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Undue Limitations in the Section 10(b) Purchaser-Seller Requirement

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This Article considers different applications of the Purchaser-Seller Rule that a plaintiff must satisfy to bring a Section 10(b) and Rule 10b-5 private action. The history and development of the Purchaser-Seller Rule under Supreme Court and lower federal court jurisprudence is considered, with emphasis on recent case law unduly constricting this Rule. In particular, the Second Circuit's restrictions on Section 10(b) standing are addressed, focusing on that appellate court's decision in Frutarom *which adhered to an overly formulaic approach to Section 10(b) standing that is out of line with prior Second Circuit and Supreme Court precedent. The Article then considers* Frutarom*'s impact both within and outside of the Second Circuit and explores a line of federal district court cases that rejected* Frutarom*'s reasoning, embracing a more coherent view of Section 10(b) standing. Deficiencies in the Second Circuit's approach to Section 10(b) standing are then addressed and recommendations are proffered for a sound approach that comports with Supreme Court precedent.*

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I. INTRODUCTION

Before plaintiffs seeking relief in private actions under the principal antifraud provisions of the federal securities laws—Section 10(b) of the

Securities Exchange Act[1] and Rule 10b-5[2] adopted thereunder—can pursue their claims, they must satisfy what is commonly referred to as the standing requirement.[3] This requirement is known as the "Purchaser-Seller Rule," and it makes intuitive sense: Concerned with investor protection,[4] Section 10(b) and Rule 10b-5 enable those persons who actually *invest*—that is, actual purchasers or sellers of securities acquired or disposed of in the United States—to seek recompense.[5] To prevent undue expansion of the remedy to encompass claimants whose alleged

1. Securities Exchange Act § 10(b), 15 U.S.C. § 78j(b).

2. 17 C.F.R. § 240.10b-5 (2023) (broadly prohibiting deceptive and manipulative conduct in connection with the purchase or sale of any security subject to the reach of the federal securities laws).

3. In *Lexmark International, Inc. v. Static Control Components, Inc.*, 572 U.S. 118, 125-28 (2014), the United States Supreme Court opined that the term "standing" is misleading in this context. Rather, the appropriate inquiry is whether the subject plaintiff has "a cause of action under the statute." *Id.* at 128; *see also* Am. Psychiatric Ass'n v. Anthem Health Plans, Inc., 821 F.3d 352, 359 (2d Cir. 2016) ("The Supreme Court [in *Lexmark*] has recently clarified . . . that what has been called 'statutory standing' in fact is not a standing issue, but simply a question of whether the particular plaintiff 'has a cause of action under the statute.'" (quoting 572 U.S. at 128)). Nonetheless, because the label "standing" has been utilized for over half a century in the Section 10(b) setting and its meaning is readily understood, this Article will use this term. Indeed, even after *Lexmark*, courts continue to use the term "standing." *See, e.g.*, *In re* CarLotz, Inc. Sec. Litig., 667 F. Supp. 3d 71, 76 n.2 (S.D.N.Y. 2023) (Although recognizing that the Supreme Court discourages the use of the term "statutory standing" in this context, the court "will nonetheless 'use [this] phrase . . . for historical reasons.'" (quoting John Wiley & Sons, Inc. v. DRK Photo, 882 F.3d 394, 402 n.4 (2d Cir. 2018)). Indeed, in *Menora Mivtachim Insurance v. Frutarom Industries Ltd.*, 54 F.4th 82, 84 (2d Cir. 2022), the court used the term "statutory standing." *See also* MARC I. STEINBERG, UNDERSTANDING SECURITIES LAW 326 (8th ed. 2023) (stating that the plaintiff must have "the status as a *purchaser or seller* of the securities").

4. STEINBERG, UNDERSTANDING SECURITIES LAW, *supra* note 3, at 325 ("Generally, the antifraud provisions of the securities acts were designed to protect investors, to help ensure fair dealing in the securities markets, and to promote ethical business practices."); James J. Park, *Reassessing the Distinction Between Corporate and Securities Law*, 64 UCLA L. REV. 116, 119 (2017) ("[A] primary goal of the federal securities laws is investor protection . . . ."); *see generally Mission*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/about/mission (last visited Oct. 30, 2024); *The Laws That Govern the Securities Industry*, U.S. SEC. & EXCH. COMM'N, https://www.investor.gov/introduction-investing/investing-basics/role-sec/laws-govern-securities-industry [https://perma.cc/T2RW-E7TU] (last visited Oct. 30, 2024).

5. *See* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 742-43 (1975) (requiring a plaintiff to be a purchaser or seller of the subject securities in order to bring a private damages action under § 10(b) and Rule 10b-5); *id.* at 749 ("[O]ne asserting a claim for damages based on the violation of Rule 10b-5 must be either a purchaser or seller of securities."). In *Morrison v. National Australia Bank Ltd.*, 561 U.S. 247, 267 (2010), the Supreme Court held that Section 10(b) reaches "only transactions in securities listed on domestic exchanges, and domestic transactions in other securities." For a discussion of *Morrison* and its ramifications, see, e.g., Marc I. Steinberg & Kelly Flanagan, *Transnational Dealings*—Morrison *Continues to Make Waves*, 46 INT'L LAW. 829 (2012).

injuries are tangential, it stands to reason that one must be a purchaser or seller of securities to bring a cause of action under these provisions.[6] Accordingly, the parameters of the Purchaser-Seller Rule first articulated by the United States Court of Appeals for the Second Circuit in *Birnbaum v. Newport Steel Co.*[7] and affirmed by the United States Supreme Court in *Blue Chip Stamps v. Manor Drug Stores*[8] should be construed in a manner consistent with the fundamental objectives of the Purchaser-Seller mandate.[9]

With this framework in focus, the Article examines the development of the Purchaser-Seller Rule for private plaintiffs under the federal securities laws, assesses the recent restrictions to Section 10(b) standing articulated by the Second Circuit in *Menora Mivtachim Insurance v. Frutarom Industries Ltd.*[10] (as well as the approached advanced by other

6. *Blue Chip Stamps*, 421 U.S. at 742-43; *accord* Birnbaum v. Newport Steel Corp., 193 F.2d 461, 463 (2d Cir. 1952) (limiting the scope of § 10(b) standing to actual purchasers or sellers of securities).

7. 193 F.2d at 463 ("[Section 10(b) and Rule 10b-5 are] aimed only at 'a fraud perpetrated upon the purchaser or seller' of securities . . . ." (quoting Birnbaum v. Newport Steel Corp., 98 F. Supp. 506, 508 (S.D.N.Y 1951))).

8. 421 U.S. at 742-43.

9. *See, e.g.*, *id.* at 740 (noting that the Purchaser-Seller Rule as articulated in *Birnbaum* reflects a policy choice by the judiciary to exclude claimants from § 10(b) private actions whose cases may be based largely on oral testimony or which may present undue risk of "vexatious litigation," such as is often the case with "strike suits"). Accordingly, the Supreme Court narrowed the universe of potential plaintiffs under Section 10(b) and Rule 10b-5 to actual purchasers or sellers of securities. *Id.* at 742-43.

10. Menora Mivtachim Ins. v. Frutarom Indus. Ltd., 54 F.4th 82, 84 (2d Cir. 2022) (holding that, to bring a private damages action under § 10(b), a plaintiff must have been a purchaser or seller of the securities of the company about which a misstatement was made).

federal court decisions),[11] and articulates the preferred framework.[12] With the realistic prospect that a circuit split will ensue on this significant issue which may prompt Supreme Court resolution, this Article is both timely and important.

This Article's contents are as follows: The next Part provides a succinct summary of Section 10(b) and Rule 10b-5's intent, scope, requirements, and applicability.[13] The Part thereafter addresses the cases that most informed the Purchaser-Seller Rule's application to securities fraud suits nationwide: *Birnbaum* and *Blue Chip Stamps*.[14] The next Part analyzes the Second Circuit's approach prior to *Frutarom* with respect to the question of how inclusive or restrictive the Purchaser-Seller Rule should be. To that end, the Part considers *Ontario Public Service Employees Union Pension Trust Fund v. Nortel Networks Corp.*,[15] which

11. District courts in the Ninth Circuit were highly critical of *Frutarom*'s holding and argued that the Second Circuit's construction of the Purchaser-Seller Rule was unduly restrictive, preventing plaintiffs with meritorious securities fraud claims from seeking redress. *See, e.g.*, *In re* CCIV/Lucid Motors Sec. Litig., No. 4:21-cv-09323-YGR, 2023 WL 325251, at *7-8 (N.D. Cal. Jan. 11, 2023), *aff'd on other grounds*, 110 F.4th 1181 (9th Cir. 2024); *In re* Robinhood Ord. Flow Litig., No. 4:20-cv-9328-YGR, 2023 WL 4543574, at *8-9 (N.D. Cal. Jan. 18, 2023); *In re* Mullen Auto. Sec. Litig., No. CV 22-3026-DMG (AGRx), 2023 WL 8125447, at *6 (C.D. Cal. Sept. 28, 2023) (all opining that the Second Circuit construed standing requirements under § 10(b) in a manner that is unnecessarily formulaic and overly exclusive). However, on appeal, a Ninth Circuit panel disagreed with the *Lucid* court's conclusions and summarily adopted the Second Circuit's approach to the Purchaser-Seller Rule. 110 F.4th at 1185-87. ("We now address that issue and agree with the Second Circuit that the *Birnbaum* Rule and *Blue Chip* limit Section 10(b) standing to purchasers and sellers of the security about which the alleged misrepresentations were made. Thus, we endorse and apply the bright-line rule [articulated by the Second Circuit in *Frutarom*].")

12. *See infra* notes 191-211 and accompanying text. This Article posits an approach to the Purchaser-Seller Rule that is less rigid and formulaic than that adopted by the *Frutarom* court and that emphasizes the nexus between the plaintiff's purchase or sale transaction, the alleged misstatements and omissions, and the causal relationship between those alleged misstatements or omissions and plaintiff's alleged injury. *See* discussion *infra* notes 201-211 and accompanying text.

13. *See infra* notes 25-33 and accompanying text.

14. *See infra* notes 34-44 and accompanying text; *Blue Chip Stamps*, 421 U.S. at 730-31, 737-38 (holding that standing under § 10(b) is limited to actual purchasers or sellers of securities and that inaction by a plaintiff does not give rise to a cause of action under § 10(b) and Rule 10b-5); Birnbaum v. Newport Steel Corp., 193 F.2d 461, 463-64 (2d Cir. 1952) (holding that a private plaintiff must be a purchaser or seller of securities in order to have standing under § 10(b)).

15. *See infra* notes 45-64 and accompanying text; Ont. Pub. Serv. Emps. Union Pension Tr. Fund v. Nortel Networks Corp., 369 F.3d 27, 34 (2d Cir. 2004) (holding that the purchaser-seller requirement is not met where the entity "whose stock [plaintiffs] purchased is negatively impacted by the material misstatement[s] of another company").

was criticized by a number of commentators,[16] and *California Public Employees' Retirement System v. NYSE (In re NYSE Specialists Securities Litigation)*,[17] which seemed to retreat from some of *Nortel*'s strict requirements.[18]

Following these considerations, this Article evaluates the development of two different perspectives on the Purchaser-Seller Rule: (1) the Second Circuit's restrictive approach to standing, exemplified in *Frutarom* and cases following it;[19] and (2) the more flexible view of district courts in the United States Court of Appeals for the Ninth Circuit,[20] which were highly critical of *Frutarom*.[21] The Ninth's Circuit's recent adoption of *Frutarom*'s construction of the Purchaser-Seller rule is also

16. *See, e.g.*, Donald C. Langevoort, *Lies Without Liars?* Janus Capital *and Conservative Securities Jurisprudence*, 90 WASH. U. L. REV. 933, 953 (2013) (observing that "*Nortel* was a step in precisely the conservative direction I have articulated and that a Second Circuit panel more aligned with the corrective justice framework of *Texas Gulf Sulphur* prevented it from going any further," and articulating hopes that "a relatively broad scope to the 'in connection with' requirement and the ancillary issues of duty and standing will be preserved," although in the face of conservative trends in securities jurisprudence, further retrenchment may be in the offing). Professor Langevoort also analyzed *Nortel*'s flawed reasoning in an earlier article, describing *Nortel* as a "doctrinal anomaly." Donald C. Langevoort, *Reading* Stoneridge *Carefully: A Duty-Based Approach to Reliance and Third-Party Liability Under Rule 10b-5*, 158 U. PA. L. REV. 2125, 2151 (2010) ("The reasoning [in *Nortel*] is cryptic—since the plaintiffs were clearly purchasers—but the court seems to suggest that one must be a purchaser or seller of securities *of the company releasing the information*. That result, however, makes little sense in terms of 'in connection with' precedent: there is nothing in Rule 10b-5 law limiting fraud liability to the issuer itself, and other Second Circuit cases plainly recognize that there is no such limitation."). Because *Nortel*'s holding was ambiguous and could have been interpreted to exclude securities actions in certain contexts against non-issuers, it was later clarified in *California Public Employees' Retirement System v. NYSE (In re NYSE Specialists Securities Litigation)*, 503 F.3d 89, 102 (2d Cir. 2007).

17. *See generally NYSE*, 503 F.3d 89 (refocusing the inquiry for standing articulated in *Nortel* and clarifying applicability to non-issuers).

18. *Id.* at 102 (clarifying that the focus of the standing inquiry under § 10(b) should be the connection between defendant's misstatements or omissions and plaintiff's purchase of stock).

19. *See infra* notes 66-103 and accompanying text; Menora Mivtachim Ins. v. Frutarom Indus. Ltd., 54 F.4th 82, 84 (2d Cir. 2022) (limiting standing under § 10(b) to purchasers or sellers of the securities of the company "about which a misstatement was made").

20. *See generally In re* CCIV/Lucid Motors Sec. Litig., No. 4:21-cv-09323-YGR, 2023 WL 325251 (N.D. Cal. Jan. 11, 2023), *aff'd on other grounds*, 110 F.4th 1181 (9th Cir. 2024) (rejecting the Second Circuit's narrow application of standing); *In re* Robinhood Ord. Flow Litig., No. 4:20-cv-9328-YGR, 2023 WL 4543574, at *10 (N.D. Cal. Jan. 18, 2023) (opining that a narrow reading of *Nortel* and *Frutarom* is too restrictive); *In re* Mullen Auto. Sec. Litig., No. CV-22-3026-DMG (AGRx), 2023 WL 8125447, at *6 (C.D. Cal. Sept. 28, 2023) (declining to adopt the Second Circuit's standing analysis).

21. *See Mullen Auto.*, 2023 WL 8125447, at *6; *see also Lucid*, 2023 WL 325251, at *8 (opining that the Second Circuit's reasoning in *Frutarom* is weak); *Robinhood*, 2023 WL 4543574 (critiquing the Second Circuit's application of *Blue Chip Stamps* in *Frutarom*).

addressed.[22] Thereafter, this Article unpacks the reasoning of the *Frutarom* court and explains that, putting it plainly and with all due respect, the Second Circuit got it wrong.[23] Recommendations for an alternative approach to Section 10(b) standing under the Purchaser-Seller Rule follow,[24] and the Article then concludes.

II. HISTORY AND DEVELOPMENT OF THE PURCHASER-SELLER RULE FOR SECTION 10(B) STANDING

The following Part considers Section 10(b) of the Securities Exchange Act, Rule 10b-5, and the creation of an implied private right of action thereunder. Later in the Article, the standing requirement for such a claim is considered in greater deal, with special attention paid to holdings in *Birnbaum*, *Blue Chip Stamps*, and their progeny, which all contributed significantly to the development of the Purchaser-Seller Rule for standing under Section 10(b).

Section 10(b) is the main statutory antifraud provision of the federal securities laws.[25] It prohibits the use of "any manipulative or deceptive device or contrivance" "in connection with the purchase or sale" of any security in contravention of SEC rules and regulations.[26] As enacted by Congress, Section 10(b) was designed to have broad applicability as a "catchall" provision.[27]

Pursuant to its statutory authority under the Exchange Act, the SEC promulgated Rule 10b-5.[28] Rule 10b-5 broadly prohibits, in connection with the purchase or sale of any security, any person, directly or indirectly:

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22. *See Lucid*, 110 F.4th 1181; *infra* notes 133-147 and accompanying text.

23. *See infra* notes 148-190 and accompanying text.

24. *See infra* notes 194-211 and accompanying text.

25. *See Securities Exchange Act of 1934*, CORNELL L. SCH. LEGAL INFO. INST., https://www.law.cornell.edu/wex/securities_exchange_act_of_1934 [https://perma.cc/B4RJ-YK9B] (last visited Oct. 30, 2024).

26. Securities Exchange Act § 10(b), 15 U.S.C. § 78j(b). Note that Section 10(b) and Rule 10b-5 reach only domestic transactions. *See* sources cited *supra* note 5.

27. Herman & MacLean v. Huddleston, 459 U.S. 375, 382 (1983) (stating that "§ 10(b) is a 'catchall' antifraud provision").

28. 17 C.F.R. § 240.10b-5; *see* Birnbaum v. Newport Steel Corp., 193 F.2d 461, 463 (2d Cir. 1952) (discussing the history, purpose, and scope of Rule 10b-5); *see also* SEC Release No. 3230, 1942 WL 34443 (May 21, 1942) (announcing the promulgation of Rule 10b-5 and stating that "[t]he Securities and Exchange Commission today announced the adoption of a rule *prohibiting fraud by any person in connection with the purchase of securities*. . . . The new rule closes a loophole in the protections against fraud administered by the Commission by prohibiting individuals or companies from buying securities if they engage in fraud in their purchase." (emphasis added)).

> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person . . . .[29]

While the language of Section 10(b) does not expressly create a private right of action on behalf of allegedly aggrieved claimants, and the legislative history of Section 10(b) also does not evince intent to do so, federal courts have long recognized a private right of action under Section 10(b).[30] In fact, such right has been a part of federal securities law jurisprudence for so long that, in the words of the Supreme Court, "[t]he existence of this implied remedy is simply beyond peradventure."[31] Although this private right of action exists, prevailing in Section 10(b) litigation is an arduous task. To successfully bring a claim under Section 10(b) and Rule 10b-5, plaintiffs must satisfy many elements[32]—and one

29. 17 C.F.R. § 240.10b-5. For a comprehensive treatise on Section 10(b) and Rule 10b-5, see ALAN R. BROMBERG & LEWIS D. LOWENFELS, BROMBERG & LOWENFELS ON SECURITIES FRAUD, Westlaw (database updated June 2024); *see also* Marc I. Steinberg, *The Propriety and Scope of Cumulative Remedies Under the Federal Securities Laws*, 67 CORNELL L. REV. 557 (1982) (addressing the propriety of cumulative remedies with respect to § 10(b) and other remedial provisions of the federal securities laws).

30. *See, e.g.*, Ernst & Ernst v. Hochfelder, 425 U.S. 185, 196 (1976) ("[T]he existence of a private cause of action for violations of the statute and the Rule is now well established."); *Huddleston*, 459 U.S. at 380 (also noting that "a private right of action under § 10(b) of the 1934 Act and Rule 10b-5 has been consistently recognized for more than 35 years"); Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 13 n.9 (1971) ("It is now established that a private right of action is implied under § 10(b).").

31. *Huddleston*, 459 U.S. at 380.

32. To succeed in a private action for damages under Section 10(b) and Rule 10b-5, a plaintiff generally must satisfy the following elements, depending in part upon whether the alleged harm was due to a misstatement or omission:

Requisite Jurisdictional Means—Plaintiffs must plead the use of a means of interstate commerce to secure the jurisdiction of the federal securities laws. Commentators and courts note that this requirement is typically met without difficulty; e.g., by proof of intrastate telephone calls or electronic messages. Loveridge v. Dreagoux, 678 F.2d 870, 874 (10th Cir. 1982) (addressing jurisdictional requirements); *see also* Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Manning, 136 S. Ct. 1562, 1566 (2016) (holding that "the jurisdictional test established by [§ 27 of the Exchange Act] is the same as the one used to decide if a case 'arises under' a federal law [pursuant to 28 U.S.C. § 1331]").

Plaintiff as Purchaser or Seller—A plaintiff must demonstrate that they are an *actual* purchaser or seller of securities. This requirement bars (1) prospective purchasers; (2) actual shareholders who allege that they opted *not* to sell their shares because they relied on positive materially false information regarding the subject company; and (3) shareholders, creditors, and

other persons who incurred loss in the value of their securities because of fraudulent corporate or insider activities. *See* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 737-38 (1975).

Manipulative or Deceptive Conduct—Plaintiffs must prove that the subject defendant(s) engaged in manipulative or deceptive conduct. Breach of fiduciary duty, unaccompanied by a material disclosure deficiency, is not actionable under Section 10(b) and Rule 10b-5. *See* Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 474 (1977) (holding that the challenged transaction "was neither deceptive nor manipulative and therefore did not violate either § 10(b) of the [Exchange] Act or Rule 10b-5"); *see also* MARC I. STEINBERG, THE FEDERALIZATION OF CORPORATE GOVERNANCE 136-40 (2018) (discussing the failed attempt to federalize corporate governance by means of expanding the reach of § 10(b) and Rule 10b-5); *see generally* Ralph C. Ferrara & Marc I. Steinberg, *A Reappraisal of* Santa Fe*: Rule 10b-5 and the New Federalism*, 129 U. PA. L. REV. 263 (1980) (addressing the Supreme Court's decision in *Santa Fe* and its ramifications).

Materiality—Plaintiffs must demonstrate that the misstatement or omission was material; i.e., that a reasonable investor would consider such information important in making an investment decision. *See, e.g*., Matrixx Initiatives, Inc. v. Siracusano, 563 U.S. 27, 38 (2011); Basic Inc. v. Levinson, 485 U.S. 224, 232 (1988); TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976).

Defendant's Scienter—Plaintiffs must establish that the subject defendant(s) acted with scienter. *Hochfelder*, 425 U.S. at 208-10. The *Hochfelder* Court opined that the term "scienter" encompasses "a mental state embracing intent to deceive, manipulate, or defraud" and may be proven by "knowing or intentional misconduct." *Id.* at 194 n.12, 197. For purposes of a Section 10(b) and Rule 10b-5 cause of action, courts generally have held that reckless misconduct satisfies the scienter requirement. As construed by the lower federal courts, reckless conduct is that which is "highly unreasonable" and constitutes "an extreme departure from the standards of ordinary care" to the extent that the danger was either "known to the defendant or [was] so obvious that the [defendant] must have been aware of it." *In re* Ikon Office Sols., Inc., 277 F.3d 658, 667 (3d Cir. 2002) (quoting SEC v. Infinity Grp. Co., 212 F.3d 180, 192 (3d Cir. 2000)); *see* Hollinger v. Titan Cap. Corp., 914 F.2d 1564, 1569 (9th Cir. 1990) (en banc); Sanders v. John Nuveen & Co., 554 F.2d 790, 793 (7th Cir. 1977). Note that scienter also is required to be proven in SEC actions alleging violations of Section 10(b) and Rule 10b-5. *See* Aaron v. SEC, 446 U.S. 680, 691 (1980) (holding that "scienter is an element of a violation of § 10(b) and Rule 10b-5, regardless of the identity of the plaintiff or the nature of the relief sought").

Plaintiff's Reliance—Plaintiffs must demonstrate that they relied upon the material misstatement or omission. Such reliance also must be justified. In cases of nondisclosure, a plaintiff's reliance is presumed. *See* Affiliated Ute Citizens v. United States, 406 U.S. 128, 153-54 (1972). Moreover, when the subject securities trade in an efficient market, investor reliance is presumed (which may be rebutted). *See* Halliburton Co. v. Erica P. John Fund, Inc., 573 U.S. 258, 268 (2014); *Basic*, 485 U.S. at 244-47.

Loss Causation—Plaintiffs must show that the alleged misconduct caused the financial loss. A customary way to prove this element is to show that, when the fraud was revealed, a corrective shift in the price of the subject securities promptly occurred. *See* Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 346 (2005); *see also* Matthew L. Fry, *Pleading and Proving Loss Causation in Fraud-on-the-Market-Based Securities Suits Post*-Dura Pharmaceuticals, 36 SEC. REG. L.J. 31, 64-71 (2008) (examining the elements of loss causation after *Dura*).

"In Connection With"—Plaintiffs must show that they purchased the securities "in connection with" the fraudulent practice. *See Matrixx*, 563 U.S. at 37-38. For purposes of this element, it is enough that a sale of securities coincided with the alleged scheme to defraud. *See* SEC v. Zandford, 535 U.S. 813, 824-25 (2002) ("[T]he SEC complaint describes a fraudulent scheme in which the securities transactions and breaches of fiduciary duty coincide. Those breaches were therefore 'in connection with' securities sales within the meaning of § 10(b).").

of the first obstacles they face is the Purchaser-Seller Rule.[33]

III. SETTING THE STAGE: *BIRNBAUM* TO *BLUE CHIP STAMPS*

In order to institute a Section 10(b) action seeking damages, plaintiffs must meet the standing requirement—namely, that they purchased or sold the subject securities in connection with a defendant's alleged fraudulent misconduct.[34] This standing requirement is known as the "[P]urchaser-[S]eller [R]ule" and is a necessary hurdle to overcome

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Omission Liability (where liability is based on silence)—Where a Section 10(b) and Rule 10b-5 claim is premised on a defendant's omission of material information, plaintiffs must establish that such information was omitted in violation of a duty to disclose. *See, e.g.*, Chiarella v. United States, 445 U.S. 222, 230 (1980).

Damages—"The customary measure of damages in a Rule 10b-5 case is the out-of-pocket loss." Hackbart v. Holmes, 675 F.2d 1114, 1121 (10th Cir. 1982). Generally, the out-of-pocket measure of damages is "the difference between the fair value of all that the [plaintiff] received and the fair value of what he would have received had there been no fraudulent conduct." Michael J. Kaufman, *No Foul, No Harm: The Real Measure of Damages Under Rule 10b-5*, 39 CATH. U. L. REV. 29, 31 (1989) (alteration in original) (quoting *Affiliated Ute Citizens*, 406 U.S. at 155); *see also* 26A MICHAEL J. KAUFMAN, SECURITIES LITIGATION: DAMAGES § 13:1, Westlaw (database updated Nov. 2023) ("The [U.S. Supreme] Court . . . has implicitly addressed the propriety of each of the four overarching theories of recovery: (1) a benefit of the bargain measure of damages, (2) an out-of-pocket measure of damages, (3) a rescissionary measure of damages, and (4) disgorgement in calculating recovery under the rule.").

Additionally, plaintiffs instituting an action under Section 10(b) must comply with the statute of limitations. *See* 28 U.S.C. § 1658(b). Claims under Section 10(b) and Rule 10b-5 must be brought within two years after the violation was discovered (or should have been discovered). *Id.* Such claims are subject further to a five-year statute of repose, which bars plaintiffs from bringing claims, in any event, more than five years after the occurrence of a violation. *Id.*; *see* Merck & Co. v. Reynolds, 559 U.S. 633, 648-50 (2010) (holding that the two-year period begins when a reasonably diligent plaintiff knew or should have been aware of the facts constituting the alleged violation); *see also* Cal. Pub. Emps. Retirement Sys. v. ANZ Sec., Inc., 137 S. Ct. 2042, 2052-55 (2017) (holding that the three-year statute of repose set forth in § 13 of the Securities Act is not subject to equitable tolling).

33. *See, e.g.*, *Blue Chip Stamps*, 421 U.S. at 723 ("A private damages action under Rule 10b-5 is confined to actual purchasers or sellers of securities . . . ."); *see* 69A AM. JUR. 2D *Securities Regulation—Federal* § 1332, Westlaw (database updated Aug. 2024) ("[O]nly purchasers or sellers have standing to maintain an implied civil action under § 10(b) of the Exchange Act or SEC Rule 10b-5 . . . .").

34. *Blue Chip Stamps*, 421 U.S. at 723. As discussed earlier in this Article, the Supreme Court has opined that the term "standing" is misleading in this context. Instead, the inquiry should focus on whether the subject plaintiff has "a cause of action under the statute." Lexmark Int'l, Inc. v. Static Control Components, Inc., 572 U.S. 118, 128 (2014). Nonetheless, because the label "standing" has been employed for over half a century in the Section 10(b) context and its meaning is widely understood, this Article uses this term. *See supra* note 3.

for any plaintiff in a securities fraud claim under Section 10(b) and Rule 10b-5.[35]

The parameters of the Purchaser-Seller Rule were first articulated by the Second Circuit in *Birnbaum*.[36] There, shareholders of Newport Steel Corporation brought suit against Newport, Russell Feldmann (then-president of Newport and chair of its board of directors), and other directors and officers of Newport, alleging violations of Section 10(b) and Rule 10b-5.[37] The suit stemmed from Newport's rejection of a merger offer from Follansbee Steel Corporation and the subsequent sale of Feldmann's controlling block of shares in Newport to the Wilport Company.[38] The court held that Section 10(b) "was directed solely at that type of misrepresentation or fraudulent practice usually associated with the sale or purchase of securities . . . and that Rule [10b-5] extended protection only to the defrauded purchaser or seller."[39] In so holding, the Second Circuit thereby barred plaintiffs who were not purchasers or sellers from bringing claims under Section 10(b) and Rule 10b-5.

The Supreme Court adopted the *Birnbaum* rule in *Blue Chip Stamps*.[40] There, pursuant to the terms of a consent decree, the company offered common stock to retailers who in the past had used its stamp service.[41] After declining to purchase the shares offered, plaintiffs alleged that their inaction was due to Blue Chip's false and overly pessimistic portrayal of the company's financial condition.[42] Observing that plaintiffs were not purchasers of a security, the Supreme Court ruled that they lacked standing under Section 10(b). It reasoned that a plaintiff:

> who neither purchases nor sells securities but sues instead for intangible economic injury such as loss of a noncontractual opportunity to buy or sell, is more likely to be seeking a largely conjectural and speculative recovery

35. *See Blue Chip Stamps*, 421 U.S. at 734, 749.

36. Birnbaum v. Newport Steel Corp., 193 F.2d 461, 464 (2d Cir. 1952).

37. *Id.* at 462 (describing facts of the contemplated merger and plaintiffs' allegations of fraud).

38. *Id.*

39. *Id.* at 464. Although paying a hefty premium for Feldmann's shares, Wilport's objective was to capture a source of steel during a period in which there was a market shortage. *Id.* at 462.

40. 421 U.S. at 723.

41. *Id.* at 725-26 ("Under the terms of the plan, the offering to non-shareholder users was to be proportional to past stamp usage and the shares were to be offered in units consisting of common stock and debentures.").

42. *Id.* at 726-27.

> in which the number of shares involved will depend on the plaintiff's subjective hypothesis.[43]

In so holding, the Court clearly articulated its ruling that "[a] private damages action under Rule 10b-5 is confined to actual purchasers or sellers of securities."[44]

IV. RESTRICTION AND RETRACING: *NORTEL* AND *NYSE*

The Second Circuit further clarified the parameters of the Purchaser-Seller Rule in *Nortel*.[45] In *Nortel*, in connection with the sale by JDS Uniphase Corporation (JDS) of its laser business to Nortel Networks Corporation (Nortel) in exchange for Nortel stock, JDS shareholders instituted suit against Nortel under Section 10(b) and Rule 10b-5, alleging Nortel made material misstatements made about its own financial prospects.[46] Plaintiffs argued that standing was proper because defendant's misstatements were material and because such material misstatements directly impacted the value of plaintiffs' shares in JDS due to its substantial business relationship with Nortel.[47] Rejecting plaintiffs' position, the Second Circuit held that plaintiffs lacked standing under

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43. *Id.* at 734-35. Along the same lines, the Court stated later in the opinion: "In the absence of the *Birnbaum* doctrine, bystanders to the securities marketing process could await developments on the sidelines without risk, claiming that inaccuracies in disclosure caused nonselling in a falling market and that unduly pessimistic predictions by the issuer followed by a rising market caused them to allow retrospectively golden opportunities to pass." *Id.* at 747.

44. *Id.* at 723. In its decision, the Court expressed its concern with "strike suit" litigation, stating: "There has been widespread recognition that litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general." *Id.* at 739. Justice Blackmun, joined by Justices Brennan and Douglas, issued a sharp dissent, asserting that the Court's opinion "exhibits a preternatural solicitousness for corporate well-being and a seeming callousness toward the investing public quite out of keeping, it seems to me, with our own traditions and the intent of the securities laws." *Id.* at 762 (Blackmun, J., dissenting).

After *Blue Chip Stamps*, lower federal courts have held that the purchaser-seller requirement was met in a number of situations, including in a derivative action where the subject corporation bought or sold its securities, in a "forced" sale transaction (such as a cash-out merger), and when the securities have been pledged. *See* MARC I. STEINBERG, SECURITIES REGULATION 506 (8th ed. 2022); Eric C. Chaffee, *Standing Under Section 10(b) and Rule 10b-5: The Continued Validity of the Forced Seller Exception to the Purchaser-Seller Requirement*, 11 U. PA. J. BUS. L. 843, 895 (2009).

45. *See generally* Ont. Pub. Serv. Emps. Union Pension Tr. Fund v. Nortel Networks Corp., 369 F.3d 27 (2d Cir. 2004) (emphasizing that a direct relationship must exist between defendant's misstatements and plaintiff's injury and holding that in this case the relationship was too remote to confer standing under § 10(b) and Rule 10b-5).

46. *Id.* at 29-30.

47. *Id.*

Section 10(b) and Rule 10b-5, reasoning that the relationship between plaintiffs' alleged injury and defendants' misstatements was not sufficiently direct.[48]

In reaching this conclusion, the Second Circuit considered several factors. First, the *Nortel* court recognized that the judicially created private right of action under Section 10(b) and Rule 10b-5 is "not unlimited," and that policy rationales and the interests of judicial economy require that this right of action must be subject to certain limitations.[49] Paramount among these interests was the prevention of vexatious litigation. In the absence of a purchaser-seller requirement, oral testimony would play a primary role in a court's decision whether to confer standing.[50] The *Nortel* court further addressed plaintiffs' arguments that they *did* purchase securities that were impacted by the alleged misstatements by Nortel. Although recognizing that Section 10(b)'s language "in connection with the purchase or sale of *any* security"[51] refers to the regulation of "*all types* of securities, and not *any affected company's* securities,"[52] the *Nortel* court held that (under the rationale of *Blue Chip Stamps*) Section 10(b) standing in private actions is limited to "those who have at least dealt in the security to which the prospectus, representation, or omission *relates*."[53]

The *Nortel* court also distinguished the facts present in that case from *Semerenko v. Cendant Corp.*, a United States Court of Appeals for the Third Circuit case which plaintiffs relied upon to assert that they had standing.[54] *Cendant*, the court pointed out, involved a prospective acquiror's misstatements during a bidding war contemplating a stock-for-

48. *See id.* at 31-34 ("Stockholders do not have standing to sue under Section 10(b) and Rule 10b-5 when the company whose stock they purchased is negatively impacted by the material misstatement of another company, whose stock they do not purchase.").

