Collateral Damage and Securities Litigation

BRADFORD CORNELL
CALIFORNIA INSTITUTE OF TECHNOLOGY
PASADENA, CA
626 833-9978
bcornell@hss.caltech.edu

JAMES RUTTEN
MUNGER, TOLLES & OLSON
LOS ANGELES, CA
213 683-9100
James.Rutten@mto.com
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Abstract
1. Introduction

Despite recent rulings, including the path-breaking decision in *Dura*, the lynchpin of damage analysis in securities litigation remains the concept of inflation. If a misrepresentation or omission fails to inflate the price of a company’s securities, then damages are zero regardless of any other considerations, and there is no reason for plaintiffs to proceed. Nonetheless, the problem of measuring inflation has received less attention in recent years as focus has shifted to issues such as assessing causality. This has led to conceptual gaps in the legal and financial analysis of inflation. This paper takes a step in redressing that deficiency.

The best way to highlight the contribution of this paper is to first explain what it does not address. To begin, this is not a paper on the economic and legal issues associated with event studies. It is assumed that the standard event study approach accurately measures the impact of a company’s disclosures on its stock price. More specifically, it is assumed that a model can be developed which produces residual returns that accurately reflect the valuation impact of news disclosures.\(^1\) This is, of course, a highly controversial assumption. In most securities cases, there is active debate regarding what model should be used to net out market and industry effects. Once a model is selected there remains the problem of confounding information that arises when more than one disclosure occurs on a given day. In addition, if there is any market inefficiency, and Grossman and Stiglitz (1980) prove that there must be some, then as Cornell and Rutten (2006) demonstrate, by using hindsight in combination with that inefficiency, plaintiffs can select those unique days on which the residual return markedly overstates the fundamental value of the information disclosed. These and other issues related to event studies

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\(^1\) See Cornell and Morgan (1990) for a description of how event study analysis is applied in litigation. A more recent discussion is contained in Ferrell and Saha (2007). Kothari and Warner (2006) provide a detailed technical overview of event study analysis.
are all important, but they have all been analyzed extensively. Because this paper focuses on conceptual issues unrelated to the application of event study techniques, it is assumed that all of these problems can be surmounted. It is important to stress that in making this assumption it is also implicitly assumed that the market is efficient. If such were not the case, then the residual return would not necessarily reflect the fundamental value of a news disclosure.

Given these assumptions, estimating inflation will be unambiguous for what we call direct misrepresentations. A direct misrepresentation is a definitive, but false, release of information by the company. An example would be a company announcement that new oil reserves had been discovered on a company’s property when, in fact, no such discovery had occurred. Under these circumstances, the residual return on the day of announcement would measure the inflating impact of the disclosure. The problem is that direct misstatements are rare birds. More commonly, misstatements involve an element of an omission, if they are not entirely omissions. A common example is a situation in which a company artificially inflates stated earnings to meet the estimates of Wall Street analysts. In that situation, the stock price of the company should be unaffected by the earnings announcement because expectations are met. Inflation arises because the stock price should have fallen to its “true value” had the correct financial information been disclosed. In this situation, and in any case that involves an element of an omission, inflation cannot be measured simply by looking at the residual return on the day of misrepresentation because the omitted information is not properly reflected in the stock price.

The standard solution to the problem of dealing with omissions has been to go forward in time to the date on which the misstatement is corrected. The event study approach is used to
estimate the residual return on the corrective disclosure date.\(^2\) It is then assumed that the original inflation is equal to the valuation impact of the corrective disclosure. Here we argue that such an assumption is typically faulty. The reaction to a corrective disclosure will commonly exceed, often by a large amount, the inflation caused by the original misstatement. In the remainder of the paper, we explain why and discuss the legal implications of this fact.

2. Over disclosure and collateral damage

The are two major reasons why the valuation impact of a disclosure that corrects a misstatement will exceed the inflation caused by the original misstatement: (1) over disclosure and (2) collateral damage. Of the two, over disclosure has been analyzed extensively going all the way back to Cornell and Morgan (1990). For that reason, the focus of our analysis here is on collateral damage. Nonetheless, before turning to a discussion of collateral damage, it is helpful to review briefly what is meant by over disclosure. *Basic* provides a good example, despite the fact that the misstatement at issue was associated with deflation rather than inflation. Except for the direction of the price movement caused by the misstatement, the issues related to the analysis of inflation are identical.

In *Basic* representatives of Basic met with and telephoned representatives of Combustion Engineering in September 1976 regarding a possible merger. During 1977 and 1998, however, Basic made public statements denying any potential merger. Then, on December 18, 1978, Basic abruptly asked the New York Stock Exchange to suspend trading in its shares pending a news announcement. The next day, Basic’s board endorsed Combustion’s $46 offer for its common stock. On December 20, the agreed upon merger was publicly announced.

\(^2\) It is possible that the corrective disclosure occurs over several days. While this complicates the computations it does not change the nature of the conceptual issues analyzed here. Therefore, to avoid unnecessary complication it assumed that the corrective disclosure occurs on one day.
If the agreed upon merger announcement is taken as the corrective disclosure, it clearly “over discloses” previous misstatements. While Basic was denying any potential merger in 1977 and early 1978, it knew that its statements were false, but only to the extent that there were ongoing merger discussions. Basic did not know that those negotiations would be successful. Consequently, the corrective disclosure that announces the merger agreement does more than correct the original misstatement. It represents an overdisclosure that will have a greater impact on the stock price than a revelation of on-going merger discussions.

The solution to the over disclosure problem is to estimate what Cornell and Morgan call the equivalent disclosure. The equivalent disclosure is the price at which a security would have traded if the omitted and misrepresented information – and only that information – were accurately disclosed at the start of the class period. Though easy to state in theory, estimating the equivalent disclosure price is difficult in practice. Courts and scholars have struggled with this issue since *Elkind v. Liggett & Myers, Inc.*3 It remains a vexing problem, but it is not one to which we address here. The focus of this article is on collateral damage.

