'Uber' Delivers on Loss Causation In Securities Fraud Cases

By **Anthony Michael Sabino**

Loss causation is the final component of the axiomatic six point test for alleging federal securities fraud. Ironically, and probably as a consequence of it being last in the sequence, this vital element of proof is often outshined by its peers, which typically garner far more attention. See, e.g., *Goldman Sachs Group v. Arkansas Teacher Retirement System*, ___ U.S. ___ (No. 20-222) (argued March 29, 2021) (anticipating a new Supreme Court landmark on reliance and the fraud on the market theory).

But the recent case of *Irving Firemen's Relief & Retirement Fund v. Uber Technologies*, ___ F.3d ___ (No. 19-16667) (9th Cir. May 19, 2021), may place loss causation on a more equal footing with its siblings. In affirming dismissal of the complaint there, the U.S. Court of Appeals for the Ninth Circuit underscored the absolute necessity of succinctly linking revelations of alleged misstatements or omissions to a loss in market value. Before proceeding to our analysis, however, a brief review of the basic tenets of pleading securities fraud is in order.

The Six Elements Of Securities Fraud

As recently exposited in this space (see Sabino, "In re Tesla, Tweets, and Securities Fraud," 264 New York Law Journal, p.4, cl.4 (Oct. 9, 2020)), §10 of the 1934 Securities Exchange Act, and Rule 10b-5 as promulgated thereunder, prohibit all manner of fraud and deceit in connection with the purchase or sale of securities. 15 U.S.C. §78j(b) and 17 C.F.R. §240.10b-5, respectively. See also *Lorenzo v. S.E.C.*, 587 U.S. ___ (2019).

The Supreme Court has established the following unassailable benchmarks for pleading federal securities fraud. A complaint must allege with specificity: (1) material misrepresentations or omissions, *Matrixx Initiatives v. Siracusano*, 563 U.S. 27 (2011); (2) scienter, *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976); (3) made in connection with the purchase or sale of a security, *S.E.C. v. Zandford*, 535 U.S. 813 (2002); (4) reliance, *Stoneridge Investment Partners v. Scientific-Atlanta*, 552 U.S. 148 (2008); (5) economic loss, *Amgen v. Connecticut Retirement Plans and Trust Funds*, 568 U.S. 455 (2013); and, lastly, (6) loss causation. *Dura Pharmaceuticals v. Broudo*, 544 U.S. 336 (2005). As with all allegations of fraud, these assertions must be pled with particularity. Fed. R. Civ. P. 9. See also *Tellabs v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007).

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The Rise and Fall of Uber's Market Value

Now to the *Irving* decision. Interestingly, the plaintiff is exactly as portrayed in the caption: a retirement fund for firefighters based in Irving, Texas. In early 2016, it purchased preferred stock from tech giant Uber in a nonpublic offering. Throughout 2017, the ride hailing innovator was besieged by a series of alleged scandals, most prominent among them: a former employee's charges of sexual harassment; allegations of the theft of trade secrets; claims of circumventing regulators in various jurisdictions; and, finally, an accusation that Uber "spoofed" archrival Lyft by allegedly creating false customer accounts.

Any reckoning of the market's reaction was imprecise at best, as there was no public market for these shares at the time. Nonetheless, "[a]s an apparent result of these cascading scandals...several funds holding stakes in Uber wrote down the value" of their holdings. By one estimate, the tech company's market value fell by at least $18 billion, "a nearly 30% decline."

Irving commenced a putative class action in federal court, complaining that the defendants had intentionally misled investors in order to induce the purchase of the aforementioned preferred stock at artificially inflated prices. But instead of asserting the typical federal causes of action for securities fraud, the retirement fund opted for state law claims brought pursuant to California statutes nearly identical to §10 and Rule 10b-5. See California Code, Corporations Code §25400(d) and §25500. When the district court dismissed the complaint for, inter alia, a failure to properly allege loss causation, this appeal followed.

Pleading Loss Causation

The Ninth Circuit wasted no time in affirming the decision below. As a threshold matter, the panel validated the district judge's reliance upon Rule 9 as the appropriate means to measure the sufficiency of the complaint. Although the retirement fund had alleged only state law causes of action, those claims did, in fact, sound in fraud, and therefore Rule 9's stringent requirement that such allegations be pled with particularity had to be satisfied. Writing for the court, Circuit Judge Ronald Gould further justified the bench's reasoning by noting that the California antifraud provisos invoked by Irving were "derived from substantially identical language" in the federal securities acts.

