March 19, 2013

The Eleventh Circuit Rules that the Disclosure of an SEC Investigation is Insufficient to Plead Loss Causation

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The US Court of Appeals for the Eleventh Circuit recently issued an important decision that addresses two types of allegations that plaintiffs routinely rely on to plead loss causation in federal securities fraud cases. In *Meyer v. Greene*, 2013 US App. LEXIS 4187 (11th Cir. Feb. 25, 2013), the Eleventh Circuit appears to have become the first federal court of appeals to rule definitively that the mere announcement of an investigation by the US Securities and Exchange Commission ("SEC") followed by a decline in a company's stock price is insufficient to plead loss causation. The Court also ruled, consistent with decisions from other federal circuits, that a negative third-party analyst presentation is not a corrective disclosure for purposes of pleading loss causation *if* the presentation is based on publicly available information.

Background

The St. Joe Company ("St. Joe" or the "Company") is one of the largest real estate development corporations in the State of Florida. The plaintiffs asserted that, despite extensive public knowledge of declining real estate prices, the Company made material misstatements and omissions in its SEC filings by overstating the value of its real estate holdings and failing to record impairment charges on its assets.

The plaintiffs claimed that the truth about St. Joe's overstated real estate holdings began to emerge on October 13, 2010, when David Einhorn, a prominent hedge fund investor, gave a presentation at an investor conference entitled "Field of Schemes: If You Build It, They Won't Come" (the "Einhorn Presentation"). In the presentation, Einhorn suggested that St. Joe's assets were significantly overvalued and should be written down. During the next two days of trading, St. Joe's stock price declined approximately 20% on unusually high volume.

The plaintiffs also asserted that the truth about the alleged securities fraud continued to emerge on January 10, 2011, when St. Joe disclosed that the SEC had initiated an informal inquiry into the Company's policies and practices concerning the impairment of its real estate assets. The truth purportedly continued to be revealed to the market six months later, when St. Joe announced that the SEC had issued an order of private investigation regarding the Company's compliance with the antifraud provisions of the federal securities laws and stock ownership reporting requirements. St. Joe's stock price declined 7% on the date the informal SEC investigation was announced and 9% on the date the order of private investigation was disclosed.

The plaintiffs filed suit against St. Joe and certain of its current and former officers for alleged violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934. The defendants moved to dismiss the plaintiffs' complaint based on the plaintiffs' purported failure to allege an actionable misrepresentation, loss causation and scienter. The district court agreed with each of the defendants' arguments and dismissed the plaintiffs' complaint with prejudice.

The Eleventh Circuit's Decision

On appeal, the Eleventh Circuit affirmed the district court's decision on the basis that the plaintiffs failed adequately to plead loss causation. The Court held that "the commencement of an SEC investigation, without more, is insufficient to constitute a corrective disclosure" for purposes of establishing loss causation. *Meyer v. Greene*, 2013 US App. LEXIS 4187, at *31. The Court noted that "stock prices may fall upon the announcement of an SEC investigation, but that is because the investigation can be seen to portend an added risk of future corrective action." *Id.* (emphasis in original). It "does not mean that the investigations, in and of themselves, reveal to the market that a company's previous statements were false or fraudulent." *Id.* As a result, the Court ruled that St. Joe's "disclosures of the two SEC investigations do not qualify as corrective disclosures" for purposes of pleading loss causation. *Id.* at *32.

The Court also ruled that the Einhorn Presentation was not a corrective disclosure sufficient to establish loss causation because it was based entirely on publicly available information. *Id.* at *20. The Court explained that a corrective disclosure must disclose new information, and "the fact that the sources used in the Einhorn Presentation were already public is fatal to the [plaintiffs'] claim of loss causation." *Id.* The Court reinforced this opinion by citing the efficient capital market hypothesis. *Id.* at *19-20. The Court stated that, under the efficient market theory, "any information released to the public is immediately digested and incorporated into the price of a security." *Id.* at *20. Consistent with this theory, the Court determined that information already known to the market, including the information in the Einhorn Presentation, could not have caused the plaintiffs' loss. *Id.*

The Court also rejected the plaintiffs' alternative argument that the Einhorn Presentation qualifies as a corrective disclosure because it provided "expert analysis" of public information that was previously unavailable to the market. *Id.* at *24. The Court stated that "the mere repackaging of already-public information by an analyst or short-seller is simply insufficient to constitute a corrective disclosure." *Id.* The Court explained that "if the information relied upon in forming an opinion was previously known to the market, the only thing actually disclosed to the market when the opinion is released *is the opinion itself*, and such an opinion, standing alone, cannot reveal to the market the falsity of the company's prior factual representation." *Id.* at *25 (emphasis in original) (internal quotation marks omitted).

Significance of *Meyer*

Meyer appears to be first federal appellate decision to hold squarely that the announcement of an SEC investigation, without more, is insufficient to plead loss causation. This decision adds weight to the growing number of district court decisions from around the country that have reached similar conclusions.[1] In addition, the Court distinguished and limited cases that plaintiffs often rely on by noting that in those cases, unlike *Meyer*, the disclosure of the SEC investigation was "coupled with a later finding of fraud or wrongdoing." *Id.* at *32 n.13. (citing *In re Take-Two Interactive Sec. Litig.*, 551 F. Supp. 2d 247, 287-90 (S.D.N.Y. 2008); *In re IMAX Sec. Litig.*, 587 F. Supp. 2d 471, 485 (S.D.N.Y.).)

Meyer is also significant because it joins decisions from other circuits, including the Second, Third, and Fourth,[2] in holding that a decline in a company's stock price following a negative report or presentation from an analyst is insufficient to plead loss causation if the report or presentation is based on a repackaging of publicly available information. *Id.* at *20.

These rulings, which directly address two types of allegations that plaintiffs routinely rely upon to plead loss causation in federal securities fraud class actions, will be helpful in future cases to rebut loss causation at the motion to dismiss stage.

1 *See*, *e.g.*, *Janbay v. Canadian Solar, Inc.*, 2012 WL 1080306, at *15-16 (S.D.N.Y. Mar. 30, 2012); *In re Moody's Corp. Sec. Litig.*, 274 F.R.D. 480, 487-88 (S.D.N.Y. 2011); *In re Maxim Integrated Prods., Inc. Sec. Litig.*, 639 F. Supp. 2d 1038, 1046-47 (N.D. Cal. 2009); *Durham v. Whitney Info. Network, Inc.*, 2009 WL 3783375, at *20-22 (M.D. Fla. Nov. 10, 2009); *In re Dell Inc., Sec. Litig.*, 591 F. Supp. 2d 877, 910 (W.D. Tex. 2008); *In re Hansen Natural Corp. Sec. Litig.*, 527 F. Supp. 2d 1142, 1162 (C.D. Cal. 2007); *In re Avista Corp. Sec. Litig.*, 415 F. Supp. 2d 1214, 1221 (E.D. Wash. 2005).

2 *See*, *e.g.*, *In re Omnicom Grp., Inc. Sec. Litig.*, 597 F.3d 501, 512 (2d Cir. 2010); *Teachers' Ret. Sys. Of La. v. Hunter*, 477 F.3d 162, 187 (4th Cir. 2007); *In re Merck & Co., Inc. Sec. Litig.*, 432 F.3d 261, 270-71 (3d Cir. 2005).

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