. Sys. of Miss. v. Amedisys, Inc., 769 F.3d 313, 321 (5th Cir. 2014) (quoting FindWhat Inv'r Grp. v. FindWhat.com, 658 F.3d 1282, 1311-12 (11th Cir. 2011)).

45 FindWhat Inv'r Grp. v. FindWhat.com, 658 F.3d 1282, 1311-12 (11th Cir. 2011).

> *probable than not* that it was the corrective disclosure–as opposed to other possible depressive factors–that caused at least a "substantial" amount of price drop.

This framework is used to show that loss causation can be proved circumstantially.[46]

Similar to the Tenth Circuit, the Seventh Circuit has held that "in order to prove loss causation, plaintiffs in securities-fraud cases need to isolate the extent to which a decline in stock price is due to fraud-related corrective disclosures and not other factors."[47] In *Glickenhaus & Co. v. Household International, Inc.*, the Seventh Circuit held that "the plaintiffs had the burden to establish that the price of the securities they 'purchased' was inflated–that is, it was higher than it would have been without the false statements–and that it declined once the truth was revealed."[48]

The Fourth Circuit has held that "the disclosure or series of partial disclosures 'need not precisely identify the misrepresentation or omission' about which the plaintiff complains, but 'must reveal to the market in some sense the fraudulent nature of' such misrepresentation or omission, and 'must at least relate back to the misrepresentation [or omission] and not to some other negative information about the company.'"[49] In *Singer v. Reali*, the Fourth Circuit held that there must be a corrective disclosure, or series of corrective disclosures, that reveals the truth to the market, prompting the stock price deflation.[50]

The First Circuit agreed with the Tenth Circuit and held that "[w]hen proving a loss causation in a securities fraud suit, plaintiffs 'bear [] the burden of showing that [their] losses were attributable to the revelation of the fraud and not the myriad other factors that affect a company's price.'"[51]

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46 *Amedisys*, 769 F.3d at 321 (quoting FindWhat Inv'r Grp. v. FindWhat.com, 658 F.3d 1282, 1311-12 (11th Cir. 2011)).

47 Glickenhaus & Co. v. Household Int'l, Inc., 787 F.3d 408, 421 (7th Cir. 2015) (citing Hubbard v. BankAtl. Bancorp, Inc., 688 F.3d 713, 725-26 (11th Cir. 2012)); *see* Miller v. Asensio & Co., Inc., 364 F.3d 223, 232 (4th Cir. 2004).

48 *Glickenhaus*, 787 F.3d at 415.

49 Singer v. Reali, 883 F.3d 425, 446 (4th Cir. 2018) (citing Katyle v. Penn Nat'l Gaming, Inc., 637 F.3d 462, 473 (4th Cir. 2005)).

50 *See id.* at 446.

51 Bricklayers & Trowel Trades Int'l Pension Fund v. Credit Suisse Sec. (USA) LLC., 752 F.3d 82, 95 (2014) (citing *In re* Williams Sec. Litig., 558 F.3d 1130, 1137 (10th Cir. 2009)).

B. Minority Standard

The minority standard upheld by the Second, Third, and Sixth Circuit has required that the *subject* of a misrepresentation or omission be revealed to the market.

The Second Circuit has held that "to establish loss causation, a plaintiff must show that 'the loss [was a] foreseeable' result of the defendant's conduct (i.e., the fraud), '*and* that the loss [was] caused by the materialization of the . . . risk' concealed by the defendant's alleged fraud."[52] Simplified, "proof of loss causation requires demonstrating that 'the *subject* of the fraudulent statement or omission was the cause of the actual loss suffered.'"[53] "[I]f the plaintiff fails to 'demonstrate a causal connection between the content of the alleged misstatements or omissions and the harm actually suffered,' a fraud claim will not lie."[54]

The Sixth Circuit held that "a misstatement or omission is the 'proximate cause' of an investment loss if the risk that caused the loss was within the zone of risk concealed by the misrepresentations and omissions alleged by a disappointed investor."[55]

The Third Circuit has held that a plaintiff only needs to show "that it was the very facts about which the defendant lied which causes its injuries."[56] In *McCabe v. Ernst & Young, LLP*, the Third Circuit stated that in order "to make the requisite loss causation showing, the ATS Plaintiffs must show that Vertex's prior registration defaults and consequent litigation risks (the very facts that Ernst & Young allegedly omitted) were a substantial factor in causing the ATS Plaintiff's economic loss."[57] Unlike the majority of Circuits, the Third Circuit does not require a corrective disclosure that reveals new information about a fraudulent misrepresentation; the Third Circuit requires that the underlying facts be a substantial factor in a plaintiff's economic loss.

IV. THE NINTH CIRCUIT'S NEW LOSS CAUSATION STANDARD

The Ninth Circuit's decision in *First Solar* resolved a split in the Circuit's prior precedent and held that the correct test was a general

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52 *In re* Vivendi, S.A. Sec. Litig., 838 F.3d 223, 261 (2d Cir. 2016) (citing Lentell v. Merrill Lynch & Co., 396 F.3d 161, 173 (2d Cir. 2005)).