49. *Id.* at 31. The *Nortel* court referenced the Supreme Court's commentary in *Blue Chip Stamps* that "[w]hen we deal with private actions under Rule 10b-5, we deal with a judicial oak which has grown from little more than a legislative acorn" and stated that *Blue Chip Stamps* represented a "restrictive view of standing under Rule 10b-5." *Id.* (alteration in original) (citing 421 U.S. at 737, 754-55).

50. *Nortel*, 369 F.3d at 31-32 (stating that concerns about vexatious litigation were a driving factor in court decisions to preclude standing with respect to non-purchasers). *See also id.* at 33 ("Here, oral testimony would play a crucial role in proving that plaintiffs relied on Nortel's financial projections when they purchased JDS's securities.").

51. *Id.* at 32 (quoting Securities Exchange Act § 10(b), 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5); *see* 6 THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION § 12:4, Westlaw (database updated May 2024).

52. *Nortel*, 369 F.3d at 32.

53. *Id.* (emphasis added) (quoting *Blue Chip Stamps*, 421 U.S. at 747).

54. *Id.* at 33; *see* Semerenko v. Cendant Corp., 223 F.3d 165, 169-72 (3d Cir. 2000).

stock merger, where purchasers of the target's stock understood that, should the transaction be consummated, their shares would be exchanged for Cendant stock.[55] "[B]ecause Cendant was in the process of merging with ABI," the Second Circuit explained, "its representations had a much more *direct relationship* to the value of ABI's stock than Nortel's statements did to the value of JDS's stock, given that no merger was contemplated between these two companies."[56] A merger, the *Nortel* court reasoned, "creates a far more *significant relationship* between two companies than does the sale of a business unit," even where each "deal" involves a "multi-billion dollar transaction."[57] Significantly, the *Nortel* court stated in dicta that "a potential merger might require a different outcome" as to a plaintiff's standing under Section 10(b) and Rule 10b-5.[58]

Nortel's holding was clarified by the Second Circuit in *NYSE*,[59] which reversed a district court holding that lead plaintiffs did not have standing under Section 10(b) to bring claims against the New York Stock Exchange.[60] While recognizing that language contained in the *Nortel* decision could be read to mean that a purchaser may only bring an action

55. 223 F.3d at 170. Noting that while the *Cendant* case was not binding in the Second Circuit, the *Nortel* court nonetheless undertook efforts to clarify why it would be inapplicable to plaintiffs. *See infra* notes 56-58 and accompanying text.

56. *Nortel*, 369 F.3d at 34 (emphasis added).

57. *Id.* (emphasis added).

58. *Id.* This statement from *Nortel* was influential in later Second Circuit cases as well as Judge Pérez's concurrence in *Frutarom*, discussed *infra* notes 59-81. *See* Menora Mivtachim Ins. v. Frutarom Indus. Ltd., 54 F.4th 82, 91 (2d Cir. 2022) (Pérez, J., concurring) ("Applying *Nortel*'s 'direct relationship' test, the question is whether Plaintiffs have demonstrated a sufficient relationship between Frutarom's alleged misstatements and IFF's stock price.").

Other federal courts outside of the Second Circuit have addressed the propriety of *Nortel*'s approach to Section 10(b) and Rule 10b-5 standing in this context. *See, e.g.*, Zaller v. Fred's, Inc., 560 F. Supp. 3d 1146, 1175-77 (W.D. Tenn. 2021) (applying *Nortel* and holding that plaintiffs lacked standing); Klein v. Altria Grp., Inc., 525 F. Supp. 3d 638, 658-59 (E.D. Va. 2021) (rejecting assertion that plaintiffs lacked standing and stating that "the connection between JUUL's allegedly false statements and Plaintiffs [sic] purchase of Altria's stock lacks the remoteness found in *Nortel Networks*"); Duane & Va. Lanier Tr. v. Sandridge Mississippian Tr. I, 361 F. Supp. 3d 1162, 1167-71 (W.D. Okla. 2019) (applying *Nortel* and denying standing); *In re* Altisource Portfolio Sols., S.A. Sec. Litig., No. 14-81156 CIV-WPD, 2015 WL 12001262, at *4 (S.D. Fla. Sept. 4, 2015) ("As in *Nortel*, the business relationship between the two companies, though substantial, is not enough to confer standing . . . ."); Zelman v. JDS Uniphase Corp., 376 F. Supp. 2d 956, 962-63 (N.D. Cal. 2005) (granting standing and stating that the court "hesitates to apply *Nortel* to the present case because the Second Circuit's rationale in that decision is problematic").

59. Cal. Pub. Emps. Retirement Sys. v. NYSE (*In re* NYSE Specialists Sec. Litig.), 503 F.3d 89, 102 (2d Cir. 2007).

60. *Id.*

under Rule 10b-5 against the *issuer* of the security acquired, the *NYSE* court retreated from that restrictive construction.[61] Instead, the court looked to *Nortel*'s emphasis on the relationship between the alleged disclosure deficiency and the plaintiff's purchase of the subject securities.[62] Moreover, such a restrictive application of *Nortel*, the court reasoned, would be undesirable for policy reasons, as it "would place beyond the reach of Rule 10b-5 false statements made by underwriters, brokers, bankers, and non-issuer sellers."[63] As clarified by *NYSE*, then, *Nortel* may be viewed as holding that complainants do not have a cause of action under Section 10(b) and Rule 10b-5 where the connection between a non-issuer's allegedly false statements and the complainants' purchase of securities is deemed too remote.[64]

V. SECTION 10(B) STANDING IN MERGERS, ACQUISITIONS, AND MORE: DIVERGING APPROACHES

Interpreting its decisions in *Nortel* and *NYSE* in a restrictive manner, the Second Circuit's decision in *Frutarom* marks a significant narrowing of the Purchaser-Seller Rule.[65] In *Frutarom*, slighting the language in *Nortel* and *NYSE* and engaging in judicial activism, the Second Circuit held that, under the Purchaser-Seller Rule, a plaintiff must have "bought or sold the securities [of the company] *about which the misstatements*

61. *Id.* (citing 369 F.3d at 34).

62. *Id.* (citing 369 F.3d at 34). Additionally, the court stated that "[i]n the particular circumstances of [*Nortel*], the *connection* between Nortel Networks' false statements about itself and the plaintiff's purchase of JDS Uniphase stock was *too remote* to sustain an action under Rule 10b-5." *Id.* (emphasis added). By contrast, the connection between the alleged fraudulent conduct and plaintiffs' purchases in *NYSE* was not too remote to preclude standing. *See id.*

63. *Id.*

64. *See* 3 BRENT A. OLSON, PUBLICLY TRADED CORPORATIONS HANDBOOK § 11:3, Westlaw (database updated July 2024) (quoting *In re* Turquoise Hill Res. Ltd. Sec. Litig., 625 F. Supp. 3d 164, 201-02 (S.D.N.Y. 2022)). For subsequent decisions in the Second Circuit interpreting *Nortel* and *NYSE*, see, e.g., *Harbinger Capital Partners LLC v. Deere & Co.*, 632 Fed. App'x 653, 656 (2d Cir. 2015) (denying standing on the basis that, "just as in *Nortel Networks*, the connection between defendants' omissions . . . and [Plaintiffs'] purchase of [the subject securities] was 'too remote to sustain an action' under § 10(b) and Rule 10b-5" (quoting *NYSE*, 503 F.3d at 102)); *Turquoise Hill*, 625 F. Supp. 3d at 201-02 (holding that plaintiffs had standing under § 10(b) because they alleged a sufficient connection between the defendants' alleged misstatements and their purchase of the subject securities); *In re Barclays Liquidity Cross and High Frequency Trading Litigation*, 390 F. Supp. 3d 432, 447 (S.D.N.Y. 2019) (holding that plaintiffs "may assert a cause of action under Section 10(b)").

65. *See* Menora Mivtachim Ins. v. Frutarom Indus. Ltd., 54 F.4th 82, 88 (2d Cir. 2022).

were made."[66] The following discussion addresses the background of the *Frutarom* case, the Second Circuit's holding and rationale for its construction of the Purchaser-Seller Rule in this manner, and notable examples of securities fraud claims involving the Purchaser-Seller Rule after *Frutarom*. As will be seen, while courts within the Second Circuit have dutifully applied *Frutarom*'s restrictive construction of the Purchaser-Seller Rule to deny standing for Section 10(b) and Rule 10b-5 claims, other courts have found *Frutarom*'s rationale problematic.[67] Thus, the Second Circuit's construction of the rule, instead of effectively resolving the question of Section 10(b) standing, has created division among the federal courts and has led to inconsistency in application.

A. The Second Circuit Adopts a Restrictive Approach to Standing in Frutarom

Frutarom picked up where *Nortel* left off and dealt with the most significant issue left open in dicta from that case—whether shareholders of a target or acquiror corporation have standing under Section 10(b) and Rule 10b-5 to sue the other entity in a merger transaction based on such entity's alleged material misstatements or omissions.[68] In *Frutarom*, the target company in connection with a merger transaction allegedly made material misstatements about itself, which induced plaintiffs to buy stock in its acquiror, International Flavors & Fragrances, Inc. (IFF).[69] The case dealt with the merger of Frutarom Industries, Ltd. and a wholly-owned subsidiary of IFF, involving misstatements made by Frutarom that were incorporated by reference into IFF's Form S-4 Registration Statement.[70]

66. *Id.* (emphasis added); *see id.* at 94 (Pérez, J., concurring in the judgment) ("It is important to acknowledge that *today's holding is an example of judicial policymaking*.") (emphasis added).

67. *See infra* notes 105-131 and accompanying text.

68. *See* Ont. Pub. Serv. Emps. Union Pension Tr. Fund v. Nortel Networks Corp., 369 F.3d 27, 34 (2d. Cir 2004) (opining that shareholders of a target or acquiror *may* have standing to sue the other entity in a merger where such entity's material misstatements or omissions in that transaction were directly connected to the shareholders' harm but declining to take a definitive position on that issue). For a summary of the facts and holding in *Frutarom*, see William O. Fisher, *Caselaw Developments 2022*, 78 BUS. LAW. 927, 963-65 (2023).

69. 54 F.4th at 84. Generally, a Form S-4 Securities Act registration statement "may be used for the registration of securities issued in combinations, mergers, consolidations, recapitalizations, acquisitions of assets, and other transactions that require [Securities Act] registration under [SEC] Rule 145." STEINBERG, UNDERSTANDING SECURITIES LAW, *supra* note 3, at 647.

70. *See Frutarom*, 54 F.4th at 84-85.

Plaintiffs were a putative class of shareholders who purchased IFF securities from May 7, 2018 (the date of announcement of the merger) to August 12, 2019 (one week following disclosure of Frutarom's misstatements).[71] Plaintiffs alleged that they purchased IFF securities in connection with the merger, and accordingly in reliance upon Frutarom's statements that the company was in compliance with applicable anti-bribery laws and that its growth in the fragrance industry was due to, inter alia, "'organic growth,' 'acquisitions,' and 'positive currency effects.'"[72] In reality, Frutarom had engaged in a bribery scheme in Russia and Ukraine.[73]

The IFF-Frutarom merger closed in October 2018, whereby Frutarom became a wholly-owned subsidiary of IFF.[74] On August 5, 2019, IFF publicly disclosed the existence of Frutarom's corrupt practices—and the next day, IFF's share price dropped nearly sixteen percent.[75] Plaintiffs brought suit against Frutarom and five of its officers, as well as IFF and two of its officers, alleging violations of Sections 10(b) and 20(a) of the Exchange Act and SEC Rule 10b-5.[76] The United States District Court for the Southern District of New York granted defendants' motion to dismiss for failure to state a claim and held that plaintiffs lacked standing to sue

71. *Id.*

72. *Id.* ("Frutarom falsely stated that since December 31, 2014, Frutarom had not 'violated the [Foreign Corrupt Practices Act], the U.K. Bribery Act 2010, the [Organisation for Economic Co-operation and Development] Convention on Combating Bribery of Foreign Public Officials in International Business Transactions or any other applicable Law relating to anti-corruption or anti-bribery.'" (alteration in original)).

73. *Id.* at 85 ("On August 5, 2019, IFF acknowledged that Frutarom had 'made improper payments to representatives of a number of customers' in Russia and Ukraine.").

74. *Id.* at 84-85.

75. *Id.* at 85.

76. *Id.* Section 20(a) of the Securities Exchange Act, 15 U.S.C. § 78t(a), provides that "[e]very person who . . . controls any person liable under any provision of this chapter . . . shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable . . . unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action." For cases construing this provision, see, e.g., *Wyoming State Treasurer v. Moody's Investors Service, Inc. (In re Lehman Bros. Mortgage-Backed Securities Litigation)*, 650 F.3d 167, 185-86 (2d Cir. 2011); *Ram Trust Services, Inc. v. Stone & Webster, Inc. (In re Stone & Webster, Inc., Securities Litigation)*, 424 F.3d 24 (1st Cir. 2005); *Harrison v. Dean Witter Reynolds, Inc.*, 974 F.2d 873, 877-82 (7th Cir. 1992).

the Frutarom defendants under Section 10(b).[77] On appeal, the Second Circuit was faced with precisely the issue *Nortel* declined to resolve.[78]

While the *Nortel* court declined to take a position on the issue of whether a merger created a significant enough relationship to confer Section 10(b) and Rule 10b-5 standing,[79] the Second Circuit's holding in *Frutarom* answered that question with a resounding "no."[80] Holding that the plaintiff IFF shareholders did not have standing under Section 10(b), the appellate court opined that "Section 10(b) standing does not depend on the significance or directness of the relationship between two companies. Rather, the question is whether the plaintiff bought or sold the securities about which the misstatements were made."[81] This holding narrows the universe of potential plaintiffs considerably and has generated challenging issues in application.

B. The Impact of Frutarom *on Private Claims under Section 10(b) in the Second Circuit*

Within the Second Circuit, district courts have applied *Frutarom* with consistency to exclude securities fraud plaintiffs in a variety of scenarios. For example, in *In re Alibaba Group Holding Ltd. Securities Litigation*,[82] the Southern District of New York followed *Frutarom* and held that Alibaba depository shareholders did not have standing to sue under Section 10(b) when Alibaba allegedly made materially misleading statements regarding the IPO of a company of which it was a controlling shareholder, and which statements allegedly impacted its own share

77. Menora Mivtachim Ins. v. Int'l Flavors & Fragrances Inc., No. 19 Civ. 7536 (NRB), 2021 WL 1199035, at *1 (S.D.N.Y. Mar. 30, 2021), *aff'd sub nom*. Menora Mivtachim Ins. v. Frutarom Indus. Ltd., 49 F.4th 790 (2d Cir. 2022), *and aff'd sub nom*. Menora Mivtachim Ins. v. Frutarom Indus. Ltd., 54 F.4th 82 (2d Cir. 2022).

78. *Frutarom*, 54 F.4th at 85, 88 ("[Plaintiffs] point to dicta noting that because 'a merger creates a far more significant relationship between two companies than does the sale of a business unit,' 'a potential merger might require a different outcome.'" (quoting Ont. Pub. Serv. Emps. Union Pension Tr. Fund v. Nortel Networks Corp., 369 F.3d 27, 34 (2d. Cir 2004))).

79. 369 F.3d at 34.

80. 54 F.4th at 88 ("[W]e now answer that question by holding that purchasers of a security of an acquiring company do not have standing under Section 10(b) to sue the target company for alleged misstatements the target company made about itself prior to the merger between the two companies.").

81. *Id.* (citing *Nortel*, 369 F.3d at 32).

82. *See generally In re* Alibaba Grp. Holding Ltd. Sec. Litig., No. 20 Civ. 9568 (GBD), 2023 WL 2601472 (S.D.N.Y. Mar. 22, 2023) (granting a motion to dismiss for lack of standing based upon the court's application of *Frutarom*).

price.[83] In *Alibaba*, plaintiffs were holders of Alibaba American Depository Shares (ADS), which were traded on the NYSE.[84] They brought suit against Alibaba and a number of its executives, alleging (among other claims) a Section 10(b) violation for statements made in Alibaba's public disclosures regarding the planned IPO of Ant Group Co., Ltd., a fintech company that was thirty-three percent owned by Alibaba.[85] In fact, Ant was spun off[86] from Alibaba and Alibaba was Ant's controlling shareholder, but in SEC filings Alibaba described Ant as an "unconsolidated related party."[87] When Alibaba announced that the Ant IPO was scuttled due to regulatory action by the People's Republic of China, the value of Alibaba ADS dropped by 8.26%.[88] Plaintiffs argued that Alibaba's disclosures and Ant's pre-IPO filings concealed significant regulatory risks, especially in regard to Alibaba's ownership of Ant, and as such were materially misleading.[89]

But the district court dismissed plaintiffs' claims as to the Ant IPO for lack of standing under Section 10(b).[90] Applying the Purchaser-Seller Rule as articulated in *Frutarom*, the court reasoned that "[t]he challenged disclosures were not about Alibaba—the company in which Plaintiffs purchased or sold stock. Instead, they related to Ant's IPO, business, and

83. *Id.* at *2-5.

84. *Id.* at *1.

85. *Id.* at *1-2.

