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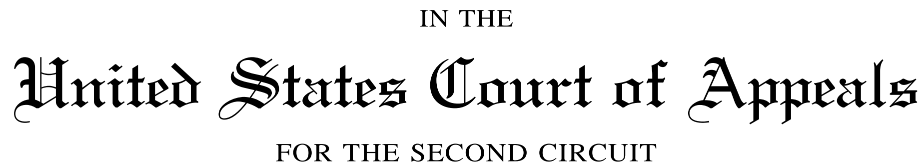

FOR THE SECOND CIRCUIT

DAVID JOFFEE, CATHERINE STONE, TERENCE KRUSKA, ROBERT J. BLUME, AMALIA CONCIATORI, SYLVIA S. EISELE, BARRY KEITH HERMAN, ELLEN NYSTROM HERMAN, ALAN JAMES, MARC A. KOEHLER, SHERRIE E. KOEHLER, EDWARD B. LEINBACH, BRUCE LILES, LINDA LILES, DAVID J. MILLER, GENNUS MILLER, JEFFREY A. MORRIS, SUZANNE N. MORRIS, JOHN J. MURPHY, SUELLEN C. MURPHY, SUSAN C. MURPHY, TIMOTHY J. MURPHY, RYAN J. MURPHY, STUART NEWBORN, DIANE NEWBORN, JOHN POLONCHAK, MYRTLE POLONCHAK, KURT SCHMITZ, LESLIE SCHMITZ, DETECTIVE JAMES SIMPSON, RICHARD VAZQUEZ, JEFFREY ZAHN, JAMES OLSON, RICHARD NORDEN, DARLENE CROWTHER, DENNIS CROWTHER, BOB EISELE, LDX OPTRONICS, INC., KATHRYN OLSON,

Plaintiffs-Appellants,

(*Caption continued on inside cover*)

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK (SWEET, D.J.)

APPELLEES' BRIEF

JAYANT W. TAMBE
AVIVA WARTER SISITSKY
TODD R. GEREMIA
JONES DAY
222 East 41st Street
New York, New York 10017-6702
(212) 326-3939

Attorneys for Defendants-Appellees
Lehman Brothers Inc.,
Kenneth N. Goldman, M.D.,
and David A. Gruber, M.D.

—against—

LEHMAN BROTHERS INC., M.D. KENNETH N. GOLDMAN,
and M.D. DAVID A. GRUBER,

Defendants-Appellees,

THE ELISABETH HERMAN TRUST, RUTH SHAPIRO and SOLOMON SINGER,

Plaintiffs.

CORPORATE DISCLOSURE STATEMENT

Defendant-Appellee Lehman Brothers Inc. is a wholly owned subsidiary of Lehman Brothers Holdings Inc.

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JURISDICTIONAL STATEMENT

Defendants-Appellees Lehman Brothers Inc., Kenneth N. Goldman, M.D., and David A. Gruber, M.D. (collectively, "Lehman") add the following that was omitted from plaintiffs' jurisdictional statement: The District Court's order granting Lehman's motion to dismiss the Third Amended Complaint was entered on January 19, 2006, and plaintiffs timely filed their notice of appeal from that order on February 17, 2006. (A21, Dkt. # 34, 35)[1] *See* Fed. R. App. P. 4(a)(1)(A).

Lehman also notes that plaintiffs' statements concerning venue are not properly part of a jurisdictional statement. *See* Fed. R. App. P. 28(a)(4). Lehman is otherwise satisfied with plaintiffs' jurisdictional statement.