To our knowledge, the term “collateral damage” was coined by Ferrell and Saha (2007), but their application of the term is confusing because they use it in two different ways. On the one hand, they discuss collateral damage in the context of an accounting misstatement and note that the disclosure of an accounting restatement necessitated by the restatement of corporate holdings can have collateral damage effects including reassessment of the quality of a firm’s management and/or internal controls, and possible disruptive legal action. However, at another juncture they argue that misstatements can be divided into two categories. In the first category are misstatements that have direct implications for future cash flows. In the second category are

3 Insert citation
misstatements that “do not have any bearing on the future cash-flows of the firm or the discount rate that should apply to those cash flows.” Collateral damage is placed in the second category. That second description of collateral damage does not square with the statement that reassessment of management credibility or a company’s internal controls are examples of collateral damage. As discussed in detail below, reassessments of management credibility or a company’s internal controls will have an impact, in some cases a large impact, on future cash flows. If it did not, and investors recognized this fact, there would be no impact on the stock price.

To avoid this confusion, there is a more direct and useful way to define collateral damage. Collateral damage is defined as the valuation impact of a corrective disclosure that is unrelated to the original inflation. The definition is best illustrated by an example and the one presented by Ferrell and Saha is instructive. They say, “a misstatement might be an accounting statement by a firm that falsely states that it has $100 more in cash than it really does while falsely understating, in the same statement, its corporate holdings of U.S. Treasury bonds by an equivalent amount, $100.” From a financial point of view, such a misstatement, at the time it occurred, would have no impact on value. Treasury bonds are sufficiently liquid that a company can move from bonds to cash, or vice-versa, virtually instantaneously at a negligible transaction cost. However, Ferrell and Saha go on to assume that the firm fails to promptly report the error. It is not until a later date that the firm issues a corrective disclosure regarding the holdings and cash and Treasury bonds. At that time, the stock price falls. Because the original misstatement could not have inflated the stock price in an efficient market, the decline following the corrective disclosure must be due to collateral damage. Before analyzing the example, it is worth noting that it is a bit unrealistic from an economic standpoint. Presumably companies engage in
securities fraud only when the management perceives that perpetrating a fraud will convey some benefit. With respect to misstating holding of cash and Treasury bonds, there is no apparent benefit to be derived.

The example raises two types of questions related to collateral damage. First, from an economic perspective, what is the source of the collateral damage? Furthermore, is there an economic framework for estimating the magnitude of collateral damage? Second, from a legal perspective should collateral damage be recoverable? That is, should it be taken account of when assessing materiality, reliance and causation or should it be considered to be independent of the alleged misstatements? We address these legal questions in the next section. Here we focus on the economic issues.

Before turning to the analysis, it is helpful to graphically summarize the concept of collateral damage. As an example, the impact of collateral damage associated with a pure omission is depicted in Exhibit 1. As shown in the figure, price and value are equal until the point in time at which the company receives negative information, for instance, that its earnings will be less than expected. At that juncture, rather than accurately disclosing the information, the company misstates its financials so that earnings appear to meet market expectations. As a result, the market price of the stock does not fall, but the true value does. The figure shows that if the correct information had been disclosed, the price would have fallen by $5 as depicted by the dotted line. Consequently, the stock price is now inflated because true value has fallen but the price remains constant. The inflation equals the difference between the solid line and the dotted line. At a later date, the company corrects the omission, by providing accurate financial information, and the stock price falls by $15. As shown, the drop exceeds the original inflation by $10. As a result, the ultimate stock price is now $10 below what it would have been in the
but-for world in which there was no misstatement. The added drop represents the collateral
damage. The economic question is what is the source of this additional decline?

3. **Value creation and collateral damage**

   Value creation does not occur in a vacuum. It is affected by the relationships between the
   various classes of stakeholders including managers, employees, customers, distributors and
   investors that are party to the nexus of both legal contracts and informal agreements that define
   the corporation. Both the contractual and informal relationships among stakeholders depend
   upon the flow of information among counterparties. Disclosure of negative information can
   damage these working relationships and, thereby, affect the ability of the firm to generate cash
   flow. We argue that the primary source of collateral damage comes from the impact that
   corrective disclosures have on stakeholder relationships. In this context, collateral damage is not
   a secondary consideration. In many situations, the collateral damage can have a larger impact on
   the stock price than the original misstatement or omission.

   A useful way to analyze the collateral damage caused by corrective disclosures is the
   stakeholder approach to corporate finance developed by Cornell and Shapiro (1987). The
   stakeholder approach builds off the large literature in economics regarding reputational capital.4
   Whereas as that literature is quite diffuse, the stakeholder approach is designed to translate the
   main concepts developed in that literature into the framework of corporate finance and
   accounting.

   The stakeholder approach begins with the recognition that relationships between a firm
   and its stakeholders are based on two types of contracts, or claims. First, there are explicit
   contractual claims, such employment contracts, sales agreements and product warranties, that

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4 See MacLeod (2007) for a recent review of this literature.
exist as legal documents. Second, there are implicit claims that are best thought of as “understandings” between the firm and its stakeholders. Implicit claims remain understandings because they are too nebulous and involve too many contingencies to reduce to writing at a reasonable cost. One example of an implicit claim the assurance that a software company offers its customers regarding future enhancements of its existing products. Neither the company nor its customers have the ability to define precisely what enhancements will be made, when they will be available, or what they will cost. Nonetheless, the implicit understanding that the firm is committed to making enhancements available at reasonable is cost is of significant value to customers. This understanding can be thought of as an implicit claim that the company sells its customers along with the legal right to use its software.

As unwritten understandings, implicit claims have weak, if any, legal standing. As a result, they are enforced via the relationship between and reputations of the counterparties.\(^5\) This makes implicit claims sensitive to information regarding the credibility of the company as a counterparty, such as the quality and credibility of corporate management and the financial strength of the company. Securities litigation can have a large impact on the value of the implicit claims and, thereby, cause significant collateral damage.

The distinction between explicit and implicit claims is critical from a valuation perspective. Under most circumstances, the explicit claims of stakeholders are senior to the claims of both bondholders and stockholders. For this reason, as long as the probability of bankruptcy is small, explicit stakeholders claims are essentially risk free and, therefore, are largely unrelated to changes in the value of the firm. The same is not true of implicit claims.

\(^5\) MacLeod (2007) also discusses economic models designed to explain how implicit contracts can be enforced by reputation in the context of repeated games.
There are numerous examples of companies defaulting on implicit claims without the firm being in financial distress. For instance, Apple abandoned the Newton, its first hand held device, leaving Newton owners with a largely worthless paper weight. The company never delivered on promised enhancements such as improved hand writing recognition software.

