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Guest Column: The Second Circuit Opines on Loss Causation in Omnicom

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On March 9, 2010, the Second Circuit decided *In re Omnicom Group., Inc. Sec. Litig.*, — F.3d —, 2010 WL 774311 (2d Cir. Mar. 9, 2010), which—in a unanimous decision—affirmed the district court's award of summary judgment dismissing securities fraud claims because plaintiffs failed to establish loss causation. The decision illustrates the stringent standard that plaintiffs must meet in the Second Circuit to show loss causation at summary judgment.

The case hinged on a June 12, 2002 *Wall Street Journal* article discussing the accounting and disclosure practices of Omnicom—the global marketing and advertising holding company—in connection with a transaction involving a private equity firm to create a new entity, Seneca. The article also discussed the resignation of Mr. Robert Callander, an Omnicom director and chair of its audit committee. In 2001, after the Internet bubble burst, Omnicom transferred its investments in various internet marketing and advertising companies to Seneca. While media coverage contemporaneous with the transaction suggested that Omnicom's creation of Seneca was an attempt to move Omnicom's investments in those internet companies off of its books, there was no significant drop in Omnicom's stock price at the time of these reports. The day after the *Wall Street Journal* article, however, Omnicom's stock price dropped nearly twenty percent, and plaintiffs filed an action under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5. Plaintiffs alleged that (i) Omnicom failed to write down the value of the internet companies prior to the Seneca transaction; (ii) the accounting for the transaction was fraudulent; and (iii) Omnicom should have accounted for Seneca's losses.

In affirming the district court's grant of summary judgment, the Second Circuit rejected each of plaintiffs' two purported bases for establishing loss causation: (1) that the market reacted negatively to a corrective disclosure of the alleged fraud in June 2002; and (2) that negative investor inferences drawn from the resignation of Mr. Callander and from various June 2002 news stories caused plaintiffs' loss and represented a materialization of a risk supposedly concealed by Omnicom.

Regarding the first theory, plaintiffs asserted that the information disclosed to the market in June 2002 constituted a partial disclosure of the fraud which caused a drop in Omnicom's share price. The Second Circuit rejected this argument, finding that none of the June 2002 disclosures "even purported to reveal some then-undisclosed fact with regard to the specific misrepresentations alleged in the complaint." Pointing to the earlier media coverage concerning Seneca, the Second Circuit ruled that the *Wall Street Journal* article did not constitute a corrective disclosure, thus making the decision particularly significant in an era where the market often reacts quickly to news reports. "A negative journalistic characterization of previously disclosed facts does not constitute a corrective disclosure of anything but the journalists' opinions," wrote Judge Ralph Winter for the panel.

The Second Circuit further explained that plaintiffs' expert testimony did not alter this conclusion. Although "courts are wary of granting summary judgment" in the face of competing expert testimony, plaintiffs' expert failed to draw the requisite connection between the information in the June 12 article and the fraud alleged in the complaint.

Regarding plaintiffs' second theory of loss causation, plaintiffs contended that Mr. Callander's resignation and the related news articles were foreseeable risks of the allegedly fraudulent Seneca transaction, and that the June 2002 share price decline resulted from the materialization of those risks. The Second Circuit disagreed. The court found that although fraud may lead to a director's resignation and negative press, "it is generally the facts underlying the fraud and resignation that cause a compensable investor's loss." Here, the allegations about the Seneca transaction were known a year before Mr. Callander's resignation, and the resignation did not add to the public knowledge any new material fact about the alleged fraud. Thus, plaintiffs had "at best shown that [Mr.] Callander's resignation and resulting negative press stirred investors' concerns that other unknown problems were lurking in Omnicom's past." Such a "generalized investor reaction of concern" was "far too tenuously connected—indeed, by a metaphoric thread—to the Seneca transaction to support liability."

Perhaps one of the lessons of *Omnicom* is that to survive summary judgment on a "materialization of the risk" theory of loss causation, plaintiffs in the Second Circuit will need evidence establishing much more than a "tenuous connect[ion]" between the alleged misstatements or omissions and the subsequent materialization of the undisclosed risk. The Second Circuit in *Omnicom* explained that this requirement is rooted in the nature and purpose of the federal securities laws. Issuers "are not required by the securities laws to speculate about distant, ambiguous, and perhaps idiosyncratic reactions by the press or even by directors." To hold otherwise "would expose companies and their shareholders to potentially expansive liabilities for events later alleged to be frauds, the facts of which were known to the investing public at the time but did not affect share price, and thus did no damage at that time to investors." In the Second Circuit's view, this "would undermine the very investor confidence that the securities laws were intended to support."

Latham & Watkins LLP represented Omnicom in the appeal before the Second Circuit and in the summary judgment proceeding before the United States District for the Southern District of New York, after having been hired to defend Omnicom and its executives in August 2006.