STATEMENT OF THE ISSUES

This appeal presents three issues. If the Court answers any of the following questions in the affirmative, it should affirm the District Court's order dismissing the complaint:

1. To state a claim for securities fraud under § 10(b) of the Securities and Exchange Act of 1934 and SEC Rule 10b-5, a plaintiff must allege "loss causation," "*i.e.*, that the misstatement or omission concealed something from the

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[1] Citations in the form "(A__)" are to the Joint Appendix on appeal. "Dkt. #" refers to entries in the District Court's docket for this case, which is reproduced at pages A1-24 of the Joint Appendix. "(Blue Br. __)" refers to the brief on appeal submitted by plaintiffs-appellants. "(SA__)" refers to the Special Appendix attached to plaintiffs' brief on appeal and includes a copy of the District Court's decision granting Lehman's motion to dismiss the Third Amended Complaint.

market that, when disclosed, negatively affected the value of the security." *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 173 (2d Cir.), *cert. denied*, 126 S. Ct. 421 (2005). Plaintiffs allege that Lehman made false "predictions" about the market for Sunrise's products. (A181 ¶¶ 120-21) They do not allege that there was any disclosure to the market that Lehman did not honestly believe its predictions. Nor do they allege that the price of Sunrise securities declined due to such a disclosure, or due to the materialization of any risk that was concealed from the market. Instead, plaintiffs allege that the price of Sunrise common stock declined because a "plummeting market for Sunrise products caused its business to fail." (A181 ¶¶ 122-23)

Did the District Court properly rule that plaintiffs failed to allege loss causation?

2. Under Federal Rule of Civil Procedure 9(b) and the Private Securities Litigation Reform Act ("Reform Act"), plaintiffs must plead with particularity that an allegedly fraudulent statement was false. *See* 15 U.S.C. § 78u-4(b)(1)(B). Plaintiffs contend that Lehman made bad "predictions" about Sunrise's business and unwarranted recommendations to "buy" Sunrise securities, but they fail to plead that Lehman did not believe these predictions or recommendations when Lehman made them.

Did the District Court correctly rule that plaintiffs' complaint should be dismissed on the alternative ground that plaintiffs have failed to plead the falsity of Lehman's allegedly fraudulent predictions and recommendations?

3. Plaintiffs' claims are time-barred unless they were brought within one year of when plaintiffs discovered, or upon the exercise of reasonable diligence should have discovered, the alleged fraud. In their brief on appeal (though not in their complaint), plaintiffs contend that their economic losses were caused by Lehman's "concealment" of the shortcomings of Sunrise's product—a laser for use in eye surgery—and information concerning Sunrise's projected sales for the year 2000. (Blue Br. 13) All of these facts were disclosed in publicly filed documents or in Lehman's analyst reports by no later than April 6, 2001.

Are plaintiffs' claims, as re-characterized in their appeal brief, barred under the applicable one-year statute of limitations, when plaintiffs filed their complaint more than three years later?

STATEMENT OF THE CASE

Plaintiffs commenced this action on May 7, 2004. (A16, Dkt. #1) Their complaint alleged securities fraud under § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b). (A187-89) This claim, according to the complaint, arose from "buy" recommendations and certain other predictions in seven Lehman analyst reports covering Sunrise Technologies, Inc., which were issued by Lehman

between December 3, 1999 and April 3, 2001. (A145 ¶¶ 2-3) Plaintiffs are 35 individual investors, each of whom alleges that he or she "relied" on Lehman's "recommendation to purchase Sunrise" stock in Lehman's analyst reports. (A147-56 ¶¶ 9-30) However, two-thirds of the plaintiffs (23 of them) purchased Sunrise stock *after* Lehman ceased issuing analyst reports on Sunrise. (A147-56, ¶¶ 10, 13-15, 19-21, 24-30)

Lehman moved to dismiss the complaint in June 2004. (A17, Dkt. #4) While that motion was pending, plaintiffs asked Lehman to stipulate, and Lehman did stipulate, to plaintiffs filing an amended complaint. (A17, Dkt. #10) Plaintiffs thereafter asked Lehman to stipulate again, and Lehman did, to plaintiffs filing a Second Amended Complaint. (A18, Dkt. #12) Lehman moved to dismiss the Second Amended Complaint on the grounds that (i) plaintiffs' claims were barred under the applicable one-year statute of limitations; and that the complaint failed to plead (ii) loss causation, (iii) fraudulent intent, and (iv) the falsity of the analyst reports. (A18, Dkt. #15)