86. *Id.* at *2. A spin-off occurs where a parent entity separates part of its business operations into a separate enterprise, and equity in the new entity is distributed to current shareholders of the parent. *See Spin-Off*, CORP. FIN. INST., https://corporatefinanceinstitute.com/resources/valuation/spin-off-and-split-off/ [https://perma.cc/MAV9-5BNQ] (last visited Oct. 30, 2024). For cases involving spin-offs, see, e.g., *SEC v. Datronics Engineers, Inc*., 490 F.2d 250 (4th Cir. 1973); *SEC v. Harwyn Industries Corp*., 326 F. Supp. 943 (S.D.N.Y. 1971); *see also* SEC Staff Legal Bulletin No. 4 (Sept. 16, 1997) (discussing the SEC's application of the Security Exchange Act to spin-offs); *see generally* Simon M. Lorne, *The Portfolio Spin-Off and Securities Registration*, 52 TEX. L. REV. 918 (1974) (discussing securities registration requirements pertaining to spin-offs).

87. *In re Alibaba*, 2023 WL 2601472, at *2. This case presented an analogous set of facts to *Frutarom* regarding the public nature of the allegedly misleading disclosures. *Compare id.* (describing the history of the Ant IPO and regulatory changes impacting the business) *with* Menora Mivtachim Ins. v. Frutarom Indus. Ltd., 54 F.4th 82, 84 (2d Cir. 2022) (describing how misstatements regarding Frutarom's business and compliance with applicable law were incorporated by reference into IFF's Form S-4 in connection with the merger).

88. *In re Alibaba*, 2023 WL 2601472, at *2.

89. *Id.*

90. *Id.* at *5 ("Plaintiffs therefore lack standing to sue Ma or Alibaba based on alleged misstatements about Ant. Accordingly, Plaintiffs' Ant IPO claims against Ma [(Alibaba's founder and a member of its board at the time of the suit)] and Alibaba are dismissed for lack of standing."); *id.* at *16 (dismissing § 10(b) claims as to Ant and Ma for lack of standing).

regulatory environment."[91] Further, because *Frutarom* foreclosed consideration of whether a "direct relationship" existed between plaintiffs' injury and defendants' misstatements, the close connection between Ant and Alibaba was not relevant to the court's determination.[92]

As another example, in *In re CarLotz, Inc. Securities Litigation*,[93] the Southern District of New York held that *Frutarom*'s rationale extended to SPACs[94]—leaving shareholders in a de-SPAC without a remedy under Section 10(b) in situations where their company's acquisition target made material misstatements or omissions that caused them harm.[95] In that case, CarLotz, initially a private company (pre-merger CarLotz), went public via a merger and de-SPAC with Acamar

91. *Id.* at *5 ("Plaintiffs did not purchase the securities about which misstatements were made, so they did not have standing to sue under Section 10(b) or Rule 10b-5." (quoting *Frutarom*, 54 F.4th at 89)).

92. *Id.* ("While Ant and Alibaba may have been 'highly related,' *Frutarom* makes clear that 'Section 10(b) standing does not depend on the significance or directness of the relationship between two companies, [sic] Rather, the question is whether the plaintiff bought or sold the securities about which the misstatements were made.'" (quoting 54 F.4th at 88)).

93. *See generally In re* CarLotz, Inc. Sec. Litig., 667 F. Supp. 3d 71 (S.D.N.Y. 2023) (applying *Frutarom* to a Special Purpose Acquisition Company transaction).

94. *Id.* at 79. Special Purpose Acquisition Companies (SPACs) are essentially public shell companies, with no business of their own, which exist for the purpose of acquiring a private company and taking that company public in a de-SPAC transaction. *Id.* at 74. For further information on SPAC structure and operations, see *What You Need to Know About SPACs - Updated Investor Bulletin*, U.S. SEC. & EXCH. COMM'N (May 25, 2021), https:///www.sec.gov/oiea/investor-alerts-and-bulletins/what-you-need-know-about-spacs-investor-bulletin. As the SEC staff commented: "The economic interests of the entity or management team that forms the SPAC . . . and the directors, officers, and affiliates of a SPAC often differ from the economic interests of public shareholders which may lead to conflicts of interest as they evaluate and decide whether to recommend business combination transactions to shareholders." SEC Div. Corp. Fin., Disclosure Guidance on Special Purpose Acquisition Companies (Withdrawn) (December 22, 2020), https://www.sec.gov/rules-regulations/staff-guidance/disclosure-guidance/disclosure-special-purpose-acquisition. To address this situation, the SEC adopted new rules "to enhance disclosures and provide additional investor protection in initial public offerings (IPOs) by special purpose acquisition companies (SPACs) and in subsequent business combination transactions between SPACs and target companies (de-SPAC transactions)." Press Release, SEC, SEC Adopts Rules to Enhance Investor Protections Relating to SPACs, Shell Companies, and Projections (Jan. 24, 2024), https://www.sec.gov/newsroom/press-releases/2024-8.

95. *CarLotz*, 667 F. Supp. 3d. at 79 ("Plaintiffs also argue that *Frutarom* creates a 'loophole' for SPAC transactions, in that 'parties to SPAC transactions [can] lie with impunity in all public statements leading up to the merger, including the proxy and offering documents.' While the Court appreciates the policy concerns implicated by *Frutarom*, the Court is bound by its holding." (alteration in original) (citation omitted)). In its reasoning, the district court notes that *Frutarom* reflects a distinct policy choice by the Second Circuit, and ultimately dismissed plaintiffs' Section 10(b) claim for lack of standing, while acknowledging the merits of their concerns. *Id.*

Partners Acquisition Corporation, becoming a public entity traded on the NASDAQ.[96] Plaintiffs were shareholders of either Acamar or post-merger, publicly-held CarLotz.[97] During the period between the public announcement of the contemplated merger and the shareholder vote in favor of the transaction, executives of pre-merger CarLotz allegedly made material misstatements[98] about CarLotz's business model that were later corrected in two public disclosures by post-merger CarLotz, precipitating drops in share price of 8.5% and 13.4%, respectively.[99]

Following *Frutarom*, the district court dismissed the plaintiffs' Section 10(b) claims for lack of standing, reasoning that because post-merger CarLotz was not the same entity as pre-merger CarLotz, statements made about pre-merger CarLotz, even if materially misleading, were not actionable by shareholders of post-merger CarLotz.[100] "*Frutarom*," the court said, "forecloses Plaintiffs' challenge to any statements made by Pre-Merger CarLotz about Pre-Merger CarLotz."[101] This holding, simply put, is concerning. As plaintiffs initially argued, it effectively creates a "loophole" for pre-SPAC entities and their leadership, putting them out of the reach of private plaintiffs under the antifraud provisions of the federal securities laws for material misstatements or omissions made before a merger and de-SPAC.[102]

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96. *Id.* at 73-75.

97. *Id.* at 76.

98. *Id.* at 75. CarLotz executives touted the pre-merger company as operating with minimal capital risk, having a "deep pool of [corporate] sourcing partners," and downplayed the impact of the COVID-19 pandemic and contemporary used car market on demand for CarLotz's inventory of vehicles, among other things. *Id.*

99. CarLotz's first disclosure revealed that the post-merger company had so much excess inventory that it was unable to efficiently process its vehicles; that CarLotz attempted to clear this "log jam" of inventory through "'aggressive pricing' 'rather than absorbing shipping and reconditioning costs of vehicles returned to [clients],'" indicating greater allocation of capital to reconditioning vehicles and undercutting prior claims that CarLotz operated with little capital risk; and that one corporate partner "accounted for over 60% of [the] vehicles sourced" by CarLotz. *Id.* CarLotz's second disclosure announced that the aforementioned single corporate partner had "paused" its relationship with the company. *Id.*

100. *Id.* at 78 ("Plaintiffs provide no explanation as to why, as a legal matter, the post-merger entity can be considered interchangeable with the pre-merger, privately held company.").

101. *Id.* ("As in *Frutarom*, neither of the named Plaintiffs purchased shares of Pre-Merger CarLotz—a privately held entity.").

102. *See id.* at 79 (acknowledging plaintiffs' concerns regarding material misstatements or omissions of privately held companies before going public via a SPAC). For another recent federal district court decision in the Second Circuit interpreting *Frutarom* and expressing similar concerns, see *Kusnier v. Virgin Galactic Holdings, Inc.*, 21-CV-3070 (ARR) (TAM), 2023 WL 8750398, at *8-9 (E.D.N.Y. Dec. 19, 2023) (denying § 10(b) standing on basis that "the statements at issue here were made by pre-merger Virgin Galactic about its own business operations . . . they

But *Frutarom* was not so warmly received, nor so faithfully followed, outside of the Second Circuit. While as of this writing few cases have addressed *Frutarom*'s rationale, several of those decisions have raised questions as to its unduly restrictive approach.[103]

C. Development of a Flexible Approach to the Purchaser-Seller Rule: District Courts in the Ninth Circuit

While courts in the Second Circuit have been bound by *Frutarom*'s restrictive interpretation of the Purchaser-Seller Rule, other courts considering similar issues have embraced a view of Section 10(b) standing that was more flexible—and directly critical—than the Second Circuit's approach. Before the Ninth Circuit's recent panel opinion in *In re CCIV/Lucid Motors Securities Litigation*,[104] *Frutarom* had only been considered by district courts in that circuit, and those courts were by no means deferential to *Frutarom*'s holding or its rationale. This subpart considers those cases in turn before the next addresses the recent appellate holding.

The first case to address *Frutarom*'s applicability outside of the Second Circuit was *Lucid*.[105] There, plaintiffs alleged that Lucid Motors and its CEO induced them to purchase stock of Churchill Capital Corporation IV, a SPAC that merged with Lucid and took it public in 2021.[106] *Lucid* presented strikingly similar facts to *CarLotz*, above: an executive of a pre-merger private company allegedly made material

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were not, under *Frutarom*, 'about' post-merger Virgin Galactic securities" and, although recognizing that the plaintiffs' "arguments are compelling, . . . they rely on the kind of functional analysis that *Frutarom* specifically rejected").

103. *See infra* notes 105-132 and accompanying text (discussing cases in other federal courts after *Frutarom* that criticize the Second Circuit's approach as, inter alia, overly formulaic and out of line with applicable precedent).

104. *See generally In re* CCIV/Lucid Motors Sec. Litig., 110 F.4th 1181 (9th Cir. 2024) (adopting the Second Circuit's *Frutarom* approach and rejecting the functional analysis developed by district courts in the cases below).

105. *In re* CCIV/Lucid Motors Sec. Litig., No. 4:21-cv-09323-YGR, 2023 WL 325251, at *1 (N.D. Cal. Jan. 11, 2023), *aff'd on other grounds*, 110 F.4th 1181 (9th Cir. 2024) (granting motion to dismiss as to materiality but denying as to standing).

106. *Id.* at *1-3. For a business enterprise to "go public," it generally entails the filing of a Securities Act registration statement with the SEC. Upon the registration statement's effectiveness, the securities registered pursuant thereto are traded on a national securities exchange, such as the NYSE. There are many consequences that impact a company that goes public, including being required to comply with the Securities Exchange Act's periodic reporting requirements. For further discussion, *see* CHARLES J. JOHNSON, JR., JOSEPH MCLAUGHLIN & ANNA T. PINEDO, CORPORATE FINANCE AND THE SECURITIES LAWS (6th ed. 2020); STEINBERG, UNDERSTANDING SECURITIES LAW, *supra* note 3, at 186-91.

misstatements and omissions that, when disclosed, negatively impacted the share price of the post-merger public entity.[107] In *Lucid*, Lucid's CEO allegedly misstated Lucid's production capability, production start date, price range, and financial condition.[108] Disagreeing with the Second Circuit's approach, the district court in *Lucid* attempted to close any SPAC "loophole" available under an overly formulaic construction of the Purchaser-Seller Rule.[109] And the court did this via a thorough analysis and sound rejection of *Frutarom*'s approach to standing.

The *Lucid* district court first commented as to the brevity of *Frutarom*'s reasoning, which focused primarily on two statements in *Blue Chip Stamps* to limit the Purchaser-Seller Rule.[110] Next, the court

107. *Compare* 2023 WL 325251, at *1-3 (discussing Lucid executive's alleged material misrepresentations and omissions, merger with SPAC, eventual disclosure of misrepresentations and omissions, and subsequent drop in post-merger Lucid share price), *with* 667 F. Supp. 3d at 73-75 (discussing CarLotz executive's alleged material misrepresentations and omissions, merger with SPAC, eventual disclosure of misrepresentations and omissions, and subsequent drop in post-merger CarLotz share price).

108. Specifically, Lucid's CEO stated in a TV interview that Lucid had already built a factory in Arizona, which was capable of producing 34,000 units, and appeared in a video done by CNBC stating that the Lucid Air (Lucid's concept electric vehicle) was launching in the spring of 2021. *Lucid*, 2023 WL 325251, at *2. Each appearance corresponded with a jump in the share price of CCIV, which was in merger negotiations with Lucid. *Id.* (noting jumps of 12.13% and 26.92%, respectively). In fact, "the Lucid factory was not functional, the Air was not fully designed, Lucid had already moved its production start date from spring of 2021 to October 2021, and had abandoned its plans to produce 6,000 units in 2021." *Id.* at *3. Public disclosures by post-merger Lucid revealed that Lucid would produce only 577 Airs in 2021, that the low price of the cars would result in a 91% reduction in expected revenue, that the Arizona factory was not built, and that production would not begin until, much less be completed by, the spring. *Id.* Understandably, these disclosures resulted in a hit to post-merger Lucid's share price, to the tune of 49.9%, a loss of approximately "$7.4 billion in market capitalization." *Id.*

109. *See CarLotz*, 667 F. Supp. 3d at 79 (addressing plaintiffs' concerns about the potential for pre-SPAC entities and executives to escape § 10(b) liability in private actions). In *Lucid*, the trial court had no difficulty finding that shareholders of a SPAC had standing to sue for statements relating to a pre-merger entity which the SPAC was taking public. 2023 WL 325251, at *8-9.

110. 2023 WL 325251, at *8 ("[*Frutarom*] asserts that *Blue Chip* requires that a plaintiff 'ha[s] bought or sold the security about which a misstatement was made in order to have standing to sue under Section 10(b).' The court provides little analysis to support this assertion but cites to the same two statements in *Blue Chip* upon which defendants rely." (citation omitted) (quoting Menora Mivatchim Ins. v. Frutarom Indus. Ltd., 54 F.4th 82, 86 (2022))). The first statement in *Blue Chip Stamps* is: "The virtue of the *Birnbaum* rule, simply stated, *in this situation*, is that it limits the class of plaintiffs to those who have at least dealt in the security to which the prospectus, representation, or omission relates." Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 747 (1975) (emphasis added). In response to the application of this language, the *Lucid* court stated: "Defendants ignore the Supreme Court's qualifying language, ('this situation'), in limiting the decision to the case and facts before it. Additionally, a representation or omission can 'relate' to more than one company, and the term is generally viewed quite broadly." 2023 WL 325251, at *6

reasoned that a plain-text reading of *Frutarom* would preclude liability for omissions, thereby vitiating scheme-liability precedents.[111] Finally, the *Lucid* court noted that, while judicially created private rights of action should be construed narrowly, they need not be unduly limited for narrowness' sake.[112] The Supreme Court, reasoned the California federal district court, has rejected limitations to the Section 10(b) private right of action before—and accordingly, the trial court in *Lucid* court rejected the Second Circuit's approach as overly restrictive. Recognizing that *Blue Chip Stamps* requires that a plaintiff must be a purchaser or seller of securities to pursue a Section 10(b) action, the court concluded that it did "not read *Blue Chip* to further require, as a standing requisite, that plaintiffs allege defendant made misrepresentations about the security plaintiffs purchased."[113]

(citation omitted). The second statement in *Blue Chip Stamps* is: Pursuant to the *Birnbaum* rule, standing under Section 10(b) is limited to "purchasers or sellers of the *stock in question*." 421 U.S. at 742 (emphasis added). In response, the court in *Lucid* reasoned: "Without explaining why, defendants assume that 'the stock in question' refers to the stock that is the subject of the alleged misrepresentation. However, the phrase is equally likely to mean the stock that is the subject of the plaintiff's claim." 2023 WL 325251, at *6 (quoting *Blue Chip Stamps*, 421 U.S. at 742).

111. *See Lucid*, 2023 WL 325251, at *8 (The *Frutarom* court "appears to require that plaintiffs plead a misstatement to have Section 10(b) standing. This conflicts with the Supreme Court's scheme-liability precedent, which allows for Rule 10[b-5](a) and (c) claims, in the absence of a misstatement." (citations omitted)). It would stand to reason that, regardless of whether *Frutarom* does in fact preclude omission liability—which it likely does not, given the Southern District of New York's consideration of omissions made by Alibaba above—proper construction of a rule designed to protect investors should avoid the appearance of foreclosing a key circumstance which could give rise to a cause of action under that rule. *See In re* Alibaba Grp. Holding Ltd. Sec. Litig., No. 20 CIV 9586 (GBD), 2023 WL 2601472, at *8-9 (S.D.N.Y. Mar. 22, 2023); *but see supra* notes 82-92 and accompanying text (considering, inter alia, potential liability for Alibaba's omissions regarding Ant, and applying *Frutarom*).