53 *Id.* (citing Suez Equity Investors, L.P. v. Toronto-Dominion Bank, 250 F.3d 87, 95 (2d. Cir. 2001) (emphasis added)).

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

55 Ohio Pub. Employees Ret. Sys. v. Fed. Home Loan Mortg. Corp., 830 F.3d 376, 384 (6th Cir. 2016).

56 McCabe v. Ernst & Young, LLP., 494 F.3d 418, 428 (3d Cir. 2007) (quoting Caremark, Inc. v. Coram Healthcare Corp., 113 F.3d 645, 648 (7th Cir. 1997)).

57 *Id.* at 429.

proximate cause test.[58] On the one hand, "one line of cases represents the rule that 'drawing a causal connection between the facts misrepresented and the plaintiff's loss will satisfy loss causation.[59] On the other hand, there was another line of cases that held "[s]ecurities fraud plaintiffs can recover only if the market learns of the defendants' fraudulent practices."[60] The intra-circuit split mirrors the nationwide circuit split on loss causation. In *First Solar*, the Ninth Circuit has been asked to determine the correct test for loss causation.

A. Intra-Circuit Split

The parties in this case agreed that "the Plaintiff must prove a causal connection between Defendant's fraudulent actions and their loss."[61] However, the parties did not agree on "how that connection must be proved."[62] The defendants advocated for the view expressed by *Daou* and its progeny. The *Daou* approach is similar to the approach adopted by a minority of the circuits. While the plaintiffs advocated for the view expressed by *Metzler* and its progeny, a view expressed by the majority of circuits.

Daou and its progeny represent the view that it is the disclosure of the company's financial condition, rather than disclosure of defendant's fraud that satisfied loss causation.[63] In *Daou*, the defendant, Daou Systems, Inc., "created, implemented, and supported computer networking systems for use in the healthcare field."[64] The plaintiffs alleged that Daou had fraudulently inflated their stock price by recognizing revenue before it was actually earned. Additionally, Daou acquired eleven companies, and its executives, and their family members, sold nearly 2.5 million shares at the inflated price for a gain of $54.57 million.[65]

The court held that that loss causation was properly plead because the "Plaintiffs allege[d] that these disclosures of Daou's true financial health, the result of prematurely recognizing revenue before it was earned, led to

58 Mineworkers' Pension Scheme v. First Solar Inc., 881 F.3d 750, 754 (2018).
59 *Id.* at 752 (2018) (citing Nuveen Municipal High Income Opportunity Fund v. City of Alameda, 730 F.3d 1111 (9th Cir. 2013)); Berson v. Applied Signal Technology, Inc., 527 F.3d 982 (9th Cir. 2008); In re Daou Systems Inc., 411 F.3d 1006 (9th Cir. 2005)).
60 *First Solar*, 881 F. 3d at 752 (citing Oregon Public Employees Retirement Fund v. Apollo Group Inc., 774 F.3d 598 (9th Cir. 2014); Loos v. Immersion Corp., 762 F.3d 880 (9th Cir. 2014); In re Oracle Corp. Securities Litigation, 627 F.3d 376 (9th Cir. 2010); Metzler Investment GMBH v. Corinthian Colleges, Inc., 540 F.3d 1049 (9th Cir. 2008)).
61 Smilovits v. First Solar Inc., 119 F. Supp. 3d 978, 987 (D. Ariz. 2015).
62 *Id.*
63 *In re* Daou Systems Inc., 411 F.3d 1006, 1025 (9th Cir. 2005).
64 *Id.* at 1012.
65 *Id.* at 1013.

a 'dramatic, negative effect on the market, causing Daou's stock to decline[.]'"[66] As the court noted, "the price of Daou's stock fell precipitously after defendants began to reveal figures showing the company's true financial condition."[67] The decision in Daou did not mention a revelation of fraud, but rather, the Court repeatedly mentioned the disclosure of the company's "true financial conditions" and the "true financial health" as the reason for finding that loss causation was adequately plead.[68]

Several years later, the Ninth Circuit articulated the proper test for loss causation in *Nuveen Municipal High Income Opportunity Fund v. City of Alameda*. In *Nuveen*, the City of Alameda offered municipal bonds "to finance the development of a cable and Internet system."[69] Nuveen purchased $17,750,000 in face value of the notes that the City of Alameda were selling.[70] In 2008, it was determined that the Notes could not be refinanced and therefore the telecom system was sold for approximately $15 million.[71] Nuveen received approximately $10 million towards the principal of the notes they held, but were still owed another $10 million. The allegations against Alameda were that the "Official Statement contained inflated and unrealistic projections that materially overstated the telecom system's anticipated performance."[72]