The District Court (Judge Sweet) granted Lehman's motion on the ground of "loss causation," *i.e.*, that plaintiffs' complaint "contained no allegations of a causal connection between the alleged misrepresentations and a subsequent economic loss suffered by the Plaintiffs," as required by, *inter alia*, the Supreme Court's decision in *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336 (2005),

and this Court's decisions in *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161 (2d Cir. 2005), and *Emergent Capital Investment Management, LLC v. Stonepath Group, Inc.*, 343 F.3d 189 (2d Cir. 2003). The District Court gave plaintiffs leave to re-plead their complaint within 20 days of entry of its order. *See Joffee v. Lehman Bros. Inc.*, No. 04 Civ. 3507, 2005 WL 1492101, at *14 (S.D.N.Y. June 23, 2005).

Plaintiffs subsequently filed their fourth complaint in this case: the Third Amended Complaint (hereinafter, the "complaint"). (A144) Lehman moved to dismiss that complaint on the same grounds that it had moved to dismiss the Second Amended Complaint. (A20-21, Dkt. # 26-27) The District Court again granted Lehman's motion, ruling that plaintiffs "fail[ed] to plead facts necessary to demonstrate: (a) loss causation, *i.e.*, that Lehman's alleged misstatements and/or omissions proximately caused the decline in Sunrise stock price; or (b) the falsity of the Analyst Reports." (SA8) Specifically, the Court ruled that plaintiffs had "not alleged any disclosure of the alleged scheme of which they complain that caused the stock price to decline." (SA11) Instead, they "alleged that their losses were caused by a decline in demand for Sunrise's products," which, under *Dura*, does not suffice to plead loss causation. (SA11) The District Court further ruled that, in any event, "each of the matters that Plaintiffs claim Lehman failed to disclose had, in fact, been disclosed to the market in Sunrise's SEC filings, the Analyst Reports themselves, and in the FDA's letters approving the Sunrise laser

for sale." (SA11) Accordingly, "Plaintiffs cannot contend that any subsequent disclosure of the allegedly Omitted Material could have caused the decline in Sunrise's stock price." (SA11)

The District Court's order dismissed the entire complaint, including plaintiffs' claim for secondary, "controlling person" liability for securities fraud under § 20(a) of the Exchange Act, 15 U.S.C. § 78t(a), and a claim for common law fraud. (SA19) On appeal, plaintiffs do not argue that the District Court erred in dismissing these claims. *See LoSacco v. City of Middletown*, 71 F.3d 88, 92 (2d Cir. 1995) ("Although [appellant] stridently opposed [defendant's] motion, he did not raise this issue in his appellate brief. Consequently, he has abandoned it."). And, in the District Court, plaintiffs did not present any independent ground for upholding their § 20(a) and common law fraud claims. (A21, Dkt. #31 at 16) They argued only that the legal sufficiency of these claims turns on whether their § 10(b) claim was adequately pleaded (*id.*), and thus effectively conceded that they should be dismissed if their § 10(b) claim is dismissed.[2]

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[2] *See, e.g.*, *Rombach v. Chang,* 355 F.3d 164, 177-78 (2d Cir. 2004) (ruling that a § 20(a) claim, "necessarily predicated on a primary violation of securities law," must be dismissed where the Court has "already determined that the district court properly dismissed the primary securities claims"); *Pension Comm. of Univ. of Montreal Pension Plan v. Banc of Am. Sec., LLC*, --- F. Supp. 2d ---, 2006 WL 2053326, at *15 (S.D.N.Y. July 20, 2006) ("Because the elements of common-law fraud in New York are 'substantially identical to those governing § 10(b), the identical analysis applies.' Plaintiffs' common-law fraud claims . . . suffer from the same deficiencies as their federal securities claims.").

The Court's decision and order granting Lehman's motion to dismiss was entered on January 19, 2006 (A21, Dkt. #34), and is published as *Joffee v. Lehman Brothers, Inc.*, 410 F. Supp. 2d 187 (S.D.N.Y. 2006).