Because implicit claims cannot be reduced to written contracts at reasonable cost, they cannot be unbundled and traded independently from the goods and services the firm buys and sells. For example, the implicit claims regarding future software enhancements described above are bundled with the initial software when it is sold to customers. Firms with a long track record of providing enhancements and with the financial strength to buttress the belief that they will continue to do so in the future can sell their implicit claims at higher prices. The higher prices for the implicit claims show up in the financial results as higher prices for the software with which they are bundled. The higher software prices, in turn, lead to greater profit margins and increased cash flow for the firm. It is via these increased cash flows that the ability to sell bundled implicit claims creates value for the firm.

As another example, a consulting company that has a reputation for providing a positive work environment can sell the implicit claim to its employees that it will continue to nurture that desirable environment. Those implicit claims create value because, holding other factors constant, people will be willing to work for the company for less than they would require to work for otherwise comparable companies that cannot sell similar implicit claims at the same price. This results in lower labor costs and greater cash flow.

The fact that implicit claims have value does not mean that selling them automatically creates value. Honoring implicit claims can be costly. For instance, to honor its implicit claims regarding enhancements, the software company in our example must develop the expected
enhancements and the consulting company must maintain its prized work environment. To the extent these activities entail expenses over and above those that would be borne in the normal course of business, honoring implicit claims involves bearing additional cost. Consequently, for the sale of implicit claims to create value, the present value of the expected receipts from their sale must exceed the present value of the expected costs of honoring them.

Despite the costs associated with honoring implicit claims, selling implicit these claims is likely to be an important source of value creation. It is through its implicit claims that companies, even in highly competitive industries with relatively homogenous products, can differentiate themselves. For instance, auto manufacturers sell implicit claims that they will make parts available for the life of the vehicle. Firms that have difficulty selling such claims, perhaps because of financial distress or low management credibility, will have to reduce the price of their cars. If the production of automobiles is highly competitive, much of the value added may come from the implicit claims that are sold with the car.

Because the payoffs on implicit claims are uncertain and depend upon counterparty assessments of the competence and integrity of management, among other things, the value of these claims will be sensitive to both information that affects investor perceptions.

_Evidence related to the value of implicit claims_

A variety of empirical studies demonstrate impact of disclosures on the value of implicit claims. One source of evidence is the market response to corporate litigation. The Texaco-Pennzoil case provides a particularly dramatic example. On November 19, 1985 a Houston jury found that Texaco had improperly interfered with Pennzoil’s plan to buy Getty Oil and directed Texaco to pay Pennzoil $11.1 billion in damages plus interest. In the seven trading days

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6 The material on Texaco-Pennzoil is taken from Cutler and Summers (1988).
following the verdict, the market value of Texaco dropped by $1.8 billion, while the market value of Pennzoil rose by only $600 million. After the judge upheld the award, Pennzoil stock rose further and Texaco fell. Overall, Texaco lost $2.58 billion in market value, while Pennzoil rose $780 million. One explanation for the $1.8 billion dollar differential between Texaco’s loss and Pennzoil gain, is changes in the value of implicit claims. Given the financial distress caused by the award, customers, suppliers and business partners were no longer willing to do business with Texaco on the same terms. For instance, Atlantic Richfield sent a letter to its staff in early December urging them to use “prudence” in doing business with Texaco. The declining value of implicit claims reduces the value of Texaco. On the other hand, receiving a windfall, as Pennzoil did, is unlikely to have much impact on the price of implicit claims. If stakeholders were already satisfied with the terms of implicit claims with Pennzoil, there is not much potential for Pennzoil to raise the price of those claims.

Though it is a dramatic illustration, the Texaco-Pennzoil example is not unique. Large corporate awards are typically associated with asymmetric valuation changes. Cornell and Engelman (1988) study five cases in detail and report results similar to those for Texaco and Pennzoil.

The devaluation of implicit claims also explains the response of stock prices to recalls by drug and auto manufacturers. In a classic study, Jarrell and Peltzman (1985) report that the drop in shareholder wealth accompanying recalls is much greater than the direct costs of the recall, including public relations expenses. In the case of drug recalls, they find he decline in shareholder is 12 times the size of the direct costs, on average. These findings are consistent with the view that drug companies are selling a variety of implicit claims with their products, perhaps the most important of which is quality control. If a recall changes consumer perceptions
of quality control and, thereby, reduces the price at related implicit claims can be sold, shareholder wealth declines.

The paper most directly related to collateral damage is the recent work of Karpoff, Lee and Martin (2008). The authors investigate 384 firms that were investigated by the SEC for accounting related issues during the period from 1978 through 2002 and for which Compustat financial data is available. The authors divide the total loss in value at the sample firms into four categories: (1) Fines and sanctions imposed by regulators; (2) Amounts paid to settle related class action securities cases; (3) The valuation impact of financial restatements; and (4) remaining reputation costs. The authors find that fourth component, the reputational effect associated with the devaluation of implicit claims accounted for more than 66% of the decline in value. Furthermore, if the reputational effect is compared with component (3) alone, that is the component associated with the original inflation, it is more than 10 times as large on average.

The bottom line is that collateral damage is not a secondary consideration. In most cases, the reputational impact and associated devaluation of implicit claims greatly exceeds any original inflation. As a result, great care must be taken to differentiate between the extent to which a disclosure corrects an original misstatement and, thereby, removes inflation and the collateral damage caused by the misstatement.

With this background, return to the example of the company which hides an earnings miss by accounting manipulation and, thereby, inflates its stock price by $5. When the accounting misstatement is disclosed, the stock price drops by $15 - $5 to correct for the accounting misstatement and $10 to reflect market reassessment of the competence and integrity of management and the quality of the company’s internal controls. The fundamental legal
question is what fraction, if any, of the added $10 decline is recoverable as part of a class action securities case?

III. DOES § 10(B) PERMIT RECOVERY FOR COLLATERAL DAMAGE?

The foregoing demonstrates that shareholders can suffer real financial harm in the form of collateral damage as a result of securities fraud, at least in a “but for” sense. It does not answer the critical legal question, however, which is whether shareholders are or should be permitted to recover for collateral damage under § 10(b) of the Securities Exchange Act of 1934 (the “Exchange Act”) and Securities and Exchange Commission (“SEC”) Rule 10b-5.8

There is good reason to tread cautiously in permitting recovery for collateral damage. Collateral damage is inherently nebulous and it is therefore difficult to identify and to measure. What may appear to be collateral damage at first blush may be attributable, in whole or in part, to market inefficiencies and to random crashes in security prices that bear no relation to changed perceptions of management’s honesty or competence.