On appeal, the Ninth Circuit held that to satisfy loss causation "a plaintiff can satisfy loss causation by showing that 'the defendant misrepresented or omitted the very facts that were a substantial factor in causing the plaintiff's economic loss.'"[73] "Disclosure of the fraud is not a sine qua non of loss causation, which may be shown even where the alleged is not necessarily revealed prior to the economic loss."[74]

Contrary to the Ninth Circuit's previous rulings, the Court in *Metzler* diverged from the standard set in *Daou*. In *Metzler*, the defendant, Corinthian Colleges, Inc., was one of the nation's largest operators of private for-profit colleges.[75] Metzler, an institutional investor, alleged that Corinthian engaged in a variety of fraudulent practices in order to maximize the amount of federal funding that they received.[76] Title IV

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66 *Id.* at 1026.
67 *Id.*
68 *Id.* at 1026-27.
69 Nuveen Mun. High Income Opportunity Fund v. Alameda, 730 F.3d 1111, 1115 (9th Cir. 2013).
70 *Id.* at 1117.
71 *Id.*
72 *Id.*
73 *Id.* at 1120.
74 *Id.*
75 Metzler Inv. GMBH v. Corinthian Colleges, Inc., 540 F.3d 1049, 1055 (9th Cir. 2008).
76 *Id.*

funding was a major source of revenue for Corinthian.[77] The complaint alleged that the fraudulent practices resulted in the artificial inflation of Corinthian's stock price,[78] and upon revelation of Corinthian's fraud, the stock price dropped.[79]

While the court in *Metzler* cited *Daou* to support their decision, the court ultimately diverged from *Daou* by holding that loss causation required that the market must learn and react to the fraud.[80] In the court's view, the "[p]laintiffs adequately pled loss causation in *Daou* because their complaint alleged that the market learned of and reacted to this fraud, as opposed to merely reacting to reports of the defendant's poor financial health generally."[81] The Ninth Circuit in *Metzler* stated that "the complaint must allege that the practices that the plaintiff contends are fraudulent were revealed to the market and caused the resulting losses."[82]

In 2014, the Ninth Circuit reaffirmed their *Metzler* decision in *Loos v. Immersion Corp*. In *Loos*, the defendant, Immersion Corporation, was a public-traded technology company.[83] The complaint alleged that Immersion reported false information regarding revenue over a period of several quarters.[84] In 2009, "Immersion advised investors that its prior financial statements 'should no longer be relied upon' due to irregularities with 'certain revenue transactions[.]'"[85] Citing Ninth Circuit precedent, the court held that "our precedent requires a securities fraud plaintiff to allege that the market 'learned of and reacted to th[e] fraud, as opposed to merely reacting to reports of the defendant's poor financial health generally.'"[86]

The split in the Ninth Circuit's decision led to the appeal in *Smilovits v. First Solar, Inc.* As the court noted in *Smilovits*, the plaintiff "must prove a causal connection between Defendants' fraudulent actions and their loss,"[87] but the question is "how that connection must be proved."[88]

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77 *Id.*
78 *Id.* at 1055-56.
79 *Id.* at 1059.
80 *See id*. at 1063.
81 *Id.*
82 *Id.*
83 Loos v. Immersion Corp., 762 F.3d 880, 883 (9th Cir. 2014).
84 *Id.* at 883.
85 *Id.* at 885-86.
86 *Id.* at 887-88.
87 Smilovits v. First Solar, Inc., 119 F. Supp. 3d. 978, 987 (D. Ariz. 2015).
88 *Id.*

B. *First Solar: The Ninth Circuit's New Standard*

In *First Solar*, the plaintiff, Mineworkers' Pension Scheme, represented a group of investors who had purchased First Solar, Inc.'s publicly traded securities.[89] The defendant, First Solar, Inc., is a producer of photovoltaic solar panel modules.[90] The plaintiff asserts that during the class period, April 30, 2008 to February 28, 2012, First Solar Inc. discovered manufacturing defects. Subsequently, First Solar Inc. "concealed these defects, misrepresented the cost and scope of the defects, and reported false information on their financial statements."[91] During the Class Period, "First Solar's stock price fell from $300 per share to nearly $50 per share."[92] There were steep declines in the stock price following the release of quarterly financial disclosures that reported "the defects and associated costs, the departure of First Solar's CEO, and disappointing financial results."[93]

First Solar filed a motion for summary judgment on all claims.[94] The district court granted the motion in part and denied in part, finding that there were material issues of fact.[95] Further, the district court stayed the case to resolve the competing lines of cases and determine the correct test for loss causation.[96]