STATEMENT OF FACTS

A. The Allegedly Fraudulent Analyst Reports

Plaintiffs allege that they purchased Sunrise common stock at prices that were "artificially inflated" due to seven different Lehman analyst reports covering Sunrise. (A172-73 ¶ 96, A181 ¶ 119) Sunrise was a "one-product company" that developed, manufactured, and marketed a laser system called the "Hyperion LTK System" for use in temporarily reducing farsightedness (or "hyperopia") in certain patients. (A170 ¶ 88, A282) The crux of the fraud, according to the complaint, is that Lehman "touted Sunrise stock as a 'Strong Buy' with a projected 'target' price of $19.00 per share" and that Lehman "knew, or recklessly disregarded" that these recommendations were purportedly "more positive . . . than were justified." (A145 ¶ 2, A173 ¶ 97(d)) *See also* A147-56 ¶¶ 9-30 (where each plaintiff alleges, "Were it not for the Lehman Reports, including Lehman's unwavering buy recommendation and $19 price target, Plaintiff [] would not have made this investment.").

The complaint alleges that Lehman's analysts made "False and Misleading Statements" (A170) in the form of purportedly disingenuous expressions of opinion and optimism such as:

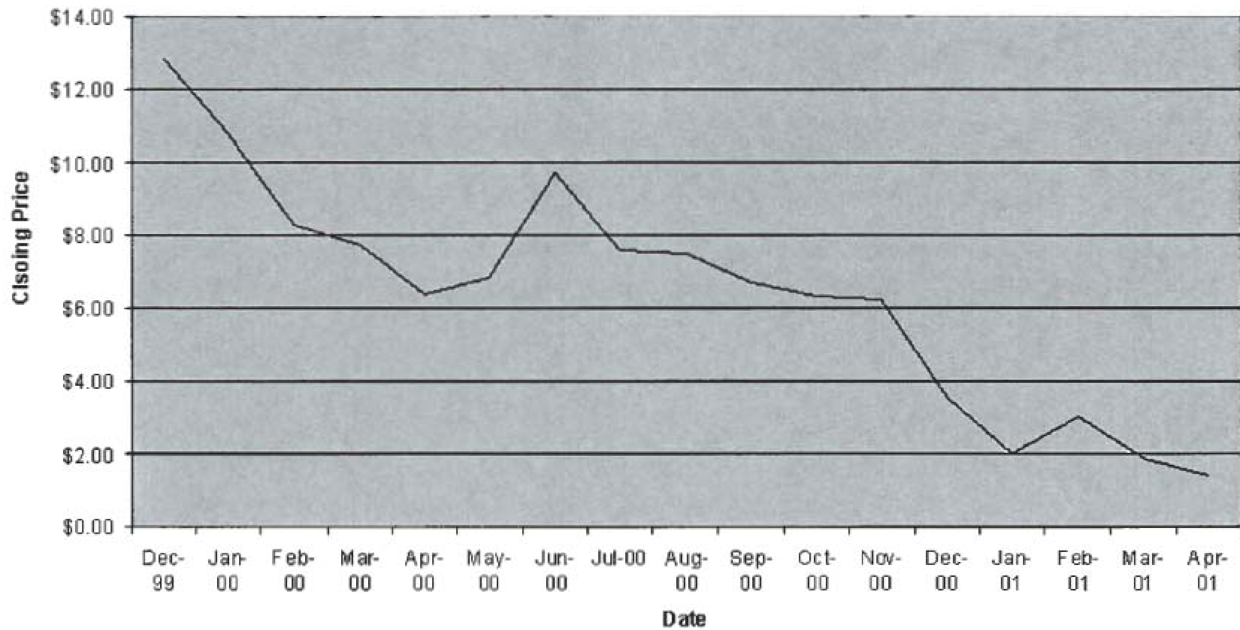
- "Except for a brief three week period . . ., all of the Lehman Reports contained Defendants' rating of Sunrise stock as a '1-Buy' . . ." (A172 ¶ 94)
- "Interest among opthalmologists remains high." (A172 ¶ 96)
- "[P]otential for explosive growth seems achievable." (A172 ¶ 96)
- "We believe that Sunrise will meet our expectations of 115 unit sales by end of year . . . ." (A172 ¶ 96)
- "We have seen doctors who already own Sunrise Hyperion lasers . . . appearing enthusiastic about Sunrise LTK." (A173 ¶ 96)
- "[B]uy as much Sunrise stock as you can." (A171 ¶ 92)
- "April 3, 2001 . . . . In this report, Lehman, Goldman, and Gruber terminated research coverage of Sunrise, without explanation. Nevertheless, the report rated Sunrise stock a '1-Strong Buy' with a price target of $19.00 per share." (A173 ¶ 96)

See also A187 ¶ 142 ("Lehman overstated the marketability and overestimated the sales of Sunrise's products.").