An example illustrates the point. On September 21, 2000, Intel Corporation (“Intel”) issued a brief and seemingly unexceptional press release.9 It projected that revenue for the third quarter would be three to five percent higher than the second quarter’s revenue of $8.3 billion – results that fell short of the company’s previous forecast of seven to nine percent growth.10 Intel stated that the lower growth was attributed to a temporary decline in European sales associated with currency exchange rate fluctuations. An Intel officer later expressed his view that the press release was relatively insignificant, in that it reflected only short-run developments in Europe (the decline of the Euro), and did not reflect “any change in Intel’s long-run strategy, product

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8 17 C.F.R. § 240.10b-5.
10 See id.
mix, competitive position, or even . . . the long-run demand for Intel’s products.” Intel’s stock price could have been expected to decline slightly on this news, but instead it plummeted. Its stock declined nearly thirty percent over the next two trading days, and $122 billion in shareholder wealth, more than twice the market capitalization of Enron Corporation at its peak, evaporated.12

One of the authors, Cornell, has compared the $122 billion drop in market value with estimates of the change in the company’s fundamental value associated with the announcement.13 Cornell, using analysts’ forecasts of future financial performance, computed the discounted present value of future cash flows for Intel before and after the September 21, 2000 announcement.14 He found that, depending on the assumptions used, the drop in the discounted cash flow value of the company accounted for between 1% and 4.5% of the market drop. The remaining $116.5 billion to $120.8 billion in lost market capitalization must have been attributable to something else.15

Plaintiffs can see a bonanza in facts like these. Plaintiffs invariably invoke efficient market theory in presenting their damages models, following a devastatingly simple chain of reasoning to the ultimate conclusion that the entire stock price drop (net of the market and the industry) is attributable to the fraud. Plaintiffs argue that if “[t]he market is acting as the unpaid agent of the investor, informing him that given all the information available to it, the value of the stock is worth the market price,”16 then the entire stock price drop following the corrective

11 Id. at 113.

12 See id.

13 See id. at 119-28.

14 See id. at 123.

15 See id. at 126.

Disclosure must be attributable to the fraud. Plaintiffs have developed a convenient response to the observation that the stock price drop in many cases is out of all proportion to the fundamental value of the information conveyed by the corrective disclosure, and that the entire drop therefore cannot represent the amount by which the shareholder overpaid for the stock (i.e., it cannot represent out-of-pocket damages). Plaintiffs portray the delta as collateral damage arising from changed perceptions of management honesty and competence, which, they contend, is a foreseeable consequence of securities fraud, and therefore recoverable not as out-of-pocket damages, but as consequential damages. After all, they argue, if the market is efficient, what other explanation can there be?

As we demonstrated in Cornell and Rutten (2006), however, there can be many explanations for a stock price drop that is out of all proportion to the fundamental value of the information conveyed by a corrective disclosure. As we show in that article, even the most efficient of markets contains inefficiencies that can cause unwarranted crashes in stock prices irrespective of changed perceptions of management honesty or competence. Certainly in the case of Intel, it is difficult to imagine how a disclosure relating to short-term fluctuations in

For present purposes, we set aside the problems in estimating damages posed by confounding information, over-disclosure, and similar factors. See generally Bradford Cornell & R. Gregory Morgan, Using Finance Theory To Measure Damages in Fraud on the Market Cases, 37 U.C.L.A. L. Rev. 883 (1990).

See, e.g., Programs v. Leighton, 90 F.3d 1442, 1449 (9th Cir. 1996) (“Rule 10b-5 plaintiffs may recover consequential damages which can be proven with reasonable certainty to have resulted from the fraud.”) (internal quotation marks and citation omitted); Garnatz v. Stifel, Nicolaus & Co., Inc., 559 F.2d 1357, 1360 (8th Cir. 1977) (“As applied to a fraudulently induced purchase of securities, [the out-of-pocket] rule provides for the recovery of the difference between the actual value of the securities and their purchase price. . . . Recovery is also allowed for any consequential damages proximately resulting from the fraud.”).

currency exchange rates conceivably could have led to changed perceptions of management to the tune of $120 billion – yet determining whether any portion of the stock price drop is attributable to such changed perceptions is a hazardous enterprise at best, and estimating how much of the drop might represent collateral damage is wholly speculative.

The problem is compounded by ex post selection bias on the part of plaintiffs. Even the largest and most sophisticated of plaintiff-side law firms have limitations on their resources and so much pick and choose which cases to take based not only on the strengths and weaknesses of the respective cases but on the potential recovery at the end of the day. A plaintiff’s lawyer naturally will prefer to take on cases with large drops in market capitalization, all else being equal, including cases in which market inefficiencies led to crashes for reasons unrelated to fraud or changed perceptions of management. Given the difficulties of differentiating the portion of a stock price drop attributable to collateral damage from a portion attributable to other factors such as market inefficiencies, permitting plaintiffs to recover for collateral damage threatens to permit recovery that does not represent collateral damage at all, and that should not be recoverable under any legal theory.

The federal securities laws are carefully structured to avoid such results. The securities laws are designed to strike a balance between deterring and remedying wrongdoing, and imposing liabilities that are so draconian that they effectively deter capital formation.20 The

20 See, e.g., H.R. Rep. No. 104-369, at 31 (1995) (“The overriding purpose of our Nation’s securities laws is to protect investors and to maintain confidence in the securities markets, so that our national savings, capital formation and investment may grow for the benefit of all Americans.”); Stoneridge Investment Partners LLC v. Scientific-Atlanta, Inc., 128 S. Ct. 761, 772 (2008) (declining to adopt an expansive interpretation of § 10(b) in part because companies “might find it necessary to protect against these threats, raising the costs of doing business,” and “[o]verseas firms with no other exposure to our securities laws could be deterred from doing business here,” which, “in turn, may raise the cost of being a publicly traded company under our law and shift securities offerings away from domestic capital markets”); United Housing Foundation, Inc. v. Forman, 421 U.S. 837, (1975) (“The primary purpose of the Acts of 1933 and 1934 was to eliminate serious abuses in a largely unregulated securities market. The focus of
securities laws therefore carefully circumscribe recoverable damages, often more sharply than the common law would. Section 28 of the Exchange Act, for example, precludes punitive or exemplary damages by providing that “no person permitted to maintain a suit for damages under the provisions of this Act shall recover . . . a total amount in excess of his actual damages on account of the act complained of.” Additional, § 21D of the Exchange Act, enacted as part of the Private Securities Litigation Reform Act of 1995 (“PSLRA”), imposes a “look back” requirement because Congress was concerned that “[t]he current method of calculating damages in 1934 Act securities fraud cases” was too “uncertain,” resulting in “windfall damages.”