At the Ninth Circuit, the Court found that the correct test for loss causation is a general proximate cause test.[97] In their reasoning, the Ninth Circuit relied on their recent decision in *Lloyd v. CVB Financial Corp*., a case decided after the appeal was filed in *Smilovits*. In *Lloyd*, the court stated that "'loss causation is a "context-dependent" inquiry as there are an "infinite variety" of ways for a tort to cause a loss.'"[98] Citing *Dura*, the Ninth Circuit in *Lloyd* found that "the ultimate issue is whether the defendant's misstatement, as opposed to some other fact, foreseeably caused the plaintiff's loss."[99] In *First Solar*, the Ninth Circuit reasoned that their decision in *Lloyd* did not suggest that the only way to prove loss causation was a revelation of fraud.[100] As long as the plaintiffs "adequately pleaded a causal connection between the material misrepresentation and

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89 Mineworkers' Pension Scheme v. First Solar Inc., 881 F.3d 750, 752 (2018).
90 *Id.*
91 *Id.*
92 *Id.*
93 *Id.*
94 *Id.*
95 *Id.*
96 *Id.*
97 *Id.* at 753.
98 *Id.* (citing Lloyd v. CVB Fin. Corp., 811 F.3d 1200, 1210 (9th Cir. 2016)).
99 *Id.*
100 *Id.*

the loss," the plaintiff will satisfy loss causation.[101] The Ninth Circuit acknowledged that there are an "'infinite variety' of causation theories a plaintiff might allege."[102] The fact that the Court has previously approved of one theory does not imply their rejection of other theories.[103] "It is the underlying facts concealed by fraud that affect the stock price."[104] The key issue is "whether the defendant's misstatement, as opposed to some other fact, foreseeably caused the plaintiff's loss."[105]

V. CIRCUIT SPLIT ON IN-AND-OUT TRADERS

After the Supreme Court's decision in *Dura*, there has been a question over whether or not an in-and-out trader would be able to recover in securities fraud litigation.[106]

Post-*Dura*, the only circuit court to address in-and-out traders at class-certification has been the Second Circuit. On a motion for class certification, the Second Circuit declined to include in-and-out traders in a securities class action.[107] The Court reasoned that the "[p]laintiffs further fail to connect the decline in the price of Flag stock to any corrective disclosures as required by the second prong of Lentell."[108] The Second Circuit found that the lower court abused its discretion in "drawing its conclusion that the in-and-out traders could prove loss causation as a matter of law."[109] Instead of remanding the case back to the district court to determine whether in-and-out traders could be included in the class, the Second Circuit concluded that the "[p]laintiffs have not presented sufficient evidence to demonstrate that the in-and-out traders will even 'conceivably' be able to prove loss causation as a matter of law, and that they therefore should not have been included in the certified class."[110]

Pre-*Dura*, the Ninth Circuit addressed the issue of in-and-out traders in *Wool v. Tandem Computers Inc*.[111] Since *Wool*, "Ninth Circuit precedent has long held that in-and-out traders are appropriately included in a class."[112] In *Wool*, the plaintiff was an in-and-out trader, "one who

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101 *Id.* (quoting Dura Pharm., Inc. v. Broudo, 544 U.S. 336, 342 (2005)).
102 *Id.* at 754.
103 *Id.*
104 *Id.*
105 *Id.* at 753 (citing Lloyd v. CVB Fin. Corp., 811 F.3d 1200, 1210 (9th Cir. 2016)).
106 *In re* BearingPoint, Inc. Sec. Litig., 232 F.R.D. 534, 543 (E.D. VA. 2006).
107 *See In re* Flag Telecom Holdings, Ltd. Sec. Litig., 574 F.3d 29, 41 (2d Cir. 2009).
108 *Id.*
109 *Id.* at 39.
110 *Id.* at 40.
111 *See* Wool v. Tandem Computers Inc., 818 F.2d 1433, 1437 (9th Cir. 1987), *overruled on other grounds by* Hollinger v. Titan Cap. Corp., 914 F.2d 1564, 1575 (9th Cir. 1990).
112 McGuire v. Dendreon Corp., 267 F.R.D. 690, 698 (W.D. Wash. 2010).

purchased stock during the period of misrepresentation but sold it before any disclosure which either partially or completely corrected the misrepresentation."[113] The defendant argued that "Wool did not suffer any actual damages and therefore had no cause of action under federal securities law."[114] The Ninth Circuit concluded that "[b]ecause market forces are independent of corrective disclosures, an in-and-out trader . . . may suffer recoverable damages . . . even in the absence of corrective disclosures."[115]

After the Supreme Court's decision in *Dura*, "courts deciding whether in-and-out traders should be included in classes have struggled with the question."[116] In the Ninth Circuit, "[i]t is unclear whether Dura's discussion of inflated purchase as it relates to loss causation overturns the Ninth Circuit's decision in *Wool*."[117] In *In re Juniper Networks, Inc. Securities Litigation*, the District Court excluded from class certification in-and-out traders who had sold their securities prior to the public dissemination of a curative disclosure.[118] The *Juniper* court reasoned that traders who sold their securities prior to the public dissemination of a curative disclosure "cannot logically prove economic loss based on Juniper's alleged misrepresentations."[119] Contrary to *Juniper*, some courts in the Ninth Circuit have included in-and-out traders in class certification.[120] In *McGuire v. Dendreon Corp.*, the court "[found] that in-and-out traders are appropriately included in the class at the class certification stage."[121] The *McGuire* court reasoned that "in-and-out traders could prove that they suffered a loss when they sold their shares because they only purchased the stock due to the misrepresentation."[122]