According to the complaint, the price of Sunrise common stock was "artificially inflated" as a result of Lehman's allegedly "false and misleading" opinions and optimistic statements about Sunrise. (A181 ¶ 119, A186 ¶ 137, A188 ¶ 146) In fact, as the District Court illustrated with the following chart, the price of Sunrise common stock *declined* steadily during the period that Lehman issued

analyst reports on Sunrise, although it spiked upwards when, in June 2000, the FDA publicly disclosed that it had approved the Sunrise laser for use in the temporary reduction of hyperopia:

Figure 1: Closing Price of Sunrise Common Stock (Based on Price Information Provided by Dow Jones and Reuters)



Joffee, 2005 WL 1492101, at *1 ("As illustrated by Figure 1 . . ., the share price of Sunrise common stock dropped from a closing price of $12.87 on December 3, 1999 [when Lehman issued its first report on Sunrise] to a closing price of $1.43 on April 3, 2001 [when Lehman issued its last report].").

The complaint also fails to allege any facts showing that Lehman did not believe its expressions of optimism and opinion regarding Sunrise. Instead, plaintiffs make conclusory averments, unsupported by any allegations of fact, that Lehman's "ratings and target prices did not reflect the analysts' true opinions of

Sunrise" (A187 ¶ 142) and that Lehman "knew or recklessly disregarded that their statements . . . and ratings system were false at the time they made these statements." (A188 ¶ 144)

B. The District Court Grants Lehman's Motion to Dismiss the Second Amended Complaint

The District Court granted Lehman's motion to dismiss the Second Amended Complaint—the one preceding the operative Third Amended Complaint—because it failed to allege that Lehman's purported misrepresentations caused plaintiffs' alleged economic losses:

> The SAC [Second Amended Complaint] contained no allegations of a causal connection between the alleged misrepresentations and a subsequent economic loss suffered by the Plaintiffs. Rather, the SAC merely alleged that (1) Sunrise stock is publicly traded and (2) that the Defendants' misrepresentations falsely inflated the value of Sunrise's shares.

See Joffee, 2005 WL 1492101, at *9. The District Court noted that the Supreme Court's decision in *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336 (2005), was "dispositive." *Joffee*, 2005 WL 1492101, at *9. In *Dura*, the Supreme Court held that a complaint asserting a private cause of action for federal securities fraud does not plead the element of "economic loss" solely by alleging that a misrepresentation caused "artificial inflation" in the price of a security. 544 U.S. at 342, 347. Such an allegation fails to plead the requisite "causal connection between the material misrepresentation and the loss" because "'artificially inflated

purchase price' is not itself a relevant economic loss." *Id.* As the Supreme Court reasoned, "[n]ormally, in cases such as this one (i.e., fraud-on-the-market cases), an inflated purchase price will not itself constitute or proximately cause the relevant economic loss." *Id.* at 342.

Even before *Dura*—and before plaintiffs commenced this action in 2004—the law in this circuit was that price inflation caused by purportedly fraudulent statements does not suffice to plead loss causation. *See Emergent Capital Inv. Mgmt., LLC v. Stonepath Group, Inc.*, 343 F.3d 189, 198 (2d Cir. 2003) ("Plaintiff's allegation of a purchase-time value disparity, standing alone, cannot satisfy the loss causation pleading requirement."); *see also Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 174 (2d Cir. 2005) ("It is not enough to allege that a defendant's misrepresentations and omissions induced a 'purchase-time value disparity' between the price paid for a security and its 'true investment quality.'") (quoting *Emergent*; some internal quotation marks omitted). As the District Court noted, however, plaintiffs did "not address the loss causation pleading requirements imposed by [this Court in] *Emergent*" in either their complaint or in their opposition to Lehman's motion to dismiss the Second Amended Complaint. *Joffee*, 2005 WL 1492101, at *8. Nevertheless, the District Court afforded plaintiffs yet another opportunity to amend their complaint—for the third time—so that they could attempt to plead some causal connection between Lehman's

allegedly fraudulent statements and the decline in the price of Sunrise stock. *See id.* at *14.