This is not to suggest that collateral damage, where it exists, does not stem from securities fraud (at least in a “but for” sense) or that it does not constitute actual financial harm to shareholders. Nor is it meant to suggest that difficulties in identifying and measuring collateral damage are sufficient reasons in and of themselves to preclude recovery, although prohibitions on recovering damages that cannot reasonably be estimated might well be dispositive in most if not all cases. The point is that the *in terrorem* effects of permitting recovery for collateral

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24 See, e.g., Ambassador Hotel Co. v. We-Chuan Investment, 189 F.3d 1017, 1030 (9th Cir. 1999) (“Consequential damages may also be awarded [under § 10(b)] if proved with sufficient certainty.”) (internal quotation marks and citation omitted); Pelletier v. Stuart-James Co., 863 F.2d 1550, 1557-58 (11th Cir. 1989) (“The measure of damages in a Rule 10b-5 case is limited to actual pecuniary loss suffered by the defrauded party, and does not include any speculative loss of profits.”); Hershock v. Fiascki, 1992 WL 164739, at *7 (E.D. Pa. July 2, 1992) ("Plaintiffs may not recover damages under any theory that would insure defrauded buyers against downside market risk[s] unrelated to the fraud. . . . The
damage cannot be ignored in evaluating whether § 10(b) should be construed to permit such recovery.

Below, we apply the United States Supreme Court’s governing analytical framework for construing the scope of the implied rights of action in the securities laws to show that recovery for collateral damage is not permitted by § 10(b), precisely because of its *in terrorem* effects. We also show that permitting recovery for collateral damage would be contrary to nearly every essential element of a cause of action under § 10(b).

A. The Supreme Court’s Analytical Framework For Construing The Scope Of The Implied Right Of Action Under § 10(b).

Section 10(b)’s language is the starting point in construing the scope of the § 10(b) right of action.25 Section 10(b) does not expressly address the damages to which a private plaintiff may be entitled, which is not surprising because the statute does not expressly create a private right of action at all; it is judicially implied.26 The statute nevertheless contains language that is relevant in determining whether collateral damage is properly recoverable.

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25 See, e.g., Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 173 (1994) (“With respect [to] the scope of conduct prohibited by § 10(b), the text of the statute controls our decision. . . . [A] private plaintiff may not bring a 10b-5 suit against a defendant for acts not prohibited by the text of § 10(b). To the contrary, our cases considering the scope of conduct prohibited by § 10(b) in private suits have emphasized adherence to the statutory language.”).

26 See id. (“[Determining] the elements of the 10b-5 private liability scheme[] has posed difficulty because Congress did not create a private § 10(b) cause of action and had no occasion to provide guidance about the elements of a private liability scheme.”); Superintendent of Insurance v. Bankers Life & Cas. Co., 404 U.S. 6, 13 n. 9 (1971) (first endorsing the consensus of the lower courts and commentators that there is an implied right of action under § 10(b) and Rule 10b-5).
Section 10(b) prohibits fraud only “in connection with the purchase or sale of any security.”27 The statute’s “purchase or sale” requirement generally is regarded as a standing requirement,28 but it is also relevant to the damages question because it indicates that Congress was focused on the purchase transaction.29 The statutory language indicates that Congress was focused on the out-of-pocket harm that befalls investors when fraud causes them to purchase at an inflated price and they later suffer losses when the value of their holdings correspondingly declines upon a corrective disclosure30 – i.e., their out-of-pocket damages – not on losses investors suffer from additional declines in value due to changed perceptions of management that do not correspond with an amount by which the investors overpaid.31


28 See Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975) (holding that persons who neither purchased nor sold securities have standing to sue under § 10(b)).

29 For simplicity, we discuss the issues in terms of defrauded purchasers, not defrauded sellers, although the analytical principles discussed are the same.

30 As the Supreme Court’s decision in Dura Pharmaceuticals, Inc. v. Broudo, 544 U.S. 336 (2005), explains, even if an investor pays an inflated price for stock, the investor suffers no real harm unless and until the stock subsequently declines in value as a result of a corrective disclosure – because at “the moment the transaction takes place, . . . the inflated purchase payment is offset by ownership of a share that at that instant possesses equivalent value.” Id. at 342. Dura makes clear that a plaintiff’s out-of-pocket damages necessarily are capped at an amount that cannot exceed the amount by which the stock price subsequently declines.

31 Cf. Strougo ex rel. Brazil Fund, Inc. v. Scudder, Stevens & Clark, Inc., 964 F. Supp. 783, _ (S.D.N.Y. 1997) (“Blue Chip Stamps and the other cases cited by the defendants in support of an out-of-pocket rule involved securities fraud claims . . . . The defendants cite no authority imposing a similar ‘purchaser-seller’ requirement in cases arising under [another statute]. Moreover, Blue Chip Stamps was decided under Section 10(b) and Rule 10b-5, which expressly require that the plaintiff be injured ‘in connection with the purchase or sale of any security.’”).
The legislative history of § 10(b) is consistent with its language. The legislative history of this particular provision of the Exchange Act is relatively sparse; most of the legislative history when it comes to the anti-fraud provisions focuses on the specific prohibitions contained in other sections. The legislative history does suggest, however, that § 10(b) was designed to ensure that the prices investors pay reflect only the legitimate forces of supply and demand.32

Although § 10(b)’s text and legislative history suggest that the statute does not permit recovery for collateral damage, they are anything but definitive. Determining whether § 10(b) permits such recovery thus requires additional analysis.

The Supreme Court repeatedly has held that when the scope of the § 10(b) right of action cannot be determined by reference to the statutory language, courts should refrain from determining its scope based on policy considerations or the like, as courts frequently do when it comes to common law causes of action. Rather, the Court has held, because the cause of action is statutory, courts should attempt to infer how the 1934 Congress would have defined the parameters of the § 10(b) cause of action had it enacted it expressly – looking for guidance in what Congress actually did provide in the causes of action it created expressly.