Turning to the paramount issue of adequately pleading loss causation, the Ninth Circuit reminds that a plaintiff's ultimate burden is to persuade that the defendant's alleged misstatements, rather than some other circum- » Page 8

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stance, were a substantial cause of the claimant's losses. Here the tribunal posited a fairly straightforward two-point test: first, the investor must demonstrate that the share price was artificially inflated by the defendant's purported misstatements; and, second, once the market learned of the deception, it devalued the security. Worthy of note is that the panel placed greater emphasis upon the latter of the two.

Judge Gould conceded that a market decline following closely on the heels of allegations of misstatements is typically sufficient to demonstrate loss causation. Yet the bench opined this was not the sole means to adequately exemplify the sixth element of securities fraud. The appeals court acknowledged that even the best of markets can suffer distortions which delay a reassessment of a stock's price. For that reason, the Ninth Circuit refused to promulgate a bright-line rule confining loss causation to an immediate market reaction in the wake of revelations of alleged misstatements.

Notwithstanding such openmindedness, the panel declared that the complaint at bar remained irredeemable, ruling that "Irving did not adequately and with particularity allege that these revelations *caused* the resulting drop in Uber's valuation." (emphasis in the original). To be sure, the appellate court took care to catalogue the quantity of the alleged misstatements (60 or more), and the impressive number of purported corporate imbroglios (eight, according to the opinion). But the preponderance of these events did nothing to compensate for the retirement fund's failure to "link Uber's reduced valuation to any particular scandal or misstatement."

More troubling to the Ninth Circuit, as one can gather from the following characterization, is that by "lump[ing] together" the alleged misrepresentations, the plaintiff failed to comply with Rule 9's unremitting mandate that any claim of fraud be sufficiently particularized, in order to give the defendants adequate notice of the nature of the charges leveled against them.

Irving had hoped to persuade the circuit judges with a chart purporting to link revelations of alleged misstatements with periodic writedowns of Uber shares by various institutional investors. To the plaintiff's undoubted dismay, this graphic depiction had the opposite effect. The panel found the chart evinced a "lack of consistency among the valuation reactions," and thereby concluded that the "disparate reactions of multiple funds to the serial revelations of scandals indicate that the funds ... were not responding to the specific revelations Irving cites."

The retirement fund had strenuously argued to the Ninth Circuit that it should focus on the aggregate 30% devaluation suffered by Uber in 2017, and put aside individual gyrations in the tech giant's share price during that period. Soundly rebuffing that overture, Circuit Judge Gould's instead held that "Irving's allegations of a general decline in valuation in response to multiple alleged scandals do nothing to alleviate [the] problem" of failing to plead loss causation with particularity.

Finally, the plaintiff fared no better with its contention that Uber's preferred stock should be analyzed differently because it was not publicly traded. Although conceding that market prices have less relevance for a privately held concern, the tribunal was adamant that, even in the case of nonpublic securities, the fundamentals of pleading loss causation are unchanged. As stated by the appellate bench, "the private nature of the transactions does not excuse Irving from pleading loss causation."

In light of the sum total of the complaint's deficiencies in pleading loss causation, the retirement fund's securities fraud action was accordingly dismissed.

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Conclusion

The Ninth Circuit's decision in *Irving* provides an object lesson in the importance of properly pleading loss causation in a securities fraud action. On the one hand, it instructs plaintiffs that, notwithstanding quantity or quality, merely alleging misrepresentations or omissions, no matter how supposedly egregious they may be, is never enough. The rule of pleading fraud with particularly demands that these alleged missteps be specifically linked to tangible devaluations in the value of the subject security.

On the other, it illustrates to defendants the importance of scrutinizing the chain of causation as alleged in the accusatory document. The Ninth Circuit made abundantly clear that a lack of correlation between the purported misstatements and demonstrable price fluctuations is ripe for exploitation by the defense.

Fittingly, just as plaintiffs endeavor to make a connection between alleged misrepresentations and their claimed losses, defendants have a nearly identical opportunity to demolish those same links, and thus smash the chain of causation.

At the end of the day, *Irving* is proof that while loss causation may be the last of the six elements essential to proving securities fraud, it is by no means the least important.