C. Plaintiffs' Loss Causation Allegations in Their Third Amended Complaint

The Third Amended Complaint, the one at issue on this appeal, did not fix the problem. It added approximately twenty boilerplate, conclusory allegations that plaintiffs' losses were a "direct and proximate result" of Lehman's alleged misstatements and omissions. (A35-45, blackline showing changes in Third Amended Complaint) And the specific allegations that plaintiffs added ostensibly to plead loss causation demonstrate, instead, that plaintiffs' losses were caused by the demise of Sunrise's business. Plaintiffs alleged "[i]n essence" that Lehman erroneously "predicted a robust and growing market for Sunrise's products and the surgical procedures made possible by those products." (A181 ¶ 120) But, according to the complaint, "[c]ontrary to Defendants' predictions, demand for the surgical procedures dropped and Sunrise's product sales plummeted." (A181 ¶ 121) This "plummeting market for Sunrise products caused its business to fail," and, in turn, "the common stock price of Sunrise plummeted . . ., to the injury of Plaintiffs." (A181 ¶¶ 122-23) *See also* A176 ¶ 104 ("The failures of marketability of both the procedure and the product caused the business failure of Sunrise.").

By writing the word "accordingly" into one of their allegations, plaintiffs tried to glue together the failure of Sunrise's business and the concomitant decline in Sunrise stock with Lehman's purportedly fraudulent predictions:

> [T]he failure of Sunrise's procedure and product caused the failure of Sunrise's business and the loss of value of the common stock of Sunrise, and accordingly Defendants' misrepresentations and omissions, also, caused the investment losses complained of herein.

(A184 ¶ 128) But plaintiffs did not allege any *facts* to make this theory stick. They failed to allege that Lehman did not believe its predictions about Sunrise. Nor did they allege that any disclosure to the market regarding whether Lehman believed its predictions caused the price of Sunrise stock to decline.

The complaint asserts that, as a general matter, Lehman's analyst reports omitted facts "concerning the marketability of Sunrise's product," but it does not allege that Lehman's alleged omissions caused plaintiffs' losses. (A181 ¶ 118) The specific facts concerning Sunrise's "marketability" that plaintiffs say Lehman omitted were as follows:

1. **The Hyperion Laser.** An October 25, 2000 Lehman analyst report stated that, at a meeting of the American Academy of Opthalmology ("AAO"), Sunrise had "an opportunity to confront [] doubting doctors with data comparing the different modalities available for hyperopia." (A174 ¶ 99) *See also* A287-88 (10/25/00 report). Another report dated November 17, 2000 stated that, at the

AAO meeting, "[d]octors who already own Sunrise Hyperion lasers [met] twice at informal scientific sessions [and] appear[ed] enthusiastic about Sunrise LTK." (A174 ¶ 99) *See also* A289-92 (11/17/00 report). These sentences, according to plaintiffs, were materially "misleading" because Lehman did not disclose that "certain opthalmologists" at the AAO meeting—the complaint does not say who or how many—told a Lehman analyst that patients treated with the Sunrise laser sometimes experienced "early regression" and "induced astigmatism," and that some doctors were unable to "consistently pre-determine the degree of vision correction" with the Sunrise laser. (A175 ¶ 103)