VI. IN-AND-OUT TRADERS AND PROXIMATE CAUSE

The Ninth Circuit's recent decision in *First Solar* has opened the door to allowing in-and-out traders to recover in securities fraud litigation. As several courts have noted, the *Dura* decision did not actually reach the

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113 *Wool*, 818 F.2d at 1437.
114 *Id.*
115 *Id.*
116 *McGuire*, 267 F.R.D. at 698.
117 *Id.*
118 *In re* Juniper Networks, Inc. Sec. Litig., 264 F.R.D. 584, 594 (N.D. Cal. 2009).
119 *Id.*
120 *See McGuire*, 267 F.R.D. at 699; *see also* Buttonwood Tree Value Partners, LP v. Sweeney, No. 10-cv-537, 2013 WL 12125980, at *15 (C.D. Cal. 2013).
121 *McGuire*, 267 F.R.D. at 699.
122 *Id.*

economics underlying loss causation.[123] The Supreme Court in *Dura* "was focused merely on the sufficiency of the plaintiff's initial pleadings, and does not address methodologies for quantifying economic loss."[124] However, courts have still cited *Dura* to construct their respective loss causation standard. Given this conflict in jurisprudence and the Ninth Circuit's recent decision in *First Solar*, the Ninth Circuit has provided a pathway for in-and-out traders to show they suffered a loss.

A. Loss Causation is Rooted in the Common Law

Loss causation bears a striking resemblance to common law torts.[125] However, the Supreme Court has misapplied the Restatement of Torts to require markets to learn of fraudulent activities before a plaintiff may recover.[126] The right test for security loss causation is a general proximate cause test.[127] In *Dura*, the Supreme Court recognized that securities fraud cases resemble the common-law deceit and misrepresentation actions.[128] However, the Court did not go far enough in their analysis of the common law.

1. The Supreme Court has Misapplied the Restatement (Second) of Torts

The *Dura* court relied on §§ 525 and 548A Restatement (Second) of Torts for their justification of denying the Ninth Circuit's "inflated purchase price" approach to loss causation.[129] Section 525 says that "[o]ne who fraudulently makes a misrepresentation of fact, opinion, intention or law for the purpose of inducing another to act or to refrain from action in reliance upon it, is subject to liability to the other in deceit for pecuniary loss caused to him by his justifiable reliance upon the misrepresentation."[130] Additionally, § 548A states that "[a] fraudulent misrepresentation is a legal cause of a pecuniary loss resulting from action

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123 *See In re* CIGNA Corp. Sec. Litig., 459 F. Supp. 2d 338, 353 (E.D. Penn. 2006); *see also McGuire*, 267 F.R.D. at 698.

124 *In re* CIGNA, 459 F. Supp. 2d at 353.

125 Dura Pharmaceuticals, Inc. v. Broudo, 544 U.S. 336, 343 (2005) ("Judicially implied private securities fraud actions resemble in many (but not all) respects common law deceit and misrepresentation actions.") (citing Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 744 (1975)).

126 In 2016, the Second Circuit, following the Supreme Court's lead, also misapplied the Restatement (Second) of Torts § 548A cmt. b to support a requirement that fraudulent activity be disclosed to the market. *See In re* Vivendi, S.A., 838 F.3d 223, 261 (2nd Cir. 2016).

127 Mineworkers' Pension Scheme v. First Solar Inc., 881 F.3d 750, 752 (9th Cir. 2018).

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

129 *See id.* at 343-44.

130 RESTATEMENT (SECOND) OF TORTS § 525 (AM. L. INST. 1977).

or inaction in reliance upon it if, but only if, the loss might reasonably be expected to result from the reliance."[131] While neither of these provisions expressly calls for the market disclosure, the Court specifically relied on a part of comment b to § 548A:

> [t]hus one who misrepresents the financial condition of a corporation in order to sell its stock will become liable to a purchaser who relies upon the misinformation for the loss that he sustains when the facts as to the finances of the corporation become generally known and as a result the value of the shares is depreciated on the market, because that is the obviously foreseeable result of the facts misrepresented.[132]

While courts have relied on this part of the comment,[133] the comment does not foreclose the opportunity that a loss could be proved in a different manner.

The structure of the comment does not mandate that the market must become generally aware of the fraud and then react to the fraud. The true purpose of the comment is to relay that "the matter misrepresented must be considered in the light of its tendency to cause those losses and the likelihood that they will follow."[134] The Supreme Court has interpreted an isolated sentence as a limiting factor in their loss causation analysis.[135] However, the meaning of that sentence turns on the meaning of "thus." When used, "thus" normally has four meanings: (1) in this or that manner; (2) so; (3) hence, consequently; and (4) as an example.[136] When read in the context of the whole comment, the word "thus" takes on the meaning of either (3) or (4). These two definitions do not create a standard but rather offer an example of what would satisfy the ultimate meaning of the comment, pecuniary losses must reasonably result from the misrepresentation.

