IN THE SUPREME COURT OF THE UNITED STATES

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DURA PHARMACEUTICALS, INC., :

ET AL., :

Petitioners :

v. : No. 03-932

MICHAEL BROUDO, ET AL. :

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Washington, D.C.

Wednesday, January 12, 2005

The above-entitled matter came on for oral argument before the Supreme Court of the United States at 10:33 a.m.

APPEARANCES:

WILLIAM F. SULLIVAN, ESQ., San Diego, California; on behalf of the Petitioners.

THOMAS G. HUNGAR, ESQ., Deputy Solicitor General, Department of Justice, Washington, D.C.; on behalf of the United States, as amicus curiae, supporting the Petitioners.

PATRICK J. COUGHLIN, ESQ., San Francisco, California; on behalf of the Respondents.

C O N T E N T S

P R O C E E D I N G S

(10:33 a.m.)

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

(Laughter.)

ORAL ARGUMENT OF WILLIAM F. SULLIVAN

ON BEHALF OF THE PETITIONERS

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

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

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

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

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

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

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

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

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

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

MR. SULLIVAN: Well, the Ninth Circuit remanded

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

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

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

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

MR. SULLIVAN: Well --

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

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

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

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

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

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

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

JUSTICE O'CONNOR: What would have happened if

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

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

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

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

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

MR. SULLIVAN: Well, the --

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

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

misrepresentation has to have caused the loss and --

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

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

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

MR. SULLIVAN: Yes, it is.

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

MR. SULLIVAN: That is correct.

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

MR. SULLIVAN: That is correct.

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

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

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

(Laughter.)

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

MR. SULLIVAN: Thank you.

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

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

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

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

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

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

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

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

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

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

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

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

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

JUSTICE O'CONNOR: But the Government --

MR. SULLIVAN: They do.

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

MR. SULLIVAN: In this case --

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

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

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

MR. SULLIVAN: The plaintiff has that burden --

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

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

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

pocket losses?

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

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

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

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

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

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

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

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

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

MR. SULLIVAN: I think --

JUSTICE STEVENS: How would you handle that case?

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

JUSTICE STEVENS: Well, maybe they don't know

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

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

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

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

The -- the other point that I would like to

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

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

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

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

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

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

JUSTICE STEVENS: You certainly may.

MR. SULLIVAN: Thank you.

JUSTICE STEVENS: Mr. Hungar.

ORAL ARGUMENT OF THOMAS G. HUNGAR

ON BEHALF OF THE UNITED STATES,

AS AMICUS CURIAE, SUPPORTING THE PETITIONERS

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

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

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

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

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

MR. HUNGAR: Yes.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

MR. HUNGAR: Well, it may be a semantic

question. That's --

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

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

JUSTICE SOUTER: Well --

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

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

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

JUSTICE SOUTER: Is -- is the --

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

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

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

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

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

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

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

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

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

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

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

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

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

stronger, but --

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

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

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

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

JUSTICE SCALIA: But they paid -- they paid

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

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

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

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

Thank you.

JUSTICE STEVENS: Thank you, Mr. Hungar.

Mr. Coughlin.

ORAL ARGUMENT OF PATRICK J. COUGHLIN

ON BEHALF OF THE RESPONDENTS

MR. COUGHLIN: Justice Stevens, may it please the Court:

In answer to your question, Justice Kennedy, yes, that's what -- exactly what we would do. We would go back and replead, if we were required to do that, with more specificity.

We don't think that (9)(b) applies in this situation because both the Eleventh and the Third Circuits have held that (9)(b) only applies to the circumstances constituting fraud. It has never been applied to materiality, loss causation, or damages.

JUSTICE BREYER: But surely they wanted to have a person be able to read a complaint and just understand what it's about in a securities fraud case. And I don't see how you could understand it unless you have in the complaint what your theory is. That's all. Nobody is asking for some facts. Is your theory that the loss took place at the time the person bought the stock because he overpaid $30? Is your theory that the stock went down and, because of that, he lost the money? Is your theory that the stock didn't go down but it would have gone up more? All they're asking is not for evidence, but a simple, clear explanation of the theory, and plead in the alternative if you want. But I mean, what's the problem? Why is that so hard to do?

MR. COUGHLIN: I don't think that's so hard to do. And you're right. We have to plead the theory, and -- and the theory is --

JUSTICE BREYER: And this case doesn't seem to do it. I looked through the entire complaint. I found exactly two paragraphs. I didn't. My law clerk did, frankly.

(Laughter.)

JUSTICE BREYER: But I told him to underline it.

In paragraph 179, he found the word, and it caused damage. Okay? And in paragraph 177, it says the same. That's all he could find. And they were harmed. That's what it says.

MR. COUGHLIN: And -- and you're right, Your Honor. There's not much in here. We plead the rises. There are approximately seven rises. We plead the purchases. We plead the big drop. Do we plead with specificity? The -- the losses as to AlSpiros? No. We could have done a better job.

Under the Ninth Circuit, though, the law, as we pled it at the time, was that we have to plead an inflation and identify the causes. And that's what we did under Ninth Circuit law. If this Court were to decide that we had to do more, could we? Certainly.

I mean, we have some of the information in

there. We -- we tie AlSpiros to the sales force, which is an announcement on 2/24. You know, there's a lack of integrity in management.

JUSTICE GINSBURG: But there's a -- but there -- there is a basic difference between, as was pointed out in the colloquy with Mr. Hungar -- one thing is the particularity of pleadings. Yes, you have to tell the details of the fraud. No, you don't have to tell the details of the loss. But you do have to have a theory on which you can recover, and if your theory is simply I bought at an inflated price and the law doesn't give you a claim for relief on that theory, then you're out the window. There's no discovery. There's nothing.