2. **<u>Sunrise's Adjusted Projection for 2000.</u>** Lehman's August 10, 2000 report on Sunrise stated (correctly) that Lehman "had predicted the manufacture and sale of 105 Hyperion units" for 2000. (A389) The same report also stated, based on Sunrise's own revised projected sales figures (A175 ¶ 103), that "unit sales will be slightly greater than anticipated" in 2000. (A389) This was misleading, according to the complaint, because Lehman "knew or [was] reckless in not knowing" that Sunrise's revised projection was due to an agreement between Sunrise and U.S. Medical, Inc. whereby U.S. Medical purchased 20 Sunrise laser

units from Sunrise. Sunrise also bought 4% of the privately owned stock in U.S. Medical. (A175 ¶ 103)[3]

All of the facts that plaintiffs contend Lehman omitted from its analyst reports were publicly disclosed. On June 30, 2000, the FDA publicly disclosed a letter approving the Sunrise Hyperion laser and extensive safety and efficacy data concerning the Sunrise laser. (A293-384) These public documents laid bare detailed statistics about the early regression of the effects of the procedure, its variable success rate, the temporary nature of the correction, and the rate of induced astigmatism in patients undergoing the procedure. (A293, A313, A315, A319, A371) The June 2000 FDA approval letter predated Lehman's October and November 2000 reports that, according to plaintiffs, omitted this very same information about the shortcomings of Sunrise's laser. (A287, A289, A293) In a Sunrise 8-K form filed with the SEC on July 17, 2000, Sunrise also disclosed the FDA's approval of the Sunrise laser, that the approval was for the "temporary reduction of hyperopia," and that "[t]he magnitude of correction with this

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[3] Plaintiffs also allege that Lehman "did not disclose" that it participated in an $11.7 million private placement for Sunrise securities through an affiliate called LBI Group, Inc. and that a Lehman employee was a Sunrise director. (A156 ¶ 31, A170 ¶¶ 86-87, A174 ¶ 98) But plaintiffs do not contend, in either their complaint or their brief on appeal, that Lehman's alleged "failure" to disclose these facts caused the price of Sunrise stock to decline. (A181-84) Nor could they. All of these facts were disclosed in either Sunrise's SEC filings or the very Lehman analyst reports that plaintiffs claim are fraudulent. (A213, A269, A390)

treatment diminishes over time." (A247) In addition, Sunrise filed an 8-K form on January 31, 2001 that disclosed its agreements with U.S. Medical and expressly stated that this agreement had the effect of "increas[ing] the number of units shipped in the fourth quarter of 2000." (A269)

D. The District Court Grants Lehman's Motion to Dismiss the Third Amended Complaint

The District Court granted Lehman's motion to dismiss the Third Amended Complaint. (SA3) The Court held that plaintiffs "have failed to allege a causal connection between [the] decline ['in demand for Sunrise's products'] and Lehman's representations or alleged omissions." (SA11) "In addition," plaintiffs did not and could not plead loss causation under *Dura*, because the complaint itself offers a "'tangle of factors'" other than Lehman's erroneous predictions that caused the decline in the price of Sunrise common stock:

> [A]s anticipated by the Supreme Court in *Dura*, here the Complaint itself offers the following new "tangle of factors affecting price": (1) a decline in demand for the Sunrise laser surgery procedure, (2) a decline in purchases of the Sunrise laser units by opthalmologists; and (3) unsatisfactory results of the surgery procedure.

(SA11, citing Compl. ¶ 126 (A182))

Moreover, on a third ground, the Court held that plaintiffs had failed to allege that any "disclosure of the alleged scheme of which they complain [] caused the stock price to decline." (SA11) "Indeed, each of the matters that Plaintiffs

claim Lehman failed to disclose had, in fact, been disclosed to the market in Sunrise's SEC filings, the Analyst Reports themselves, and in the FDA's letters approving the Sunrise laser for sale." (SA11) For this reason, plaintiffs cannot allege that Lehman's alleged omissions in the analyst reports caused their economic losses: "Plaintiffs cannot contend that any subsequent disclosure of the allegedly Omitted Material could have caused the decline in Sunrise's stock price." (SA11)