Ultimately, to the extent that *Frutarom* could be read as excluding omission, half-truth, or scheme liability, it is mistaken and contrary to Supreme Court precedent. *See, e.g.*, Lorenzo v. SEC, 139 S. Ct. 1094, 1100-01 (2019) ("[D]issemination of false or misleading statements with intent to defraud can fall within the scope of subsections (a) and (c) of Rule 10b-5, as well as the relevant statutory provisions. In our view, that is so even if the disseminator did not 'make' the statements and consequently falls outside subsection (b) of the Rule.") (addressing scheme-liability structure of § 10(b) and Rule 10b-5); Affiliated Ute Citizens v. United States, 406 U.S. 128, 153-54 (1972) (stating that where defendants were market makers, defendants "possessed the affirmative duty under the Rule to disclose this fact" to plaintiffs; that "sellers had the right to know that the defendants were in a position to gain financially from their sales and that their shares were selling for a higher price in that market"; and holding that liability exists under Rule 10b-5 for omissions where there is an affirmative duty to disclose a material fact).

112. 2023 WL 325251, at *9 (noting that "[n]arrow interpretation does not mean that *any* suggested limitation on the right of action should be adopted" (emphasis added)).

113. *See id.* at *6, *9 (citing Basic Inc. v. Levinson, 485 U.S. 224, 231-32, 247 (1988)) (rejecting limitations of the § 10(b) private right of action as to materiality of merger negotiations

The United States District Court for the Northern District of California was confronted with a similar standing question in *In re Robinhood Order Flow Litigation*.[114] There, the district court rejected defendant Robinhood's argument that, because the plaintiff purchased a security with respect to which Robinhood did not make a misstatement, he lacked standing to sue under Section 10(b) and Rule 10b-5.[115] As in *Lucid*, above,[116] the court rejected *Frutarom*'s reasoning and holding.[117] But unlike in *Lucid*, the plaintiff, as representative of the class, brought suit alleging that "he suffered tangible damages from securities he purchased and sold on Robinhood's platform."[118] In both cases, defendants argued that standing under Section 10(b) and Rule 10b-5 was improper and relied on *Frutarom*.[119] And in both cases, the district court rejected the Second Circuit's rationale and held that standing was proper.[120]

In re Mullen Auto Securities Litigation provides another example where a California federal district court rejected *Frutarom*'s holding and reasoning.[121] In that case, the court denied the defendants' motion to

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and broadening such right of action by establishing a "presumption of reliance" in plaintiffs' favor where the subject security traded in an efficient market).

114. *In re* Robinhood Ord. Flow Litig., No. 4:20-cv-9328-YGR, 2023 WL 4543574, at *1 (N.D. Cal. Jan. 18, 2023) (holding that plaintiff met *Blue Chip Stamps*' purchaser-seller requirement to bring suit under § 10(b)). In *Robinhood*, the district court attached to its opinion a copy of that judge's decision in *Lucid*. *See id.* at *2-13.

115. *Id.* at *1. Note that the defendants were Robinhood Financial LLC, Robinhood Securities, LLC, and Robinhood Markets, Inc.—collectively referred to by the court as Robinhood. *Id.*

116. *See supra* notes 105-113 and accompanying text.

117. *Robinhood*, 2023 WL 4543574, at *1.

118. *Id.*; *see* 17 C.F.R. § 240.10b-5 (prohibiting "directly or indirectly" fraudulent conduct "in connection with the purchase or sale of any security"). This argument is distinct in kind from that advanced by the plaintiffs in *Lucid*, where plaintiffs brought suit against post-merger Lucid and related parties, as opposed to the trading platform in *Robinhood* used to purchase and sell securities. Nonetheless, in both cases, the district court held that plaintiffs had standing to bring suit under Section 10(b) and Rule 10b-5. *Robinhood*, 2023 WL 4543574, at *1; *Lucid*, 2023 WL 325251, at *11 (both denying respective defendants' motion to dismiss as to standing); *see also* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 731, 751, 754 (1975) (stating that standing under § 10(b) and Rule 10b-5 is limited to plaintiffs who are actual purchasers and sellers).

119. *Robinhood*, 2023 WL 4543574, at *1; *Lucid*, 2023 WL 325251, at *7-8.

120. *Robinhood*, 2023 WL 4543574, at *1 ("Plaintiff alleges that he suffered tangible damages from securities he purchased and sold on Robinhood's platform. As such, the Court finds that plaintiff satisfies the purchaser-seller rule adopted in *Blue Chip*."); *Lucid*, 2023 WL 325251, at *7-8.

121. *In re* Mullen Auto. Sec. Litig., No. CV 22-3026-DMG (AGRx), 2023 WL 8125447, at *5-6 (C.D. Cal. Sept. 28, 2023).

dismiss for lack of standing where allegedly misleading statements were made by Mullen both before and after a reverse merger that took the company public.[122] There, a private electric vehicle startup (Mullen Technologies, Inc.) merged with a public online payment system (Net Element, Inc.)—both of which were struggling financially[123]—and the resulting public entity was named Mullen Automotive, Inc.[124] Plaintiffs alleged that defendants made a number of material misstatements regarding the merger, Mullen's manufacturing capacity, and the technical specifications of its EV batteries.[125] When these misstatements were

122. *Id.* at *6 (holding that standing is proper under § 10(b) and Rule 10b-5). Note that the situation of a reverse merger with a public company—in this case Net Element, Inc., a payment processing company—allowed Mullen Technologies, Inc. access to the public capital markets without subjecting it to the rigors of an IPO—a situation which, under *Frutarom*, may well have rendered the misstatements at issue not actionable. *Compare id.* at *1 ("By engaging in a 'reverse merger' with Net Element, Mullen Tech could backdoor its way into a public stock market listing without having to complete a traditional IPO") *with In re* CarLotz, Inc. Sec. Litig., 667 F. Supp. 3d 71, 78-79 (S.D.N.Y. 2023) (addressing plaintiffs' concerns that *Frutarom* had, inter alia, created a "loophole" for SPAC transactions, which (similarly to a reverse merger) allow for quick access to public markets, and that *Frutarom* may preclude standing for misstatements or omissions made by the private company or its representatives before the transaction was consummated), *and* Menora Mivtachim Ins. v. Frutarom Indus. Ltd., 54 F.4th 82, 88 (2d Cir. 2022) (requiring plaintiffs to be actual purchasers or sellers of the security about which a misstatement was made to have standing in a § 10(b) and Rule 10b-5 private cause of action, and therefore holding that misstatements by a pre-merger company whose securities plaintiffs did not own were not actionable).

123. *Mullen Auto*., 2023 WL 8125447, at *1 (describing Net Element as a "struggling" company and noting that Mullen Technologies had realized no revenue and operated at a net loss from September 30, 2019, to March 31, 2022). Further, Mullen relied largely on equity offerings to raise funds due to a lack of either revenue or cash flows. *Id.* at *3.

124. *Id.* (describing parties to the case and the reverse merger between Mullen Tech and Net Element).

125. Similarly to *Frutarom*, where IFF incorporated Frutarom's misstatements into its public disclosures, here Net Element utilized information provided by Mullen Tech in a press release announcing the merger. *Compare id.* at *2 (comparing the statements made in the press release) *with Frutarom*, 54 F.4th at 84 (reviewing what was included in IFF's S-4). The misstatements at issue in *Mullen* concerned the production and capacity of its EV batteries, production capability and timeline of its EVs, material contracts with a dispensary for over 1,000 vehicles, and more. 2023 WL 8125447, at *3-4. Corrective disclosures regarding these misstatements impacted both Net Element's share price pre-merger, as well as Mullen Automotive's price post-merger. *See id.* For example, when Mullen Technologies disclosed that it would be importing, assembling, and rebranding vehicles from a Chinese EV manufacturer, the share price of Net Element dropped by 7.4%. *Id.* Mullen's errors culminated in an aptly-titled report by Hindenburg Research LLC: "Mullen Automotive: Yet Another Fast Talking EV Hustle," which prompted further disclosures by then-public Mullen Automotive and resulted in further price corrections. *Id.* at *4 ("Mullen Auto's stock price fell by 2.6% and then by 10.2% over the next two days . . . .").

revealed and corrective disclosures were made, Net Element/Mullen Automotive shares underwent several pricing corrections, totaling an eighty-eight percent loss from the date of Mullen Tech's merger with Net Element.[126]

The defendants in *Mullen* argued that the lead plaintiff lacked standing as to the misstatements and omissions made by Mullen Technologies before its merger with Net Element, relying heavily on *Frutarom*'s construction of the Purchaser-Seller Rule.[127] Drawing on *Lucid*, the *Mullen* court found both *Frutarom*'s and *Nortel*'s "extrapolations from *Blue Chip* unpersuasive"[128] and held that standing was proper.[129]

In the wake of the Second Circuit's *Frutarom* decision, a line of cases developed that explicitly rejected its reasoning as unpersuasive and unduly restrictive.[130] This approach, exemplified in the district court cases above, maintained the position that the concerns expressed by the Supreme Court in *Blue Chip Stamps* are absent in many cases.[131] Rather, the preferred view, as expressed by these district courts, was that Section 10(b) standing should be conferred in situations where a plaintiff has purchased or sold securities, has identified specific alleged

126. *Mullen Auto*., 2023 WL 8125447, at *4.

127. *Id.* at *4-5 (distinguishing the case at bar from both *Blue Chip Stamps* and *Frutarom*, since *Blue Chip Stamps* addressed liability where there was *inaction* by plaintiff, and *Frutarom*'s construction of the Purchaser-Seller rule had not been adopted in the Ninth Circuit). The *Mullen* court, discussing the incompatibility of the Second Circuit's restrictive Purchaser-Seller Rule to cases brought in the Ninth Circuit, bluntly noted that: "Defendants fail to point to any Ninth Circuit authority—let alone a generally settled rule—barring a purchaser from bringing suit based on material misstatements made by a corporate predecessor to the company whose securities the plaintiffs acquired." *Id.* at *5.

128. *Id.* at *6. The court examined the applicability of the *Birnbaum* rule as articulated in *Blue Chip Stamps*, and noted that "[t]his case, however, does not concern abstention from purchasing and does not fit within the rule articulated by *Blue Chip* or raise the same concerns regarding the speculative nature of a claim of abstention from purchase." *Id.* at *5.

129. *Id.* at *6 (criticizing *Frutarom* and stating that "although simple to apply, the rule in the Second Circuit failed to ensure 'confidence in the markets,' ignored that the Supreme Court has also rejected limitations on the Section 10(b) right of action in some circumstances, and overlooked that limiting standing in such a manner would be redundant with Section 10(b)'s materiality analysis." (first citing *In re* CCIV/Lucid Motors Sec. Litig., No. 4:21-cv-09323-YGR, 2023 WL 325251, at *9-10 (N.D. Cal. Jan. 11, 2023), *aff'd on other grounds*, 110 F.4th 1181 (9th Cir. 2024); and then citing *In re* Robinhood Ord. Flow Litig., No. 4:20-cv-9328-YGR, 2023 WL 4543574, at *1 (N.D. Cal. Jan. 18, 2023))).

130. *See supra* notes 105-129 and accompanying text.

131. *See, e.g*., *Lucid*, 2023 WL 325251, at *9 ("*Blue Chip* focused on the unique problem that arises when a plaintiff's claim is based on *inaction* and when it is likely that oral testimony will be the primary, or only, evidence. That problem does not exist here . . . .").

misstatement(s) or omission(s), and the alleged loss is discernible.[132] However, the Ninth Circuit had yet to speak on the issue.

D. The Ninth Circuit Adopts Frutarom*'s Standing Rule*

In August of 2024, a Ninth Circuit panel considered the question of Section 10(b) standing and summarily adopted the Second Circuit's holding in *Frutarom*.[133] Accordingly, in the two circuits that have considered the Purchaser-Seller Rule since *Frutarom*, a Section 10(b) claim may be brought only by a plaintiff who purchased the specific securities of the company about which a misstatement was made.[134] This subpart addresses several shortcomings of the Ninth Circuit's recent opinion in *Lucid*.

Most significantly, the Ninth Circuit misconstrued applicable law to defend the Second Circuit's narrow construction of the Purchaser-Seller Rule. *Frutarom*, the panel opined, "reaffirmed *Blue Chip*'s bright-line rule: that standing depends on 'whether the plaintiff bought or sold the securities about which the misstatements were made.'"[135] But that's wrong. *Blue Chip Stamps* never mandated that plaintiffs purchase the specific securities about which a misstatement was made—in actuality, the Supreme Court in *Blue Chip Stamps* held only that a Section 10(b)

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132. *See, e.g.*, *id.*; *see also* Zelman v. JDS Uniphase Corp., 376 F. Supp. 2d 956, 962 (N.D. Cal. 2005) (Decided prior to *Frutarom*, the district court declined to apply *Nortel* "because the Second Circuit's rationale in that decision is problematic . . . [and] the conclusion reached in *Nortel* is not compelled by *Blue Chip Stamps*.").

133. *See Lucid*, 110 F.4th at 1185 ("[T]he district court considered and expressly rejected the reasoning of the Second Circuit, noting that the Ninth Circuit had not yet spoken on the limits of Section 10(b) standing. We now address that issue and agree with the Second Circuit that the *Birnbaum* Rule and *Blue Chip* limit Section 10(b) standing to purchasers and sellers of the security about which the alleged misrepresentations were made."). As with the *Frutarom* decision, the opinion of the appellate court in *Lucid* is remarkable for its brevity given the importance of the issue. Instead, the Ninth Circuit largely relies on the reasoning of the Second Circuit, which is addressed *infra* notes 148-190 and accompanying text.

134. *See* Ann Lipton, *Ninth Circuit Follows* Frutarom, BUS. L. PROFESSORS BLOG (Aug. 9, 2024), https://lawprofessors.typepad.com/business_law/2024/08/ninth-circuit-follows-frutarom.html; Nicole Banas, *9th Circuit Nixes SPAC Investors' Standing in Lucid Motors Suit*, WESTLAW SEC. ENF'T & LITIG. DAILY BRIEFING (Aug. 13, 2024), 2024 SECDBRF 0158, https://next.westlaw.com/Document/Ia21c2825599811ef9a5f906d9a270520/View/FullTe't.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default).

135. *Lucid*, 110 F.4th at 1185 (quoting Menora Mivtachim Ins. v. Frutarom Indus. Ltd., 54 F.4th 82, 88 (2d Cir. 2022)). Notably, the panel does not cite *Blue Chip Stamps* in support of the "bright-line rule" that it states was compelled by that case. The reason for this omission appears quite clear—this is *Frutarom*'s rule, not *Blue Chip Stamps*'s rule. *See infra* notes 136-144 and accompanying text.

private damages action is limited to actual purchasers or sellers of securities.[136] The Court's holding was intended to foreclose suits by non-transacting plaintiffs, not to bar injured purchasers or sellers merely because they did not transact in a specific security.[137]

In defense of its position, the panel argued correctly that the *Birnbaum* rule as adopted by the Supreme Court limits standing to purchasers or sellers of the "stock in question."[138] But it incorrectly ascribes to the Court the holding "that a plaintiff must demonstrate he purchased or sold 'the securities described in the allegedly misleading prospectus' and must allege that he was misled by 'the representations contained in' 'a prospectus of the issuer.'"[139] These quotes, put simply, are taken out of context,[140] and do not, as the *Lucid* panel asserts, define "stock in question" as "the security about which the alleged misrepresentations were made."[141]

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136. *See* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 731, 737-55 (1975) ("For the reasons hereinafter stated, we are of the opinion that *Birnbaum* was rightly decided, and that it bars respondent from maintaining this suit under Rule 10b-5.").

137. *Id.* at 747 ("In the absence of the *Birnbaum* doctrine, bystanders to the securities marketing process could await developments on the sidelines without risk, claiming that inaccuracies in disclosure caused nonselling in a falling market and that unduly pessimistic predictions by the issuer followed by a rising market caused them to allow retrospectively golden opportunities to pass.").

138. *Lucid*, 110 F.4th at 1185 (quoting *Blue Chip Stamps*, 421 U.S. at 742).

139. *Id.* at 1186 (quoting *Blue Chip Stamps*, 421 U.S. at 727, 746).

140. Full quotations and context follow:

The first quoted portion of *Blue Chip Stamps* describes the narrow issue before the court, which cabins the question presented to the specific context of whether a non-transacting plaintiff meets the standing requirements of Section 10(b): "The only portion of the litigation thus initiated which is before us is whether respondent may base its action on Rule 10b-5 of the Securities and Exchange Commission without having either bought or sold *the securities described in the allegedly misleading prospectus*." 421 U.S. at 727 (emphasis added for the portion quoted by the *Lucid* panel). The Court here does not speak to the definition of "stock in question."

The next quoted portions stem from the same passage, reproduced here in full, which describes practical considerations undergirding the limits of the *Birnbaum* rule:

> The very real risk in permitting those in respondent's position to sue under Rule 10b-5 is that the door will be open to recovery of substantial damages on the part of one who offers only his own testimony to prove that he ever consulted *a prospectus of the issuer*, that he paid any attention to it, or that *the representations contained in it* damaged him.

Id. at 746 (emphasis added for portions misused by the Ninth Circuit) (describing concerns about bystander suits under Section 10(b)). Neither does this passage supply the support that the *Lucid* panel supposed.