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131 RESTATEMENT (SECOND) OF TORTS § 548A (AM. L. INST. 1977).

132 RESTATEMENT (SECOND) OF TORTS § 548A cmt. b (AM. L. INST. 1977).

133 *See Dura*, 544 U.S. at 344; *see also In re* Vivendi, S.A. Sec. Litig., 838 F.3d 223, 262 (2d Cir. 2016) (holding that it was sufficient that the alleged loss resulted from the relevant truth leaking out from "events constructively disclosing the fraud").

134 RESTATEMENT (SECOND) OF TORTS § 548A cmt. b (AM. L. INST. 1977).

135 *Dura*, 544 U.S. at 344 ("Indeed, the Restatement of Torts, in setting forth the judicial consensus, says that a person who 'misrepresents the financial condition of a corporation in order to sell its stock' becomes liable to a relying purchaser 'for the loss' the purchaser sustains' when the facts . . . become generally known' and 'as a result' share value 'depreciate[s].'").

136 *Thus*, A DICTIONARY OF MODERN AMERICAN USAGE 654 (OXFORD UNIVERSITY PRESS 1998).

2. Proximate Cause Standard

The loss causation standard in securities actions is rooted in common law negligence.[137] In a typical negligence case, the plaintiff must show that the defendant owed a duty, the defendant breached that duty, the defendant caused the harm, and the plaintiff suffered damages. In regard to the causation element, the common law "employed the term 'legal cause' to encompass two distinct inquiries: factual cause and proximate cause."[138] The former concerns whether the defendant caused the plaintiff's harm.[139] The latter concerns the scope of defendant's liability for their actions.

Factual causation is equated with the but-for causation standard.[140] In order to satisfy the factual cause requirement, the plaintiff must prove that the defendant's conduct was the cause of the plaintiff's harm.[141] As Prosser and Keeton explained, "[t]he defendant's conduct is a cause of the event if the event would not have occurred but for the conduct; conversely, the defendant's conduct is not a cause of the event, if the event would have occurred without it."[142] The Restatement (Third) reiterates the but-for standard: "an act is a factual cause of an outcome if, in the absence of the act, the outcome would not have occurred."[143] Proof of factual causation alone, while necessary, is not sufficient to establish legal causation.[144]

In addition to factual causation, the plaintiff must prove that the cause was within the scope of liability. The central purpose of proximate cause inquiry is "that an actor should be held liable only for harm that was among the potential harms–risks–that made the actor's conduct tortious."[145] Two distinct patterns exist under proximate cause: direct harm pattern and intervening cause harm pattern.[146] The direct harm pattern occurs when "the defendant negligently creates a risk of a harm–call it Harm A–but an entirely different harm–Harm B–results."[147] For this analysis, "most courts simply ask whether the harm that occurred was foreseeable, that is, whether it was one of the general kinds of harm that was unreasonably risked by the defendant's negligence."[148] In the intervening cause pattern,

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137 Jill E. Fisch, *Cause for Concern: Causation and Federal Securities Fraud*, 94 IOWA L. REV. 811, 829-830 (2009).
138 RESTATEMENT (THIRD) OF TORTS § 26 cmt. a (AM. L. INST. 2010).
139 DAN B. DOBBS ET. AL., THE LAW OF TORTS § 185 (2d ed. 2019).
140 Fisch, *supra* note 137, at 830.
141 THE LAW OF TORTS, *supra* note 139, § 183, at 614.
142 W. PAGE KEETON ET. AL., PROSSER AND KEETON ON THE LAW OF TORTS § 41, at 266 (5th ed. 1984).
143 RESTATEMENT (THIRD) OF TORTS § 26 cmt. b (AM. L. INST. 2010).
144 THE LAW OF TORTS, *supra* note 139, § 183, at 614.
145 RESTATEMENT (THIRD) OF TORTS § 29 cmt. d (AM. L. INST. 2010).
146 THE LAW OF TORTS, *supra* note 139, § 201, at 693.
147 *Id.*
148 *Id.*

"the defendant creates a risk of harm but the immediate trigger for the harm is some other force or person."[149]

The intervening cause pattern is limited by superseding causes. Under this pattern, there is a secondary act that has an effect on the causation analysis. If the secondary act is a new cause that comes into play after the defendant's conduct, then the secondary act is an intervening cause.[150] However, if the intervening act is the only proximate cause of the harm, then the intervening cause is called a superseding act.[151] A defendant is not liable when an intervening act is also a superseding act. As Dobb's explained,

> [t]he rule is that if the intervening cause itself is part of the risk negligently created by the defendant, or if it is reasonably foreseeable at the time of the negligent conduct, then it is not a superseding cause at all. In that case, the defendant is not relieved of liability merely because some other person or force triggered the injury.[152]

When courts utilize a proximate cause inquiry, the extent of the liability is determined by whether the intervening cause is foreseeable.[153] The focus is not on the foreseeability of the intervening act[154], but rather, the focus is on the foreseeability of the nature[155] and the manner[156] of the harm done.