In Musick, Peeler & Garrett v. Employers Insurance of Wausau,33 for example, the Court considered “whether a right to contribution is within the contours of the 10b-5 action.”34 The Court criticized the parties for “devot[ing] considerable portions of their briefs to debating

32 For example, one of the Senate Reports states: “Certain devices employed for the purpose of artificially raising or depressing security prices are specifically prohibited by the act. Others have not been forbidden outright but have been placed under the control of the Securities and Exchange Commission.” S. Rep. No. 1455, at 54 (1934) (emphasis added). The reference to “other[]” provisions appears to be a clear reference to § 10(b), which prohibits fraud in connection with the purchase or sale of securities “in contravention of such rules and regulations as the Commission may prescribe.” 15 U.S.C. § 78j(b).


34 Id. at 294.
whether a rule of contribution or of no contribution is more efficient or more equitable,” and “declined to rule on such matters.” The Court explained:

Our task is not to assess the relative merits of the competing rules, but rather to attempt to infer how the 1934 Congress would have addressed the issue had the 10b-5 action been included as an express provision in the 1934 Act. We do this not as an exercise in historical reconstruction for its own sake, but to ensure that the rules established to govern the 10b-5 action are symmetrical and consistent with the overall structure of the 1934 Act and, in particular, with those portions of the 1934 Act most analogous to the private 10b-5 right of action that is of judicial creation. . . . [O]ur goals in establishing limits for the 10b-5 action [are] to ensure the action does not conflict with Congress’ own express rights of action, to promote clarity, consistency, and coherence for those who rely upon, or are subject to, 10b-5 liability, and to effect Congress’ objectives in enacting the securities laws.

Similarly, in Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., the Court considered whether defendants can be liable for aiding and abetting violations of § 10(b). The Court applied the same approach:

When the text of § 10(b) does not resolve a particular issue, we attempt to infer how the 1934 Congress would have addressed the issue had the 10b-5 action been included as an express provision in the 1934 Act. For that inquiry, we use the express causes of action in the securities Acts as the primary model for the § 10(b) action.

The Court explained: “The reason is evident: Had the 73d Congress enacted a private § 10(b) right of action, it likely would have designed it in a manner similar to the other private rights of action in the securities Acts.”

The Court repeatedly has applied this approach in numerous cases presenting questions about the scope of § 10(b), such as whether only purchasers or sellers of securities have standing

35 Id.

36 Id. at 294-95 (citations omitted).


38 Id. at 178.

39 Id.
to sue, whether there is a *scienter* requirement, whether there is a reliance requirement, the appropriate statute of limitations, and where the line is between primary and secondary liability.

The most relevant express causes of action to consult in construing the scope of § 10(b) are contained in § 9 and § 18 of the Exchange Act, because they are “close in structure, nonderivative private civil remedies, created by Congress contemporaneously with the passage of § 10(b), for violations of various provisions of the 1933 and 1934 Acts are by their terms expressly limited to purchasers or sellers of securities. . . . It would . . . be anomalous to impute to Congress an intention to expand the plaintiff class for a judicially implied cause of action beyond the bounds it delineated for comparable express causes of action.” (emphasis added).

See Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 735-36 (1975) (“The principal express nonderivative private civil remedies, created by Congress contemporaneously with the passage of § 10(b), for violations of various provisions of the 1933 and 1934 Acts are by their terms expressly limited to purchasers or sellers of securities. . . . It would . . . be anomalous to impute to Congress an intention to expand the plaintiff class for a judicially implied cause of action beyond the bounds it delineated for comparable express causes of action.”) (emphasis added).

See Ernst & Ernst v. Hochfelder, 425 U.S. 185, 200 (1976) (“It is . . . evident that Congress fashioned standards of fault in the express civil remedies in the 1933 and 1934 Acts on a particularized basis. Ascertainment of congressional intent with respect to the standard of liability created by a particular section of the Acts must therefore rest primarily on the language of that section.”).


See Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. 350, 359 (1991) (“[W]e are faced with the awkward task of discerning the limitations period that Congress intended courts to apply to a cause of action it really never knew existed. . . . We can imagine no clearer indication of how Congress would have balanced the policy considerations implicit in any limitations provision than the balance struck by the same Congress in limiting similar and related protections. When the statute of origin contains comparable express remedial provisions, the inquiry usually should be at an end.”) (citations omitted). The Supreme Court decided *Lampf* before Congress amended 28 U.S.C. § 1658 to provide an express statute of limitations for securities fraud claims.

See Stoneridge Investment Partners LLC v. Scientific-Atlanta, Inc., 128 S. Ct. 761, 768 (2008) (“The Court doubted the implied § 10(b) action should extend to aiders and abettors when none of the express causes of action in the securities Acts included that liability.”).
purpose, and intent to the 10b-5 action.” They “both target the precise dangers that are the focus of § 10(b), and the intent motivating all three sections is the same – to deter fraud and manipulative practices in the securities markets, and to ensure full disclosure of information material to investment decisions.” Section 9, like Rule 10b-5(a) and (c), generally prohibits manipulative securities transactions, such as wash sales and the like. Section 18, similar to Rule 10b-5(b), prohibits “false or misleading” statements, albeit limited to the context of documents filed with the SEC. Both statutes expressly discuss the damages a private plaintiff may recover. Section 9 provides that “[a]ny person who willfully participates in any act or transaction in violation of [the statute] shall be liable to any person who shall purchase or sell any security at a price which was affected by such act or transaction, and the person so injured may sue . . . to recover the damages sustained as a result of any such act or transaction.” Similarly, § 18 provides that “[a]ny person [who makes a false statement in violation of the statute] shall be liable to any person . . . who, in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement, for damages caused by such reliance.”

Sections 9 and 18 are similar to § 10(b) in that they both contain a “purchase or sale” requirement. Moreover, §§ 9 and 18 explicitly reference “a price which was affected by” the fraud, thereby strongly suggesting that Congress was focused on the harm that can befall

46 Id. § 78r.
48 Id. (internal quotation marks and citations omitted).
52 Id. §§ 78i(e), 78r(a).
investors when they purchase shares at an inflated price and later suffer losses from a corresponding decline in value – i.e., their out-of-pocket damages. Section 9, by providing that only an investor “so injured” may sue, further underscores that Congress was focused on investors’ out-of-pocket harm. The legislative history of §§ 9 and 18 is in accord. Not surprisingly, the statutes have been construed to permit recovery of out-of-pocket damages.