141. *Compare Lucid*, 110 F.4th at 1186, *with Blue Chip Stamps*, 421 U.S. at 747 (permitting Section 10(b) standing where alleged misrepresentations or omissions relate to the security purchased or sold by plaintiffs) ("The virtue of the *Birnbaum* rule, simply stated, in this situation,

Moreover, the panel opined that the "plain language of *Blue Chip*" foreclosed plaintiff's desired formulation of the Purchaser-Seller Rule, characterized by the court as follows: "hypothetical plaintiffs would need only to have purchased a security—*any* security—to satisfy the purchaser-seller requirement."[142] But this formulation of the rule is consistent with *Blue Chip Stamps*, which limited standing in private Section 10(b) claims to actual purchasers and sellers.[143] Indeed, far from being foreclosed, such a construction of the Purchaser-Seller Rule adheres to language employed by the Supreme Court in a later case: namely, that "a § 10(b) action can be brought by a purchaser or seller of '*any* security' against '*any* person' who has used '*any* manipulative or deceptive device or contrivance' in connection with the purchase or sale of a security."[144]

Additionally, while extolling the virtues of the "bright-line rule" that it adopted, the court acknowledged that it was inherently arbitrary and reflected a clear policy choice.[145] Further, the appellate panel in *Lucid* expressly acknowledged the existence of the SPAC loophole left open by the holding in *Frutarom*.[146] In spite of this glaring deficiency, the panel deferred to the construction of the Second Circuit, arguing that the policy of judicial economy necessitated this significant restriction of the standing inquiry and warranted foreclosure of the Section 10(b) remedy to an entire class of securities.[147]

Ultimately, by joining the Second Circuit on the issue of Section 10(b) standing, the Ninth Circuit avoided a circuit split for the time being—but at the cost of adopting as precedent a rule that lacks a sufficient legal foundation and that, in practice, gives rise to unacceptable results.

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is that it limits the class of plaintiffs to those who have at least dealt in the security to which the prospectus, representation, or omission relates.").

142. *Lucid*, 110 F.4th at 1186.

143. 421 U.S. at 723.

144. Herman & MacLean v. Huddleston, 459 U.S. 375, 382 (1983) (quoting Securities Exchange Act § 10(b), 15 U.S.C. § 78j(b)).

145. *See Lucid*, 110 F.4th at 1186 (arguing in favor of *Frutarom*'s reading of *Blue Chip Stamps* that "[t]he Supreme Court adopted a bright-line rule for standing—even at the risk of it being 'arbitrary' in some cases").

146. *Id.* at 1187 ("Although there are exceptions to the *Birnbaum* Rule, there is no recognized exception for transactions involving SPACs.").

147. *See id.* at 1186-87 (deferring to the Second Circuit's construction of the Purchaser-Seller Rule).

VI. THE NEED FOR A BALANCED APPROACH TO SECTION 10(B) STANDING

This Part addresses deficiencies in *Frutarom*'s reasoning and problems with the Second Circuit's unduly restrictive construction of Section 10(b)'s standing requirements. Next, recommendations for an alternative approach to standing are provided, as well as the practical application of such recommendations to *Frutarom*, *CarLotz*, and similar cases.

A. Faults in Frutarom*'s Reasoning and Problems in Application*

1. The Second Circuit's Restrictive Approach Creates a New Statutory Standing Requirement

A primary issue with the *Frutarom* court's construction of the Purchaser-Seller Rule is that it adds an additional element to the traditional standing requirements for a private cause of action under Section 10(b) and Rule 10b-5[148]—namely, that a plaintiff must "purchase [or sell] the securities about which misstatements [or omissions] were made."[149] This additional hurdle was not contemplated by Section 10(b) and is inconsistent with prior construction of the Purchaser-Seller Rule by the Supreme Court.[150] While the standing question precedes judicial analysis of whether the alleged misstatements or omissions were "in connection with" the purchase or sale at issue, the "in connection with"

148. *Blue Chip Stamps*, 421 U.S. at 723 ("A private damages action under Rule 10b-5 is confined to actual purchasers or sellers of securities."); Birnbaum v. Newport Steel Corp., 193 F.2d 461, 463 (2d Cir. 1952) (stating that a private plaintiff must be an actual purchaser or seller of securities for standing to be proper under § 10(b)). *See* Brief for Amici Curiae Securities Law Scholars in Support of Plaintiffs-Appellants at 1-6, Menora Mivtachim Ins. v. Frutarom Indus. Ltd., 54 F.4th 82 (2022) (No. 21-1076-cv) (arguing that standing was proper for the *Frutarom* plaintiffs and seeking en banc review of the Second Circuit panel's ruling).

149. *Frutarom*, 54 F.4th at 89.

150. Traditionally, the only question posed in the Purchaser-Seller Rule's test for standing is simply whether the plaintiff or plaintiffs were actual purchasers or sellers of securities; inaction by a putative plaintiff was not actionable under Section 10(b). *See, e.g.*, *Blue Chip Stamps*, 421 U.S. at 723. By holding that standing is proper only where (1) a plaintiff was an actual purchaser or seller (2) of the company's securities (3) about which the alleged misstatement was made, the *Frutarom* court unduly added two novel requirements to the traditional test for standing in a Section 10(b) private right of action, contrary to *Birnbaum*. *Compare* 193 F.2d at 463 ("[Rule 10b-5 is] aimed only at 'a fraud perpetrated upon the purchaser or seller' of securities . . . ." (quoting Birnbaum v. Newport Steel Corp., 98 F. Supp. 506, 508 (S.D.N.Y. 1951))) *with* 54 F.4th at 84 (holding that a plaintiff must have been a purchaser or seller of the securities of the company about which a misstatement was made in order to confer standing under § 10(b)).

requirement has been broadly construed by the Supreme Court.[151] These two considerations, while separate, are similar enough that an inclusive analysis of the "in connection with" requirement should inform a proportionate analysis of the status of plaintiffs as purchasers or sellers.[152]

While *Frutarom* espoused the policy of limitation by the courts when addressing a judicially created private right of action, the Second Circuit missed the mark by creating new law.[153] There is a cogent argument that rigid application of this policy, far from weighing in favor of a restrictive Purchaser-Seller Rule, in fact weighs against it. While a judicially implied private right of action should be construed narrowly,[154] once it has been established, it should be modified with prudence.[155] Such

151. *See, e.g.*, Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit, 547 U.S. 71, 85 (2006) (first citing SEC v. Zandford, 535 U.S. 813, 820, 822 (2002); and then citing Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6 (1971)) (stating that when the Court has sought "to give meaning to the phrase ['in connection with'] in the context of § 10(b) and Rule 10b-5, it has espoused a broad interpretation"); *see also* SEC v. Tex. Gulf Sulphur Co., 401 F.2d 833, 860 (2d Cir. 1968) (en banc) ("[I]t seems clear from the legislative purpose Congress expressed in the Act, and the legislative history of Section 10(b) that Congress when it used the phrase 'in connection with the purchase or sale of any security' intended only that the device employed, whatever it might be, be of a sort that would cause reasonable investors to rely thereon, and, in connection therewith, so relying, cause them to purchase or sell a corporation's securities."). While the "in connection with" requirement is a separate element from the standing inquiry, the court in *Blue Chip Stamps* used that language to inform its policy determinations as to the class of plaintiffs that may sue under Section 10(b) and Rule 10b-5. *See* 421 U.S. at 733-34.

152. Chadbourne & Parke LLP v. Troice, 571 U.S. 377, 393 (2014) (citing for authority five Supreme Court decisions interpreting § 10(b)) (stating that, when ascertaining whether a purchase or sale was "in connection with" the allegedly actionable conduct under § 10(b), previous Supreme Court decisions "concerned a false statement (or the like) that was 'material' to another individual's decision to 'purchase or s[ell]' a statutorily defined 'security' or 'covered security'" (alteration in original)); *see* sources cited *supra* note 151.

153. *See* 54 F.4th at 89 (Pérez, J., concurring) (stating that the majority in *Frutarom* "created new law").

154. Alexander v. Sandoval, 532 U.S. 275, 287 (2001) ("Raising up causes of action where a statute has not created them may be a proper function for common-law courts, but not for federal tribunals." (quoting Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. 350, 365 (1991) (Scalia, J., concurring in part and concurring in the judgment))); *see In re* CCIV/Lucid Motors Sec. Litig., Case No. 4:21-cv-09323-YGR, 2023 WL 325251, at *9 (N.D. Cal. Jan. 11, 2023), *aff'd on other grounds*, 110 F.4th 1181 (9th Cir. 2024) (acknowledging the need to interpret judicially created private rights of action narrowly but noting that "[n]arrow interpretation does not mean that *any* suggested limitation on the right of action should be adopted." (emphasis added)); *accord* Brief for Amici Curiae Securities Law Scholars in Support of Plaintiffs-Appellants, *supra* note 148, at 5.

155. *Lucid*, 2023 WL 325251, at *9; *accord* Brief for Amici Curiae Securities Law Scholars in Support of Plaintiffs-Appellants, *supra* note 148, at 5 ("Although the panel invoked principles of judicial restraint to narrow an implied right of action, it betrayed those principles by adding requirements not authorized by the text of §10(b) or Rule 10b-5.").

restraint serves to buttress both commercial certainty and judicial economy.[156]

Further, other elements of the Section 10(b) cause of action, such as materiality,[157] loss causation,[158] and heightened pleading requirements[159] already serve to limit the universe of potential plaintiffs, rendering the Second Circuit's more restrictive standing requirement unwarranted.[160]

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156. *See* Marc I. Steinberg, *Implied Private Rights of Action Under Federal Law*, 55 NOTRE DAME LAW. 33, 47-48 (1979) (addressing propriety of judicial restraint with respect to implied rights of action in specified situations); *see also id.* at 52 ("Judicial implication of private rights of action under federal law raises fundamental issues underlying the relationship between the federal judiciary and Congress on one hand, and, to a lesser extent, between the federal government and the States.").

157. *See, e.g.*, Matrixx Initiatives, Inc. v. Siracusano, 563 U.S. 27, 38 (2011); Basic Inc. v. Levinson, 485 U.S. 224, 232 (1988); TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976). Pursuant to these cases, the materiality standard is met under Section 10(b) if the plaintiff can prove that the disclosure deficiency, if accurately disclosed, would have been considered important to a reasonable investor. Stated differently, to meet the materiality requirement, there must be "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available." *Matrixx*, 563 U.S. at 38 (quoting *Basic*, 485 U.S. at 231-232).

158. *See* Securities Exchange Act § 21D(b)(4), 15 U.S.C. § 78u-4(b)(4) (requiring that a plaintiff in an action for damages under the Securities Exchange Act establish causation between the defendant's misconduct and such plaintiff's financial loss); Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 346 (2005) (holding that private plaintiffs in a § 10(b) action for damages must "allege and prove the traditional elements of causation and loss"); Ohio Pub. Emps. Retirement Sys. v. Fed. Home Loan Mortg. Corp., 830 F.3d 376, 384 (6th Cir. 2016) ("Loss causation is the causal link between the alleged misconduct and the economic harm ultimately suffered by the plaintiff." (quoting Lentell v. Merrill Lynch & Co. 396 F.3d 161, 172 (2d Cir. 2005))); *see also* Richard Booth, *Loss Causation and the Materialization of Risk Doctrine in Securities Fraud Class Actions*, 75 BUS. LAW. 1791 (2020); Merritt B. Fox, *Understanding* Dura, 60 BUS. LAW. 1547 (2005).

159. *See* Securities Exchange Act § 21D(b)(2), 15 U.S.C. § 78u-4(b)(2) (stating, in part, that a plaintiff must "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind"); Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 324 (2007) ("A complaint [alleging violation of § 10(b)] will survive, we hold, only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged."); STEINBERG, UNDERSTANDING SECURITIES LAW, *supra* note 3, at 328 ("Pursuant to the Private Securities Litigation Reform Act of 1995 . . . Section 21(D)(b) of the Securities Exchange Act generally requires that a plaintiff: must specifically plead each alleged misrepresentation or nondisclosure and why such is misleading; and must allege specific facts as to each such disclosure deficiency supporting a 'strong inference' that the subject defendant knew that the misstatement or omission was false.").

160. For a critical analysis of private rights of actions (as well as many other important issues) under the federal securities laws, see MARC I. STEINBERG, RETHINKING SECURITIES LAW 163-209, 311-15 (2021) (awarded winner best law book of 2021 by American Book Fest).

2. Restrictive Approaches to Section 10(b) Standing Unduly Exclude Entire Classes of Securities

A restrictive construction of the Purchaser-Seller Rule, as in *Frutarom*, excludes wide varieties of securities transactions from adjudication under Section 10(b) and Rule 10b-5.[161] The approach to standing articulated in *Frutarom* requires plaintiffs to have purchased or sold securities of the enterprise about which a misstatement was made.[162] This holding is problematic, especially in light of the fact that many classes of securities and securities transactions may not involve purchases or sales of the shares of the specific company about which a disclosure violation occurred. Assuming that the Second and Ninth Circuits strictly follow *Frutarom*'s language and holding, among the categories of securities and transactions that may be precluded by *Frutarom*'s overly restrictive standing requirements are SPACs[163] and American Depository Shares.[164] And, as was the situation in *Frutarom*, purchasers and sellers of

161. *See supra* notes 82-102 and accompanying text (addressing application of the overly restrictive *Frutarom* rule to bar standing in the Second Circuit); *see also* Brief for Amici Curiae Securities Law Scholars in Support of Plaintiffs-Appellants, *supra* note 148, at 5 (arguing that additional standing elements were added in error).

162. Menora Mivtachim Ins. v. Frutarom Indus. Ltd., 54 F.4th 82, 88 (2d Cir. 2022).

163. *See id.*; *see generally Special Purpose Acquisition Company (SPAC)*, CORP. FIN. INST., https://corporatefinanceinstitute.com/resources/management/special-purpose-acquisition-company-spac/ [https://perma.cc/FC94-EMT7] (last visited Oct. 30, 2024) (describing SPACs as entities formed for the sole purpose of raising capital through an IPO). Once the panel's holding in *Frutarom* was articulated, a group of securities law professors expressed concerns that such a restrictive construction of the Purchaser-Seller Rule would entirely preclude standing for SPAC shareholders if their acquisition target made a disclosure violation which would otherwise be actionable under Section 10(b). Brief for Amici Curiae Securities Law Scholars in Support of Plaintiffs-Appellants, *supra* note 148, at 5. Their concerns appear to have been justified. *See In re* CarLotz, Inc. Sec. Litig., 667 F. Supp. 3d 71, 76 (S.D.N.Y 2023); *In re* CCIV/Lucid Motors Sec. Litig., 110 F.4th 1181, 1187 (9th Cir. 2024).

164. Since American Depository Shares are distinct from the securities of the foreign entity to which they are connected, a restrictive construction of the Purchaser-Seller Rule may preclude buyers or sellers of ADS from seeking remedies under Section 10(b). *See Frutarom*, 54 F.4th at 88; *see generally American Depositary Shares (ADS)*, CORP. FIN. INST., https://corporatefinance institute.com/resources/equities/american-depositary-shares-ads/ [https://perma.cc/NT4U-MEF N] (last visited Oct. 30, 2024) (discussing ADS and their structure). As is the case with SPACs, *Frutarom* has already been applied in the Second Circuit to preclude Section 10(b) claims by ADS holders. *See In re* Alibaba Grp. Holding Ltd. Sec. Litig., No. 20 Civ. 9568 (GBD), 2023 WL 2601472, at *5 (S.D.N.Y. Mar. 22, 2023) (holding that standing was improper for purchaser of Alibaba ADS under *Frutarom*). Indeed, taken at face value with a restrictive interpretation, *Frutarom*'s holding could be extended to exclude options and other derivatives in situations where a plaintiff did not buy or sell the security about which the alleged disclosure deficiency was made (namely, the security of the company upon which the option or derivative was based). The

securities in certain mergers and acquisitions may be precluded from bringing a Section 10(b) cause of action,[165] including in SPAC mergers—as evidenced by the SPAC "loophole" discussed above in *CarLotz*.[166] Removing wide swaths of market participants, who themselves purchased or sold securities, from the protections of Section 10(b) is an unacceptable ramification for the sake of judicial economy and simplicity of application.[167]

3. Plaintiffs Denied Standing Due to a Restrictive Purchaser-Seller Rule May Be Left Without Recourse

The Second and Ninth Circuits demonstrably have left plaintiffs in these circuits without judicial redress, even where injury is adequately alleged. For example, the *Frutarom* plaintiffs, and those like them, have little, if any, recourse where these restrictions on standing are applied.[168] While plaintiffs barred by *Frutarom*'s construction of the Purchaser-Seller Rule could potentially seek remedy through a derivative or double derivative suit,[169] this avenue likely will be time- and cost-intensive, and depending on applicable state law and how the entities at issue have structured their corporate leadership and governing documents, chances of success ordinarily are slim.[170]

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adoption of such an approach would be detrimental to the integrity of the U.S. securities markets and investor protection.

165. *See Frutarom*, 54 F.4th at 88 (holding that purchasers of an acquiror's shares in a merger lacked standing under § 10(b) where the target company made misrepresentations that were incorporated by reference into the acquiror's public disclosures).

166. 667 F. Supp. 3d at 79; *see supra* notes 94-96 and accompanying text.

167. *See* Brief for Amici Curiae Securities Law Scholars in Support of Plaintiffs-Appellants, *supra* note 148, at 10-11 ("Up to now, federal securities law has been flexible enough to accommodate the economic reality of these transactions and protect their participants from fraud. The panel's new rule withdrawing that protection would upset pervasive and settled expectations, with no-doubt-unintended consequences for securities markets that are hard to predict.").

168. *See supra* notes 82-102 and accompanying text (discussing district court holdings within the Second Circuit that left purchasers of ADS and pre-merger SPAC shares without remedy in private actions under § 10(b) pursuant to *Frutarom*'s construction of the Purchaser-Seller Rule).