While negligence requires foreseeability, intentional torts are not bound by the same restriction; securities actions require a different causation analysis than the standard negligence analysis. "The requirements in negligence cases that the plaintiff's harm be expectable or foreseeable consequence of the defendant's actions does not apply to intentional torts."[157] As the Restatement (Third) of Torts § 33(a) states: "[a]n actor who intentionally causes harm is subject to liability for that harm even if it was unlikely to occur."[158]

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149 *Id.*
150 *Id.*
151 THE LAW OF TORTS, *supra* note 139, § 204, at 706-07.
152 *Id.*
153 *Id.*
154 *See id.*
155 THE LAW OF TORTS, *supra* note 139, § 205, at 711.
156 THE LAW OF TORTS, *supra* note 139, § 206, at 711.
157 Fisch, *supra* note 137, at 832.
158 RESTATEMENT (THIRD) OF TORTS § 33(A) (AM. L. INST. 2010).

While courts correctly recognize the general proximate cause test as the correct inquiry, it is through an intervening cause pattern that loss causation can be shown in the absence of any corrective disclosure.

B. Showing Loss Causation

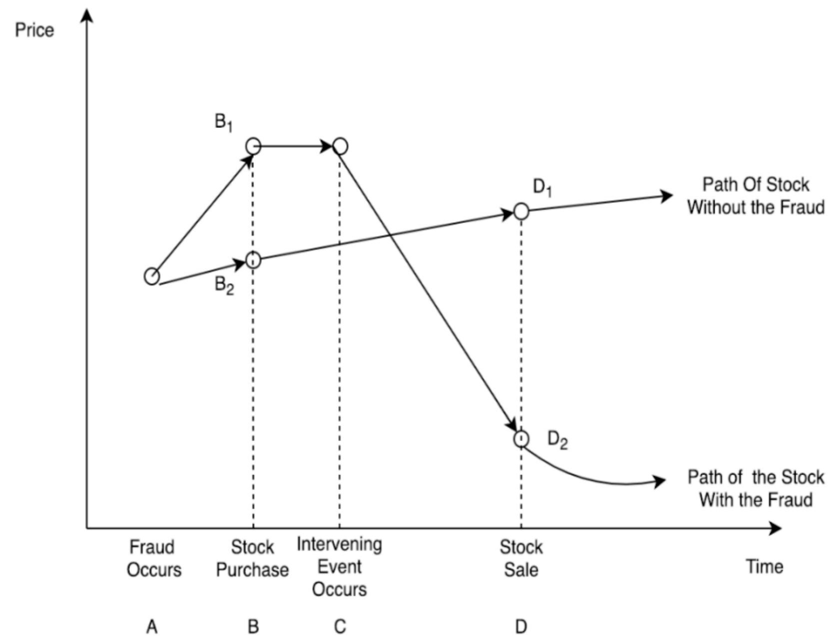

FIGURE 1

The disclosure requirement imposed by the court is an unnecessary limitation to the loss causation analysis. As the Ninth Circuit correctly pointed out, there are an infinite number of ways to prove loss causation.[159] However, most courts have chosen the most obvious example, a decline in stock price after a public announcement revealing the defendant's fraudulent conduct, as the standard for securities litigation. Returning to the hypothetical laid out at the beginning of this article, we can show loss causation can occur in the absence of a disclosure.

159 Mineworkers' Pension Scheme v. First Solar Inc., 881 F.3d 750, 754 (9th Cir. 2018).

The proposed loss causation analysis relies on the intervening cause pattern. Using FIGURE 1, the intervening pattern shows that a plaintiff can be harmed in the absence of a market disclosure. In the model, the defendant makes a fraudulent statement at point A. Shortly after the fraudulent statement is made, the plaintiff purchases the stock at the inflated price, B_1. However, had the defendant not made the fraudulent statements, the plaintiff would have purchased the stock at a non-inflated price, B_2. Shortly after the purchase, an intervening event occurs, forcing the stock price to plummet. Yet, without the fraudulent statement, investor expectations would not have been affected by the intervening event. The stock price without the fraudulent price baked in would have remained level. Due to the intervening event, the purchaser sells the stock at point D_2, resulting in damages. Had the fraudulent statements never been made, the purchaser would have owned stock at price D_1.