You have to have, as Justice Souter pointed out, a viable theory of relief, and that's the difference between -- you say it's enough that the stock was selling for much more than it should have, and the other side said, no, that's not enough. You have to show that when the misrepresentation was corrected, the price dropped.

MR. COUGHLIN: Your Honor, I don't think it's enough to prove that we just paid an overinflated price. You cannot recover under Ninth Circuit law unless you not only prove that you paid an inflated price, but also that you prove that inflation came out.

I think where we differ from the Government and

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

MR. COUGHLIN: Because those --

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

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

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

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

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

MR. COUGHLIN: Well, that's --

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

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

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

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

MR. COUGHLIN: The inflation came out of the

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

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

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

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

MR. COUGHLIN: You can only recover --

JUSTICE SCALIA: To me your -- your --

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

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

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

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

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

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

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

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

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

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

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

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

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

JUSTICE SCALIA: And that's worrying me too.

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

I'm a liar.

JUSTICE SCALIA: Right.

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

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

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

(Laughter.)

MR. COUGHLIN: The other --

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

(Laughter.)

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

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

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

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

MR. COUGHLIN: Right.

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

those gains, just as you'd never have the losses. How does that factor?

MR. COUGHLIN: Well, I dream to have those clients that gain four times, but since we don't usually have those and it is the drops that we're really talking about. The but-for transaction, when they say, hey, and -- and you buy it, and then it goes up, and then you learn about the fraud -- and I'm assuming that there's no drop but you can prove that the inflation was there and never came out, and can you prove that it should have gone to $250? You know? I'd have to prove that it went to $250. I agree with you. You know, I would agree with you that, you know, that I'd get an expert. Mr. Fischel would come in and testify that it should have been worth $250. And that's what, you know, would happen.

JUSTICE GINSBURG: But there's a problem. Take the concrete facts of this case. The bad news about -- what is it? Albuterol?

MR. COUGHLIN: AlSpiros.

JUSTICE GINSBURG: Yes. That bad news didn't come out until 9 months after the end of the period that you identify for your class. You say the class is April 15th, '97 until February 24th, '98 purchases. The bad news doesn't come out until November of '98. So how could you possibly hook up your loss to the news that comes out

later?

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

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

MR. COUGHLIN: Product, Ceclor?

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

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

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

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

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

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

MR. COUGHLIN: I wish that the circuit said if the bad news came out, but the Koger case and -- and emergent out of the Second Circuit seem a little stronger and talk about almost the only way it can happen is with a corrective disclosure. And that's -- and that's a concern of ours.

The Ninth Circuit law is pretty clear, is very clear actually, with the three cases, Blackie, Green, Judge Sneed in the Green v. Occidental case, and the Wool case, saying that the loss occurs at the time of purchase and overpayment, but recoverable damages --

JUSTICE O'CONNOR: Well, that may be clear but it may be clearly wrong.

(Laughter.)

MR. COUGHLIN: That -- it -- it -- I understand that, Your Honor. I'm hoping that it's not clearly wrong. It's been on the books for 30 years. It was the law. It was the law on the books at the time that this was codified. There was no real or perceived conflict in the circuits at the time this was codified.

JUSTICE KENNEDY: Well, I -- I thought that Judge Sneed recognized that if the stock was sold before any loss was incurred, even if there's been a misrepresentation, recovery should be denied.

MR. COUGHLIN: That's correct.

JUSTICE KENNEDY: All right.

MR. COUGHLIN: That's absolutely correct.

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

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

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

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

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

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

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

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

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

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

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

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

why it's desirable not to include that at the pleading stage.

MR. COUGHLIN: I don't think I said that that was difficult or hard to prove. I said it was difficult or hard to plead. It is difficult and hard to plead, and -- and to tie that -- those inflationary things back up because you only get to recover -- you only get to recover for things that took the inflation out. I mean, if the stock drops -- let's say -- let's say the stock drops $60 or $50, and where he paid $60, it drops down to $10. But half of that -- half of that drop is unrelated to the fraud absolutely. Well, under a 10(b) cause of action, you don't get to recover for that market loss. We have to tie -- that's why Judge Sneed in Occidental -- in Green v. Occidental tied it right to the overpayment because Judge Sneed was worried about -- about the issuers being insurers for the market.

In other words, if the stock -- if -- if a down market takes the stock way past what you paid over inflation, defendants should not be liable for the whole market loss as they might in a section 33 case. And that's really what the -- what the point is, to fix the loss.

That's why Judge Sneed fixed the loss at the date of overpayment because Judge Sneed didn't want

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

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

JUSTICE BREYER: But that's a --

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

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

JUSTICE O'CONNOR: Well --

JUSTICE SOUTER: No.

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

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

MR. COUGHLIN: There's no doubt.

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

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

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

MR. COUGHLIN: That's fair to say.

JUSTICE SOUTER: Okay.

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

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

This section here --

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

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

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

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

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

MR. COUGHLIN: Correct.

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

about the fraud.

MR. COUGHLIN: Correct.

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

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

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

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

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

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

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

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

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

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

JUSTICE GINSBURG: You -- you seem --

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

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

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

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

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

MR. COUGHLIN: Thank you, Justice Stevens.

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

REBUTTAL ARGUMENT OF WILLIAM F. SULLIVAN

ON BEHALF OF THE PETITIONERS

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

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

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

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

MR. SULLIVAN: And -- and --

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

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

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

JUSTICE BREYER: Where do you disagree?

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

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

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

Thank you.

JUSTICE STEVENS: Thank you, Mr. Sullivan.

The case is submitted.

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