169. *See* 13 FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS § 5977, Westlaw (database updated Sept. 2023) ("A double derivative suit is based upon injury suffered indirectly by a parent corporation, in which a plaintiff-shareholder does have an interest, as a result of injury to the subsidiary. A fundamental requirement of a double derivative suit is that injury to the subsidiary must also cause injury to the corporate parent in which the plaintiff-shareholder holds stock.").

170. Jenness E. Parker & Elisa M. Klein, *In the Name of the Company: When Stockholders Interfere in the Boardroom*, SKADDEN (June 1, 2022), https://www.skadden.com/insights/publications/2022/06/the-informed-board/in-the-name-of-the-company-when-stockholders-

As a general principle, in a derivative action, demand on the board of directors normally must be made by a plaintiff-shareholder.[171] Typically, after conducting an adequate inquiry, the subject corporation's independent directors (who comprise the special litigation committee) determine that the derivative suit is not in the company's best interests.[172] Thereupon, dismissal of the litigation typically ensues with the court applying the broad parameters of the business judgment rule.[173] Hence,

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interfere [https://perma.cc/E875-HXMQ] (addressing demand requirements for derivative actions, and noting that Delaware law, for example, allows for the adoption of bylaws which can limit acceptable fora for derivative suits, and that companies may request a stay of derivative actions pending resolution of any underlying class actions).

171. Approximately twenty states adhere to universal demand. Joel F. Houston, Chen Lin & Wensi Xie, *Shareholder Protection and the Cost of Capital*, 61 J.L. & ECON. 677 (2018). In these states, demand on the board of directors is required unless irreparable harm will be incurred by the subject company. *See, e.g.*, ARIZ. REV. STAT. ANN. § 10-742 (1996); CONN. GEN. STAT. ANN. § 33-722 (West 2011); FLA. STAT. ANN. § 607.0742 (West 2020); N.C. GEN. STAT. ANN. §§ 55-7-42 (West 1995); TEX. BUS. ORGS. CODE ANN. § 21.553 (West 2019); VA. CODE ANN. § 13.1-672.1 (West 2019). With respect to enterprises incorporated in Delaware, demand on the board of directors must be made unless the plaintiff-shareholder shows that such demand is futile. *See, e.g.*, United Food & Com. Workers Union v. Zuckerberg, 262 A.3d 1034, 1040 (Del. 2021); Aronson v. Lewis, 473 A.2d 805 (Del. 1984). In many situations, this burden is challenging, if not nearly insurmountable, for derivative suit plaintiffs.

172. *See, e.g.*, James D. Cox, *Searching for the Corporation's Voice in Derivative Suit Litigation: A Critique of* Zapata *and the ALI Project*, 1982 DUKE L.J. 959, 963 (commenting that "in all but one [case] the [special litigation] committee concluded that the [derivative] suit in question was not in the corporation's best interests"); Daniel J. Morrissey, *The Path of Corporate Law: Of Options Backdating, Derivative Suits, and the Business Judgment Rule*, 86 OR. L. REV. 973, 1003 (2007) (stating that special litigation committees "almost always recommend its dismissal"); Charles W. Murdock, *Corporate Governance—The Role of Special Litigation Committees*, 68 WASH. L. REV. 79, 84 (1993) (asserting that "[i]nvariably the [special litigation] committee moves to dismiss the [derivative] litigation").

173. For example, in those states that require universal demand, *see supra* note 171, a court is required to grant dismissal if it concludes that the independent directors (or special litigation committee comprised of independent directors) have determined "in good faith, after conducting a reasonable inquiry upon which its conclusions are based, that the maintenance of the derivative proceeding is not in the best interests of the corporation." MODEL BUSINESS CORPORATION ACT § 7.44(a) (Am. Bar Ass'n 2024) (adopted in many states). Similarly, even with respect to those states that have not enacted this statute, the business judgment rule ordinarily is applied to the independent directors' determination that the derivative suit should be dismissed. *See, e.g.*, Boland v. Boland, 31 A.3d 529 (Md. 2011); *see also* Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1981) (applying the business judgment rule in demand-required cases); Auerbach v. Bennett, 393 N.E.2d 994 (N.Y. 1979); Desaigoudar v. Meyercord, 133 Cal. Rptr. 2d 408 (Cal. Ct. App. 2003).

The business judgment rule is a bedrock principle of corporate law. Stated generally, the rule "is a presumption that directors act in good faith, on an informed basis, honestly believing that their action is in the best interests of the company." Stanziale v. Nachtomi (*In re* Tower Air, Inc.), 416 F.3d 229, 238 (3d Cir. 2005) (interpreting Delaware law). The standard for rebutting the business judgment rule is gross negligence. *See* Smith v. Van Gorkom, 488 A.2d 858, 873 (Del.

even if the subject corporation has purchased or sold its securities and therefore a derivative action on its behalf can be initiated by an aggrieved shareholder, dismissal of the litigation is the likely outcome with the prospect of a meaningful recovery being minimal.[174]

The Private Securities Litigation Reform Act (PSLRA)[175] and Securities Litigation Uniform Standards Act (SLUSA)[176] place further limits on the potential alternate remedies for plaintiffs barred by the Second Circuit's Purchaser-Seller Rule. With its stay of discovery and heightened pleading requirements, the PSLRA presents a continual challenge to securities plaintiffs.[177] More problematic in this setting is SLUSA, which, with specified carve-outs, requires that securities class actions involving nationally traded securities must be brought in federal court with only federal law applying.[178] Pursuant to the Supreme Court's

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1985). This standard of culpability is challenging for plaintiffs to prove. *See, e.g.*, *In re* McDonald's Corp. S'holder Derivative Litig., 291 A.3d 652, 690 n.21 (Del. Ch. 2023) ("To hold a director liable for gross negligence requires conduct more serious than what is necessary to secure a conviction for criminal negligence."); Tomczak v. Morton Thiokol, Inc., Civ. A. No. 7861, 1990 WL 42607, at *12 (Del. Ch. 1990) ("In the corporate context, gross negligence means 'reckless indifference to or a deliberate disregard of the whole body of stockholders' or actions which are 'without the bounds of reason.'" (first quoting Allaun v. Consol. Oil Co., 147 A. 257, 261 (Del. Ch. 1929); and then quoting Gimbel v. Signal Cos., 316 A.2d 599, 615 (Del. Ch. 1974))).

174. *See* Cox, *supra* note 172, at 963.

175. Securities Exchange Act § 21D, 15 U.S.C. § 78u-4. The PSLRA imposes significant additional hurdles for class actions under Section 10(b), including a stay of discovery pending a motion to dismiss, sanctions for frivolous litigation, a safe harbor for forward-looking statements by Exchange Act companies, and heightened pleading requirements. *See id.*; STEINBERG, UNDERSTANDING SECURITIES LAW, *supra* note 3, at 372-76.

176. *See* Securities Exchange Act § 28, 15 U.S.C. § 78bb. *See* Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit, 547 U.S. 71, 78 (2006). SLUSA requires removal of nearly all securities fraud class actions, such as the claims at issue in this Article, to federal court. Securities Exchange Act § 28(f)(2), 15 U.S.C. § 78bb(f)(2) ("Any covered class action brought in any State court involving a covered security, as set forth in paragraph (1), shall be removable to the Federal district court for the district in which the action is pending, and shall be subject to paragraph (1).").

177. Pursuant to Securities Exchange Act § 21D(b)(3)(B), 15 U.S.C. § 78u-4(b)(3)(B), added by the PSLRA, all discovery in private actions "shall be stayed during the pendency of any motion to dismiss, unless the court finds upon the motion of any party that particularized discovery is necessary to preserve evidence or to prevent undue prejudice to that party." With respect to the PSLRA's heightened pleading requirements, see *supra* note 159 and accompanying text.

178. *See* Securities Exchange Act § 28, 15 U.S.C. § 78bb. SLUSA's language was drafted to apply to Section 10(b) actions. *See* Securities Exchange Act § 28(f)(2), 15 U.S.C. § 78bb(f)(1) ("No covered class action based upon the statutory or common law of any State or subdivision thereof may be maintained in any State or Federal court by any private party alleging—(A) a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security; or (B) that the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security."). A nationally traded security generally is a security that is listed on a national securities exchange, such as the

interpretation of SLUSA in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, the requisite showing of preemption is met if the alleged misconduct occurred in connection with the acquisition or sale of a subject security.[179] The Court's approach may preclude state class actions involving nationally traded securities from being brought in situations where plaintiffs bought or sold securities of companies other than those about which the alleged misstatements or omissions were made. Because these alleged misstatements or omissions negatively impacted the price of the securities that the plaintiffs purchased or sold, the requisite "in connection with" link may be present. As the Supreme Court opined in *Dabit*, "[t]he misconduct of which [the plaintiffs] complain[] . . . unquestionably qualifies [under SLUSA] as fraud 'in connection with the purchase or sale' of securities."[180] Nonetheless, it may be posited that the Supreme Court's subsequent decision in *Chadbourne & Parke LLP v. Troice* may be construed to signify that SLUSA preemption arises only when the alleged misconduct occurs in connection with the purchase or sale of a subject security about which the misstatements or omissions were made.[181] Even if this view ultimately prevails, the fact remains that state common law and securities actions ordinarily are a poor substitute

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NASDAQ and the NYSE. Marc I. Steinberg, *Pleading Securities Fraud Claims—Only Part of the Story*, 45 LOY. U. CHI. L.J. 603, 604 n.4 (2014). Carve-outs include: individual actions, derivative suits, class actions brought solely alleging Securities Act claims, and class actions in connection with mergers and acquisitions, such as mergers, going-private transactions, tender offers, and the exercise of appraisal rights. *See* 26 MICHAEL J. KAUFMAN, SECURITIES LITIGATION DAMAGES § 5:8, Westlaw (database updated Nov. 2023). In these situations, actions may be brought in state court. *See generally* Cyan, Inc. v. Beaver Cnty. Emps. Ret. Fund, 138 S. Ct. 1061 (2018) (holding that state courts have jurisdiction to hear class action claims alleging violations of the Securities Act of 1933); Richard W. Painter, *Responding to a False Alarm: Federal Preemption of State Securities Fraud Causes of Action*, 84 CORNELL L. REV. 1, 3 (1998).

179. *See* 547 U.S. at 84.

180. *Id.* at 85, 89 ("Under our precedents, it is enough [for SLUSA preemption] that the fraud alleged 'coincide' with a securities transaction—whether by the plaintiff or by someone else. The requisite showing, in other words, is 'deception in connection with the purchase or sale of any security, not deception of an identifiable purchaser or seller.'" (citation omitted) (quoting United States v. O'Hagan, 521 U.S. 642, 658 (1997))); *see generally* Mark J. Loewenstein, Merrill Lynch v. Dabit*: Federal Preemption of Holders' Class Actions*, 34 SEC. REG. L.J. 209 (2006).

181. *See* Chadbourne & Parke LLP v. Troice, 571 U.S. 377, 387 (2014). In *Troice*, the plaintiffs alleged that, with respect to their purchases of uncovered securities, they were falsely told that these securities were backed by covered securities (namely, securities that were traded on a national securities exchange). The Court held that their action was not preempted under SLUSA, stating that "[a] fraudulent misrepresentation or omission is not made 'in connection with' such a 'purchase or sale of a covered security' unless it is material to a decision by one or more individuals (other than the fraudster) to buy or sell a 'covered security.'" *Id.*

for investor redress when compared to the federal securities class action remedial framework.[182]

4. A Plain-Language Reading of *Frutarom* Is Problematic Since It Could Exclude Omission Liability and Conflict with the Supreme Court's Scheme-Liability Precedents

The plain language of *Frutarom*'s construction of the Purchaser-Seller Rule has further muddied the waters due to its underinclusive, overly-simplified articulation.[183] Read literally, the Second Circuit's holding that Section 10(b) standing is only available to purchasers or sellers of "the securities about which the *misstatements* were made"[184] seems to preclude claims under Rule 10b-5(a) and (c) that address both omission liability and scheme liability.[185] The cursory language used in *Frutarom* prompted federal district courts outside the Second Circuit to specifically address and reject its implications.[186] And while, for the avoidance of doubt, the Second Circuit did not likely intend its ruling in

182. In *Frutarom*, the Second Circuit stated: "In appropriate circumstances, the acquiring company or its shareholders may have claims against the target company and its officers under state law." Menora Mivtachim Ins. v. Frutarom Indus. Ltd., 54 F.4th 82, 89 n.9 (2d Cir. 2022). Any such state cause of action, assuming it is available, likely will not have the remedial attributes of a federal securities class action seeking relief based on violations of Section 10(b). *See Cyan*, 138 S. Ct. at 1066 ("In the wake of the 1929 stock market crash, Congress enacted two laws, in successive years, to promote honest practices in the securities markets."); *see generally* Steven A. Ramirez, *The Virtues of Private Securities Litigation: An Historic and Macroeconomic Perspective*, 45 LOY. U. CHI. L.J. 669 (2014) (addressing the benefits of private securities litigation).

183. *In re* CCIV/Lucid Motors Sec. Litig., No. 4:21-cv-09323-YGR, 2023 WL 325251, at *8-9 (N.D. Cal. Jan. 11, 2023), *aff'd on other grounds*, 110 F.4th 1181 (9th Cir. 2024); *see supra* note 111 and accompanying text.

184. *Frutarom*, 54 F.4th at 88 (emphasis added).

185. An analogy to canons of statutory construction, coupled with the plain text of the Second Circuit's holding, supports reading *Frutarom* in this manner. Although such wide preclusion is likely beyond what the *Frutarom* court intended, it is nevertheless a reasonable concern given that decision's brief reasoning and the sweeping language of its holding. *Id.* at 87 ("[W]e must give narrow dimensions to a right of action Congress did not authorize." (quoting Janus Cap. Grp., Inc. v. First Derivative Traders, 564 U.S. 135, 142 (2011))) (collecting cases that argue for a narrow application of the § 10(b) private right of action); *cf*. 73 AM. JUR. 2D *Statutes* § 112, Westlaw (database updated Aug. 2024) ("Under the general rule of statutory construction expressio unius est exclusio alterius, the expression of one or more items of a class implies that those not identified are to be excluded.").

186. *See, e.g.*, *Lucid*, 2023 WL 325251, at *8-9 (noting that *Frutarom* "*appears* to require that plaintiffs plead a misstatement to have Section 10(b) standing. . . . This conflicts with the Supreme Court's scheme-liability precedent, which allows for Rule [10b-5](a) and (c) claims, in the absence of a misstatement." (emphasis added)).

Frutarom to be that exclusive,[187] the court did not take adequate care to ensure that its holding was in line with prior precedent. Any ruling that plausibly could be read to exclude Rule 10b-5(a) and (c) omission or scheme liability is poorly drafted at best, and, at worst, fundamentally inconsistent with Supreme Court precedent.[188]

5. *Frutarom* and Its Progeny Have Created Confusion and Division Among the Courts

Hence, the Second Circuit's narrow construction of the Purchaser-Seller Rule has not accomplished what it set out to do: Instead of increasing certainty,[189] the decision has increased division among the federal courts and has materially impeded the ability of parties in a Section 10(b) action outside of the Second or Ninth Circuits to ascertain whether the requirements for statutory standing have been met.[190] This, coupled with *Frutarom*'s manifold other faults, precipitates a simple conclusion: The decision is wrong and correction is necessary.

B. Recommendations for a Revised Approach to Standing Under Section 10(b)

The current approach to the Purchaser-Seller Rule in the Second and Ninth Circuits, as exemplified by *Frutarom*, is wooden, unduly formulaic,

187. In the Second Circuit, *Frutarom* has been applied where omission liability was alleged. *See In re* Alibaba Grp. Holding Ltd. Sec. Litig., No. 20 Civ. 9568 (GBD), 2023 WL 2601472, at *2-5 (S.D.N.Y. Mar. 22, 2023); *see also supra* notes 82-92 and accompanying text (considering, inter alia, potential liability for Alibaba's omissions regarding Ant, and applying *Frutarom*). Nonetheless, the plain language of the *Frutarom* court's ruling is concerning.

188. *See* Lorenzo v. SEC, 139 S. Ct. 1094, 1100-01 (2019) (addressing scheme-liability structure of § 10(b) and Rule 10b-5(a) and (c)); *see also* Affiliated Ute Citizens v. United States, 406 U.S. 128, 153 (1972) (holding that liability exists under Rule 10b-5 for omissions where there is an affirmative duty to disclose a material fact).

189. *See Frutarom*, 54 F.4th at 86-87 (discussing rationales for narrow construction of the judicially created § 10(b) private right of action).

190. *Compare Alibaba*, 2023 WL 2601472 *and In re* CarLotz, Inc. Sec. Litig., 667 F. Supp. 3d 71, 78 (S.D.N.Y. 2023) (both applying *Frutarom* to deny standing under § 10(b)), *with Lucid*, 2023 WL 325251, at *8, *In re* Robinhood Ord. Flow Litig., No. 4:20-cv-9328-YGR, 2023 WL 4543574, at *9 (N.D. Cal. Jan. 18, 2023), *and In re* Mullen Auto. Sec. Litig., No. CV 22-3026-DMG (AGRx), 2023 WL 8125447, at *6 (C.D. Cal. Sept. 28, 2023) (criticizing *Frutarom*'s rationale and refusing to follow its holding). While these district court opinions were not adopted by the Ninth Circuit, their reasoning is sound and may be influential for other courts faced with similar issues. *See In re* CCIV/Lucid Motors Sec. Litig., 110 F.4th 1181 (9th Cir. 2024) (adopting *Frutarom*). More to the point, a decision that is divisive enough to create the potential for a circuit split cannot simultaneously create commercial certainty for either plaintiffs or defendants.

and overly restrictive.[191] Its holding and rationale should be rejected. If investors are to be accorded the protections that the federal securities laws envisioned,[192] and which prior courts emphasized when crafting the parameters of the Section 10(b) private right of action,[193] then a flexible approach to Section 10(b) standing that adheres to the *Birnbaum* rule is necessary.