53 S. Rep. No. 792, at 7 (1934) (“Several devices are employed for the purpose of artificially raising or depressing security prices.”) (emphasis added); id. at 8 (stating that the anti-manipulation provisions of the bill were designed to prohibit “transactions specifically designed to manipulate the price of a security”) (emphasis added); id. at 12-13 (“[T]he bill provides that any person who unlawfully manipulates the price of a security . . . shall be liable in damages to those who have bought or sold the security at prices affected by such violation or statement.”) (emphasis added); id. at 17 (“To manipulate the price of a security . . . is prohibited by [§ 9].”) (emphasis added); id. at 21 (§ 18 creates liability to any person “who in reliance on the statement . . . has purchased the security to which it relates at a price affected by it”) (emphasis added); S. Rep. No. 1455, at 30 (1934) (“The true function of an exchange is to maintain an open market for securities, where supply and demand may freely meet at prices uninfluenced by manipulation.”); id. at 54 (“Certain devices employed for the purpose of artificially raising or depressing security prices are specifically prohibited by the act.”); H.R. Rep. No. 1383, at 10 (1934) (“The bill seeks to give to investors markets where prices may be established by the free and honest balancing of investment demand with investment supply.”) (emphasis added); id. (“False and misleading statements designed to induce investors to buy when they should sell and sell when they should buy are . . . outlawed and penalized.”) (emphasis added).

The other express causes of action in the Exchange Act, though less relevant because they are less analogous to § 10(b), underscore that Congress was careful in defining recoverable damages so to avoid creating liability that is unduly open-ended and unpredictable. Section 16 relates to short-swing trading and permits recovery of only the “profit realized by [the trader].” Section 20(a) imposes derivative liability on “controlling persons” only “to the same extent [that a] controlled person” is liable under one of the substantive sections of the Exchange Act. Section 20A of the Exchange Act relates to insider trading, and although it is arguably irrelevant here because it was enacted in 1988 instead of by the 1934 Congress, it too is careful to cap recoverable damages at a definite and certain amount. Section 20A provides that “[t]he total amount of damages [recoverable by persons who traded in the market at the same time as the insider] shall not exceed the profit gained or loss avoided in the transaction or transactions.”

The Securities Act of 1933 (the “Securities Act”), however, has a somewhat different focus. The Securities Act contains two express causes of action (other than a cause of action against “controlling persons” that is identical insofar as relevant here to § 20(a) of the Exchange Act).

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56 Id. § 78p(b).


58 Id.

59 Id. § 78t-1.


Act). Section 11 of the Securities Act relates to false and misleading registration statements, and prescribes a damages measure of “the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public)” and the market price at certain subsequent points in time, subject to a “negative causation” defense that “any portion or all of such damages represents other than the depreciation in value of such security resulting from [the] registration statement . . . not being true.” Section 12 of the Securities Act relates to sales of unregistered securities or pursuant to false or misleading prospectuses or oral communications, and provides for rescission of the transaction or a rescissionary measure of damages, again subject to a negative causation defense. Sections 11 and 12, rather than referencing the amount the plaintiff overpaid, explicitly look to the amount by which the plaintiff’s investment declined – an amount that can include collateral damage – while taking care to ensure that the plaintiff cannot recover for damages not proximately caused by the fraud.

Sections 11 and 12, however, are vastly different from § 10(b). Section 11 relates to sales pursuant to false or misleading registration statements, a context in which the sale price is set by the issuer, not the open market – and in the case of initial public offerings, before there is

62 Id. § 77o.
63 Id. § 77k.
64 Id. § 77k(e).
65 Id. §§ 77l.
66 See id. § 77l(a) (“Any person who [violates the statute] shall be liable . . . to the person purchasing such security from him, who may sue . . . to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.”); see also Randall v. Loftsgaarden, 478 U.S. 647, 649 (1986) (stating that investors are “entitled under § 12(2) . . . to rescind the fraudulent transaction or obtain rescissory damages”); Farley v. Henson, 11 F.3d 827, 837 (8th Cir. 1993) (rescissionary measure of damages under § 12).
any secondary market for the securities at all. Accordingly, § 11, unlike § 10(b), by definition cannot look to market-price inflation in calculating the plaintiff’s damages. Although § 11 does permit recovery in connection with open-market purchases, it requires an open-market purchaser plaintiff to “trace” its shares to the challenged registration statement, which, in light of the way modern-day securities trades are cleared, is usually impossible if the same class of securities has been offered pursuant to more than one registration statement. Further, § 11 provides that

68 See, e.g., Lee v. Ernst & Young LLP, 294 F.3d 969, 978 (8th Cir. 2002) (“[Section 11] is broad enough to encompass some aftermarket purchases, subject, of course, to the long-recognized requirement” that “the security was indeed issued under that registration statement and not another.”); Krim v. pcOrder.com, Inc., 210 F.R.D. 581, 586 (W.D. Tex. 2002) (even where 91% of the stock in the market came from the challenged registration statement, the plaintiffs could not prevail under § 11 because “[p]laintiffs must demonstrate all stock for which they claim damages was actually issued pursuant to a defective statement, not just that it might have been, probably was, or most likely was, issued pursuant to a defective statement”) (emphasis removed); In re Quarterdeck Office Sys., Inc. Sec. Litig., 1993 WL 623310, at *2-3 (C.D. Cal. Sep. 30, 1993) (holding that the plaintiff lacked § 11 standing even though fully 97% of the shares outstanding were issued pursuant to the allegedly defective registration statement); Lorber v. Beebe, 407 F. Supp. 279, 287 (S.D.N.Y. 1975) (“[I]t is insufficient that stock ‘might’ have been issued pursuant to a defective registration statement. A plaintiff must show that it actually was so issued.”).

69 Most broker-dealers clear trades through the Depository Trust Company (“DTC”), which “will hold all certificates of a particular company, both old and new, in its nominee name as pooled shares in a fungible mass for the benefit of all its members. . . . Assuming that some of the shares held by the [DTC] were issued in the offering, all of them would be held in a common pool. The fungible nature of the shares held by the [DTC] makes it virtually impossible for a purchaser to ascertain the exact origin of his stock even if the stock certificate he receives is new. A person who acquires securities in the open market following a registered offering is no better off. . . .” 17 J. William Hicks, Civil Liabilities: Enforcement and Litigation Under the 1933 Act § 4.14 (2002).