This model tends to agree with illustration 2 to § 548A. This illustration does not require the market to become generally aware of the fraud in order for the plaintiff to recover pecuniary losses. The illustration states:

> A, seeking to buy bonds for investment, approaches B. B offers A the bonds of X Oil Corporation, fraudulently misrepresenting its financial condition. In reliance upon these statements, A buys the bonds. After his purchase conditions in the oil industry become demoralized and as a result of financial losses the X Oil Corporation becomes insolvent. Because of the insolvency A suffers a pecuniary loss greater than that which would have resulted from the deterioration of conditions in the industry alone. It is found that if the financial condition of the Corporation had been as represented it would probably have weathered the storm and not become insolvent. B is subject to liability to A for the additional pecuniary loss resulting from the insolvency.[160]

This illustration is based off *Hotaling versus A.B. Leach & Co, Inc., et al.* In *Hotaling*, Judge Cardozo, writing for the court, said that the "[u]ltimate loss of investment was due to the weakness inherent in the investment concealed by the defendant."[161] He further went on to say "[a]s long as the fraud continued to operate and to induce the continued holding of the bond, all loss flowing naturally from that fraud may be regarded as its proximate cause."[162] Pecuniary losses were not dependent on the market becoming aware of the fraud; pecuniary losses were dependent on a connection between the loss and the fraud.

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160 RESTATEMENT (SECOND) OF TORTS § 548A illustration 2 (AM. L. INST. 1977).

161 Hotaling v. A.B. Leach & Co, Inc., et al., 159 N.E. 870, 873 (1928).

162 *Id.*

The key to our intervening cause pattern is the absence of a superseding event. A superseding event destroys the chain of causation. Looking at the illustration, the scenario was dependent on the company being able to weather a collapse in the oil industry. If the company's stock, without the fraud factored in, had fallen with the rest of the oil industry, the loss would not be linked to the fraud. The loss would be linked to overwhelming market conditions.

While the illustration presents an extreme example, the model still holds under less extreme conditions. As our model shows, an in-and-out trader just needs to show that the actual stock price fell below the contrafactual stock price while the actual stock price was still influenced by the fraud.

VII. AN INTERVENING CAUSE PATTERN WOULD NOT BE INVESTOR INSURANCE

Courts have been cautious in their rulings on loss causation in order to prevent the conversion of Rule 10b-5 into a scheme for investor's insurance.[163] However, dismissing a plaintiff who was wrongfully harmed because they sold their shares before the market was made explicitly aware of fraudulent acts ignores the intent of Rule 10(b)-5. The Commission's intent was "to provide protection against investors being duped into purchasing or selling securities."[164] As the Supreme Court acknowledged in *Basic*, "it is hard to imagine that there ever is a buyer or seller who does not rely on market integrity."[165]

In-and-out traders rely on the market to accurately reflect the true financial condition of the company whose stock is being purchased. When they are fraudulently induced to buy a stock by a company's misstatements, in-and-out traders are also hurt. In-and-out traders have given up alternative opportunities because of misleading statements. While the Ninth Circuit's decision opens the court system to more possible claims, these claims will not be insurance for those who lost money. These new plaintiffs will still need to show the court that their loss was linked to a fraudulent statement made by the defendant and not the result of a superseding event.

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163 Dura Pharmaceuticals, Inc. v. Broudo, 544 U.S. 336, 345 (2005).
164 Thomas Lee Hazen, LAW OF SECURITIES REGULATION § 12:16 (2019).
165 Basic Inc. v. Levinson, 485 U.S. 224, 230 (1988) (quoting Schlanger v. Four-Phase Systems Inc., 555 F.Supp. 535,538 (SDNY 1982)).

CONCLUSION

While the Ninth Circuit resolved their own circuit split in *First Solar*, the Court's reasoning opened the door to allow more potential plaintiffs to recover beyond the Ninth Circuit. In-and-out traders are usually excluded from recovering damages caused by a company's fraudulent misstatement or omission because they exited their position prior to a market disclosure. However, under the Ninth Circuit's reasoning, "it is the underlying facts concealed by fraud that affect the stock price."[166] As the Court noted, there are an "'infinite variety' of causation theories a plaintiff might allege to satisfy proximate cause."[167] Since it is the facts that affect the stock price, a market disclosure is a possibility but not a condition for proving loss causation.

Under a general proximate cause standard, it can be shown that investors can show loss causation in the absence of a corrective disclosure. The purpose of Rule 10(b)-5 was to protect investors from being duped into purchasing stocks. By preventing in-and-out traders from recovering in the absence of a corrective disclosure, courts are going against the intent of the Commission. While the Ninth Circuit's decision in *First Solar* was a step in the right direction, it will take action from the Supreme Court to open the courts to all those who have been harmed. As one SEC commissioner put it in 1942, "we are against fraud, aren't we?"[168]

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166 Mineworkers' Pension Scheme v. First Solar Inc., 881 F.3d 750, 754 (9th Cir. 2018).

167 *Id.*

168 Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 767 (1975) (Blackmun, J., dissenting) (citing Remarks of Milton Freeman, *Conference on Codification of Federal Securities Laws*, 22 BUS. LAW. 793, 922 (1967)).