1. Laying the Foundation for a Nexus Approach

Clearly, when investors purchase or sell securities of the enterprise about which misstatements or omissions are made, the traditional *Birnbaum* rule applies—namely, their status as a purchaser or seller of the subject securities confers statutory standing under Section 10(b), enabling them to pursue their right of action under the statute and Rule 10b-5.[194] The discussion herein addresses the situation presented in *Nortel*, *Frutarom*, and subsequent case law.

Instead of focusing on whether a plaintiff bought or sold the *securities* of the *specific company about which misstatements or omissions were made*, courts considering standing in a Section 10(b) claim should look to the nexus between: (1) the plaintiff's transaction (purchase or sale), (2) the alleged misstatement(s) or omission(s), and (3) the alleged injury. If there is adequately pled a sufficient nexus between the plaintiff and the transaction to show an allegedly concrete injury, then standing is proper under Section 10(b).[195] This approach adheres to *Birnbaum* and *Blue Chip Stamps*, is consistent with the statutory framework, and allows for greater flexibility in application than the rigid ruling in *Frutarom*.

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191. *See Lucid*, 2023 WL 325251, at *8-9 (commenting on *Frutarom*'s restrictive holding and inflexibility and criticizing its rationale).

192. *See* Herman & MacLean v. Huddleston, 459 U.S. 375, 386-87 (1983) ("[W]e have repeatedly recognized that securities laws combating fraud should be construed 'not technically and restrictively, but flexibly to effectuate [their] remedial purposes.'" (alteration in original) (quoting SEC v. Cap. Gains Rsch. Bureau, 375 U.S. 180, 195 (1963))).

193. *See* SEC v. Zandford, 535 U.S. 813, 819 (2002) (reasoning that § 10(b) must not be construed "technically and restrictively, but flexibly to effectuate its remedial purposes" (quoting *Affiliated Ute Citizens*, 406 U.S. at 151)); cases cited *supra* note 192.

194. *See* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 742-43 (1975); Birnbaum v. Newport Steel Corp., 193 F.2d 461, 463 (2d Cir. 1952); *supra* notes 34-44 and accompanying text.

195. Note that ordinary, rather than heightened (as is the case with fraud), pleading rules should apply. *See* Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 346-47 (2005) (recognizing that "ordinary pleading rules" apply with respect to the element of loss causation in a § 10(b) claim).

A correctional approach is necessary in part because the concerns expressed in *Blue Chip Stamps*[196] are not present in *Frutarom* or related cases. As such, the need to limit standing requirements is significantly minimized.[197] First, the cases that have arisen in the wake of *Frutarom* and that are discussed herein are not instances of *inaction*—the plaintiffs in each instance *actually* bought or sold securities, and alleged misstatements or omissions were made that impacted an affected company and its securities.[198] Second, in *Frutarom* and most of the cases following it, the plaintiffs were allegedly directly harmed by misstatements or omissions committed by the named defendants.[199] In these cases, evidently plaintiffs adequately alleged transaction and loss causation, especially in those situations where the subject securities traded in an efficient market, the price of the subject securities was impacted by the alleged misconduct, and the fraud on the market theory could be invoked.[200]

Under a construction of the Purchaser-Seller Rule that places a primacy on the nexus between the plaintiff, the purchase or sale, and the alleged injury, courts would apply a more holistic and adaptable[201]

196. 421 U.S. at 740-43 (noting concerns about "strike suits," since securities fraud class actions often have a "settlement value to the plaintiff out of any proportion to its prospect of success at trial," and cases that are based largely upon "rather hazy issues of historical fact the proof of which depended almost entirely on oral testimony.").

197. *See, e.g.*, Menora Mivtachim Ins. v. Frutarom Indus. Ltd., 54 F.4th 82, 84 (2d Cir. 2022) (considering no oral testimony in majority opinion). Neither did *Frutarom* consider investor inaction, as in *Blue Chip Stamps*, since plaintiffs were actual purchasers of IFF stock in connection with the IFF-Frutarom merger. *Compare id.* (where plaintiffs actually purchased or sold securities) *with* 421 U.S. at 754 ("[R]espondent and the members of its class are neither 'purchasers' nor 'sellers,' as those terms are defined in the 1934 Act . . . .").

198. *See, e.g.*, *In re* CCIV/Lucid Motors Sec. Litig., No. 4:21-cv-09323-YGR, 2023 WL 325251, at *7 (N.D. Cal. Jan. 11, 2023), *aff'd on other grounds*, 110 F.4th 1181 (9th Cir. 2024) ("*Blue Chip* focused on the unique problem that arises when a plaintiff's claim is based on *inaction* and when it is likely that oral testimony will be the primary, or only, evidence.").

199. *See supra* notes 65-129 and accompanying text (describing the facts, holdings, and rationales of *Frutarom*, *Alibaba*, *CarLotz*, *Lucid*, *Robinhood*, and *Mullen Auto*.).

200. See *supra* note 32 for Supreme Court cases addressing transaction causation (namely, reliance) and loss causation. Stated generally, the fraud on the market theory, which has received Supreme Court approbation, *see, e.g.*, Halliburton Co. v. Erica P. John Fund, Inc., 573 U.S. 258 (2014), applies a rebuttable presumption of reliance in Section 10(b) litigation and facilitates certification of class actions. The theory "posits that the market price of an issuer's stock traded in an efficient market reflects all available material public information regarding that issuer." STEINBERG, UNDERSTANDING SECURITIES LAW, *supra* note 3, at 602.

201. *See supra* notes 161-167 and accompanying text (noting problems with *Frutarom*'s inflexible Purchaser-Seller Rule as it relates to a wide variety of transactions).

standing analysis than under *Frutarom*'s misguided approach.[202] Additionally, such an analysis allows for adaptability to a wide variety of nuanced securities disputes.[203]

2. A Nexus Approach Properly Supplements the *Nortel* Direct Relationship Test and Adheres to *Blue Chip Stamps*

The nexus approach to the Purchaser-Seller Rule herein articulated asks a related but different question than that posed by the *Nortel* "direct relationship test." As Judge Pérez explained in her *Frutarom* concurrence, the direct relationship test inquires as to "whether [p]laintiffs have demonstrated a sufficient relationship between [the non-issuer's] alleged misstatements and [the] stock price [of the corporation in which they purchased or sold securities]."[204] The approach suggested herein refines *Nortel* by focusing on the relationship between the plaintiff's purchase (or sale), the alleged disclosure deficiency, and the alleged injury. By reframing the inquiry as regarding the alleged misstatements (or omissions) and the causal relationship between those misstatements (or omissions) and the alleged injury, this twist on the *Nortel* test should avoid much of the confusion that *Nortel*'s holding generated.[205]

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202. 54 F.4th at 88. While the virtue of *Frutarom* is largely its simplicity, the devil is in the details, and even courts within the Second Circuit have expressed concerns that its holding may be too narrow. *See, e.g.*, *In re* CarLotz, Inc. Sec. Litig., 667 F. Supp. 3d 71, 79 (S.D.N.Y. 2023).

203. A more nuanced approach to standing in a Section 10(b) private action would allow for applicability to derivatives, SPACs, ADS, and mergers & acquisitions—provided that plaintiffs could allege a sufficient nexus between their transactions, defendants' alleged misstatements or omissions, and the causal relationship to their injury. Plaintiffs under this approach would not need to be holders of the specific company's securities about which a misstatement or omission was made in order for standing to be proper under Section 10(b). *See Frutarom*, 54 F.4th at 88; *supra* notes 161-167 and accompanying text.

204. 54 F.4th at 91 (Pérez, J., concurring).

205. Language that is overly restrictive on its face is not a new issue in the Second Circuit's Purchaser-Seller Rule jurisprudence: *Nortel*'s holding led many to believe that only issuers could be defendants in a Section 10(b) private action, requiring the court to clarify the scope of its prior holding in *NYSE*. *See* Cal. Pub. Emps. Retirement Sys. v. NYSE (*In re* NYSE Specialist Sec. Litig.), 503 F.3d 89, 102 (2d Cir. 2007); *In re* Turquoise Hill Res. Ltd. Sec. Litig., 625 F. Supp. 3d 164, 201 (S.D.N.Y. 2022) (elucidating that *Nortel* "stand[s] for the proposition that investors lack standing where the 'connection between' the false statements of the non-issuer and 'plaintiff's purchase' of stock is 'too remote'").

Courts outside of the Second Circuit have also found *Nortel*'s reasoning difficult to apply, further underscoring the need for revision. *See, e.g.*, Zelman v. JDS Uniphase Corp., 376 F. Supp. 2d 956, 962 (N.D. Cal. 2005) ("The Court also hesitates to apply *Nortel* to the present case because the Second Circuit's rationale in that decision is problematic. . . . Moreover, the conclusion reached in *Nortel* is not compelled by *Blue Chip Stamps*. . . . [T]he proof problems the *Blue Chip Stamps* Court described in connection with claims of harm resulting from decisions not to act are

Additionally, such a view of Section 10(b) standing fits within the ambit of the *Birnbaum* rule as articulated in *Blue Chip Stamps*.[206] The utility of the Purchaser-Seller Rule, according to the Court in *Blue Chip Stamps*, "is that it limits the class of plaintiffs to those who have at least dealt in the security to which the prospectus, representation, or omission *relates*."[207] By focusing on the nexus between the transaction, the alleged misstatement or omission, and that disclosure deficiency's causal connection to the plaintiff's alleged injury, this approach to Section 10(b) standing—if implemented faithfully—ensures that plaintiffs who have dealt in a security to which the alleged disclosure deficiency relates and have allegedly suffered harm may pursue the remedies that the securities laws envisioned.

The nexus view posited herein is balanced and comports with the holding of *Blue Chip Stamps* that a plaintiff must be a purchaser or seller of securities in order to have standing under Section 10(b).

In situations where investors purchase or sell a security (or a derivative of that security, such as an option) of a company about which a misstatement or omission was *not* made but nonetheless allegedly suffer injury thereby, they should be entitled to seek redress under the federal securities laws—provided they satisfy certain criteria. By requiring that plaintiffs must allege a sufficient nexus between their securities transactions, the subject defendants' misstatements or omissions, and their financial harm, only those complainants who allegedly have suffered concrete injury will be eligible to pursue their Section 10(b) claim. By formulating the Purchaser-Seller Rule in this setting, the standing question becomes at once more *in*clusive and more *ex*clusive—the universe of potential plaintiffs in a Section 10(b) private action is expanded,[208] but those plaintiffs must adequately allege the additional element of loss causation for standing to be proper (with that element, at a later stage in the litigation, being necessary for them to prove in order to

not present in situations such as the present case or *Nortel*, where documentary proof of transactions is available.").

206. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 747 (1975) (articulating policy rationales for adopting the *Birnbaum* Purchaser-Seller Rule).

207. *Id.* (emphasis added).

208. *See id.* (limiting standing in a § 10(b) private action to actual purchasers or sellers). While the court in *Blue Chip Stamps* placed limits on who could be a plaintiff in a Section 10(b) private action, the ruling in *Blue Chip Stamps* encompasses far more potential plaintiffs, and a wider array of transactions, than that adopted by the Second Circuit.

prevail on the merits).[209] As such, the nexus approach proposed herein aptly addresses faithful statutory construction and policy concerns by being at once more inclusive than *Frutarom* and compatible with *Blue Chip Stamps*.[210] Indeed, as the Supreme Court stated in *Herman & MacLean v. Huddleston*, "a § 10(b) action can be brought by a purchaser or seller of '*any* security' against '*any* person' who has used '*any* manipulative or deceptive device or contrivance' in connection with the purchase or sale of a security."[211]

VII. CONCLUSION

In closing, proper construction of the Purchaser-Seller Rule for standing in a Section 10(b) private action requires balancing many competing interests but must not be overly exclusive. The decision of the Second Circuit in *Frutarom* to restrict standing under Rule 10b-5 to plaintiffs who "bought or sold the securities *about which the misstatements were made*"[212] fails on multiple fronts and has been problematic since it was handed down by that court.

Within the Second and Ninth Circuits, *Frutarom* has been relied on to preclude plaintiffs from bringing otherwise potentially meritorious claims under the antifraud provisions of the securities laws.[213] The overly restrictive *Frutarom* approach has been used to bar claims in several types of transactions, including mergers,[214] IPOs,[215] and de-SPACs.[216] Unfortunately, it has denied allegedly injured plaintiffs access to the

209. Further, because the PSLRA places a stay on discovery during the pendency of a motion to dismiss in any covered private action, it ordinarily is necessary for plaintiffs to allege loss causation on information in their possession prior to being afforded discovery. Securities Exchange Act § 21D(b)(4)(B), 15 U.S.C. § 78u-4(b)(4)(B). As such, requiring that loss causation be adequately alleged as a component of the standing inquiry should not place an unduly onerous burden on plaintiffs in private actions under Section 10(b).

210. *Compare* Menora Mivtachim Ins. v. Frutarom Indus. Ltd., 54 F.4th 82, 88 (2d Cir. 2022) (holding that standing in a Section 10(b) private action is proper only where a plaintiff "bought or sold the securities about which the misstatements were made") *with* 421 U.S. at 754-55 (holding that § 10(b) standing is limited to actual purchasers or sellers of securities).

211. Herman & MacLean v. Huddleston, 459 U.S. 375, 382 (1983) (quoting Securities Exchange Act § 10(b), 15 U.S.C. § 78j(b)).

212. 54 F.4th at 88 (emphasis added).

213. *See In re* Alibaba Grp. Holding Ltd. Sec. Litig., No. 20 Civ. 9568 (GBD), 2023 WL 2601472, at *5 (S.D.N.Y. Mar. 22, 2023); *In re* CarLotz, Inc. Sec. Litig., 667 F. Supp. 3d 71, 76 (S.D.N.Y 2023).

214. Indeed, the situation in *Frutarom* involved a triangular merger. *See supra* notes 68-81 and accompanying text.

215. *See Alibaba*, 2023 WL 2601472, at *5.

216. *See CarLotz*, 667 F. Supp. 3d at 74.

courthouse—precluding even the opportunity to have the allegations set forth in their complaints considered by a federal court.

Frutarom embodies a wooden, strict application of the Purchaser-Seller Rule contrary to the holding and concerns set forth in *Blue Chip Stamps*.[217] In so holding, the Second Circuit mistakenly removed the flexibility of the Purchaser-Seller Rule and created a blunt tool with limited use and no room for organic development.

Where a problem is presented, it normally is appropriate to accompany it with suggestions for its correct resolution. As a given, in situations where a plaintiff purchases or sells a security about which a misstatement or omission allegedly was made, Section 10(b) standing has been recognized by the Supreme Court since *Blue Chip Stamps*, decided nearly fifty years ago. In situations where a plaintiff purchases or sells a security about which a misstatement or omission was *not* made, a balanced approach compatible with statutory construction should be adopted. This Article proposes such an approach to standing in this contextual Section 10(b) situation, whereby courts would look to the nexus between the plaintiff's purchase or sale, the alleged misstatement(s) or omission(s), and the alleged injury, and decide from there whether there exists a requisite basis to confer standing.[218]

To some extent, this approach bears similarity to the *Nortel* "direct relationship" test as set forth by the concurrence in *Frutarom*,[219] albeit that this approach provides a more distinct structure for determining whether a plaintiff satisfies the Section 10(b) standing requirement in this contextual situation. As such, concerns about an "endless case-by-case erosion"[220] of the *Birnbaum* Rule are allayed. A nexus approach, further, maintains the integrity of the Purchaser-Seller Rule as it has been applied for decades, while at the same time allowing courts the flexibility to consider nuanced securities disputes in an ever-changing regulatory and business environment. Accordingly, implementation of the nexus standard proposed herein would provide a balanced approach that adheres to Section 10(b)'s statutory construction and the rationale of *Blue Chip Stamps*. It bears emphasis that the Supreme Court's language in *Huddleston* is strikingly on point in this contextual situation: "[A] § 10(b)

217. *See* 54 F.4th at 86 (addressing concerns about "vexatious litigation," where much of the plaintiff's case-in-chief would be based on hazy oral testimony (quoting Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 740 (1975))).

218. *See supra* notes 194-211 and accompanying text.

219. *See supra* notes 204-207 and accompanying text.

220. *Frutarom*, 54 F.4th at 86 (quoting *Blue Chip Stamps*, 421 U.S. at 755).

action can be brought by a purchaser or seller of '*any* security' against '*any* person' who has used '*any* manipulative or deceptive device or contrivance' in connection with the purchase or sale of a security."[221]

In closing, the "judicial oak"[222] of a Rule 10b-5 private right of action was overzealously pruned in *Frutarom*. *Frutarom*'s holding and rationale should be rejected, but further correction is needed. It is far past time to consider grafting in old branches to heal the tree before it withers.

221. Herman & MacLean v. Huddleston, 459 U.S. 375, 382 (1983) (quoting Securities Exchange Act § 10(b), 15 U.S.C. § 78j(b)).

222. *Blue Chip Stamps*, 421 U.S. at 737 ("When we deal with private actions under Rule 10b-5, we deal with a judicial oak which has grown from little more than a legislative acorn.").