70 See Abbey v. Computer Memories, Inc., 634 F. Supp. 870, 872-73 (N.D. Cal. 1986) (holding that because the plaintiff’s shares “were purchased in the open market,” and at one time were “part of the common pool of . . . shares held in DTC’s vault,” the plaintiff could not trace his shares to the relevant
even when a plaintiff can trace (e.g., where there is only one registration statement), the plaintiff’s purchase price shall be deemed to be not more than “the price at which the security was offered to the public.”\textsuperscript{71} Section 11 is therefore narrowly focused on registration statements, provides much more limited remedies, and unlike § 10(b), provides no remedy with respect to shares purchased at an inflated market price. Section 11 provides little support for construing § 10(b) to permit recovery for subsequent declines in the price of a security that do not correspond with inflation in the market price at the time of purchase.

Section 12 is similar. Section 12 creates liability only on the part of persons who “offer[] or sell[]” securities in the prohibited circumstances, and provides a remedy only to “the person purchasing such security from him.”\textsuperscript{72} Section 12 thus imposes what is effectively a privity requirement, authorizing suit only against the seller (and as construed by the case law, certain persons acting on behalf of or in conjunction with the seller).\textsuperscript{73} Section 12 therefore tends to be limited to direct seller-purchaser transactions at prices the parties specifically negotiated or that one side dictated (e.g., face-to-face transactions, direct purchases from the issuer in a public offering), rather than open-market transactions at prices set by the market. Section 12 is therefore much more limited than § 10(b) and provides little support for construing § 10(b) to permit recovery for subsequent declines in the price of a security that do not correspond with inflation in the market price at the time of purchase.

In sum, § 10(b) and its analogous provisions, §§ 9 and 18, all suggest that Congress was focused on the out-of-pocket harm that can befall investors when fraud causes them to overpay for stock and they later suffer a loss when the value of their holdings correspondingly declines

\textsuperscript{71} 15 U.S.C. § 77k(e).

\textsuperscript{72} Id. § 77l.

\textsuperscript{73} See Pinter v. Dahl, 486 U.S. 622, 643 n.21 (1988).
upon a corrective disclosure – not on losses they suffer from additional declines due to changed perceptions of management that do not correspond with an amount of overpayment at the time of purchase. The other express causes of action further demonstrate that Congress was careful to craft remedies that were utterly open-ended and unpredictable, as § 10(b) would threaten to be if recovery for collateral damage were permitted. The language of § 10(b), and the express causes of action, all are consistent with the overall balance struck by the securities laws: protecting investors by deterring and remedying wrongdoing, while not imposing liabilities that are so blunderbuss that they deter capital formation. This counsels against permitting recovery for collateral damage under § 10(b).

B. The Elements Of The § 10(b) Cause Of Action.

A misleading statement or omission that causes collateral damage can be viewed as having two components: a substantive misstatement or omission (e.g., “We had third quarter revenues of $100 million” when actually they were $50 million), and an omission to disclose that management was dishonest, reckless, or incompetent in making the statement. Permitting recovery for losses caused by the former is what § 10(b) is all about if the other elements of liability are satisfied. Permitting recovery for losses caused by the latter, however, would be contrary to nearly every element of the § 10(b) cause of action as they have developed in the case law, including the existence of a duty to disclose, materiality, reliance, loss causation, and that the defendant’s statement or omission be made in connection with the purchase or sale of a security.

1. The Existence of a Duty To Disclose.

The courts have made clear that § 10(b) prohibits only dishonest statements and conduct in connection with the purchase or sale of a security, not dishonest character, and not managerial incompetence. The courts consistently reject § 10(b) claims that allege nothing more than dishonest character or managerial incompetence, and have rejected attempts by plaintiffs to bootstrap such issues into § 10(b) claims by alleging that the defendants failed to disclose such dishonesty or incompetence.
Santa Fe Industries, Inc. v. Green,74 is the seminal case in this area. In Santa Fe, the ninety-five percent majority shareholder of a company tried to effect a short-form merger by cashing out the minority shareholders at a price of $150 per share – a $25 per share premium over the value set forth in an appraisal the majority shareholder had commissioned and that it provided to the minority shareholders when it made the $150 offer. The minority shareholders concluded that the value of their shares was significantly higher, but rather than availing themselves of their appraisal rights in state court, they sued under § 10(b). The minority shareholders alleged that the majority shareholder deliberately had commissioned a “fraudulent appraisal,” and that its provision of the appraisal to them represented an attempt to “lull [them] into erroneously believing that [the majority shareholder] was generous” when in fact it was trying to “freeze [them] out . . . at a wholly inadequate price.”75

The Supreme Court held that § 10(b) did not extend to the misconduct alleged in the complaint, because the majority shareholder had fully disclosed the bases of the $150 offer, including the appraisal itself, and the plaintiffs’ remedy was to avail themselves of their appraisal rights in state court – even though the plaintiffs clearly alleged that the majority shareholder harbored a dishonest motive in making the offer and transmitting the appraisal. The Court concluded that the complaint alleged nothing more than a breach of fiduciary duty, and the notion that “the term ‘fraud’ in Rule 10b-5 . . . bring[s] within the ambit of the Rule all breaches of fiduciary duty in connection with a securities transaction.”76 The Court explained:

75 Id. at 467.
76 Id. at 472.
The claim of fraud and fiduciary breach in this complaint states a cause of action under any part of Rule 10b-5 only if the conduct alleged can be fairly viewed as “manipulative or deceptive” within the meaning of the statute. . . . There was no “omission” or “misstatement” in the information statement accompanying the [$150 per share] offer. . . . The cases do not support the proposition . . . that a breach of fiduciary duty by majority stockholders, without any deception, misrepresentation, or nondisclosure, violates the statute and the Rule. . . . We do not think [Congress] . . . meant to bring within the scope of § 10(b) instances of corporate mismanagement such as this, in which the essence of the complaint is that shareholders were treated unfairly by a fiduciary. . . . We thus adhere to the position that Congress by § 10(b) did not seek to regulate transactions which constitute no more than internal corporate mismanagement.77

[Discuss how subsequent case law has construed Santa Fe -- no duty to disclose management dishonesty or incompetence; permitting recovery for collateral damage would trample on this doctrine, etc.]

See the case GMG cited in the “purchase or sale” portion of the summ j. brief.

Can we make a loss/proximate causation arg based just on policy issues? Do loss causation cases talk about policy, like proximate causation cases do in Cal?

77 Id. at 473-79.
References