The District Court then rejected plaintiffs' arguments that they are either not required to allege loss causation stemming from Lehman's analyst reports or, in the alternative, that they had properly pleaded it. First, the Court rejected plaintiffs' argument that "they are not required to make any allegations connecting the Analyst Reports and the decline in sales." (SA13) The Court noted that this Court's decision in *Lentell* makes clear that "a plaintiff must allege . . . that the subject of the fraudulent statement or omission was the cause of the actual loss suffered." *Lentell*, 396 F.3d at 173 (ellipsis in original; internal quotation marks omitted). (SA13)

Second, the District Court rejected plaintiffs' argument that they "'have met the requirements of *Emergent Capital*'" because, according to plaintiffs, they had adequately pleaded the "foreseeability of the consequences of the allegedly concealed risk." (SA13-14, quoting Pls.' Br. at 6) The District Court quoted this

Court's ruling in *Lentell* that "the tort-law concept of proximate cause, *i.e.*, that the damages suffered by a plaintiff must be a foreseeable consequence of any misrepresentation" "is imperfect." *Lentell*, 396 F.3d at 173. In a private securities case, the Second Circuit has made clear that, to properly plead loss causation, a plaintiff must allege "that the misstatement or omission concealed something from the market that, when disclosed, negatively affected the value of the security." *Id.*

Third, the District Court rejected plaintiffs' argument that a corrective disclosure is not required to show loss causation in this case. The Court noted that, under *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1095-96 (1991), statements of opinion are actionable as securities fraud only to the extent that they are not honestly held. (SA16) Thus, to plead that Lehman's "buy" recommendations or its "predictions" about Sunrise stock are actionable, "it is critical for Plaintiffs to allege that the 'relevant truth,' *i.e.*, the alleged dishonesty of the opinions, is revealed to the market." (SA16) Plaintiffs failed to do this.

The District Court then ruled in the alternative that, even assuming plaintiffs' theory of loss causation relates to undisclosed "risks" concerning Sunrise instead of, as the complaint expressly alleges, "predictions" that turned out to be erroneous, plaintiffs' "own pleading demonstrates that the true facts about demand for Sunrise products never [were] concealed." (SA17) The Court had already noted that each of the matters that plaintiffs claim Lehman failed to

disclose had, in fact, been publicly disclosed. (SA11) And the complaint itself alleges that "the market for Sunrise securities 'digested all information with respect to Sunrise from all publicly-available sources and reflected such information in Sunrise's stock price.'" (SA17, quoting Compl. ¶ 139 (A187)) Thus, because all of the facts that Lehman allegedly omitted from its analyst reports were publicly available in Sunrise's SEC filings, the FDA's June 2000 approval letter, or the analyst reports themselves, Lehman did not "conceal" any facts that were not already reflected in the market price of Sunrise's stock. (SA17)

The District Court therefore granted Lehman's motion to dismiss the complaint. (SA19) Though plaintiffs now make a fleeting request, in a footnote, that this Court grant them "permission to amend any deficiencies" in their complaint (Blue Br. 13 n.3)—that is, permission to amend their pleading for a *fourth* time—they did not make a motion to amend in the District Court.

SUMMARY OF THE ARGUMENT

I. The District Court properly ruled that plaintiffs failed to plead loss causation. Plaintiffs allege that Lehman's purportedly false "predictions" of a "robust and growing market for Sunrise's products" caused "artificial inflation" of the price of Sunrise stock. (A181 ¶¶ 119-21) But, according to the complaint, it was the "plummeting market" for Sunrise's product that caused the decline in the price of Sunrise common stock. (A181 ¶¶ 121-23)

These allegations do not plead that any statements in Lehman's analyst reports proximately caused plaintiffs' economic losses. The Supreme Court and this Court have made clear that "artificial inflation," standing alone, does not show loss causation. *See Dura Pharms.*, 544 U.S. at 342, 347. Rather, "to establish loss causation," plaintiffs must allege "that the misstatement or omission concealed something from the market that, when disclosed, negatively affected the value of the security." *Lentell*, 396 F.3d at 173. Plaintiffs have not satisfied this standard. They failed to allege that the price of Sunrise stock declined due to any disclosure to the market regarding whether Lehman believed its predictions. Nor do plaintiffs allege that there has *ever* been a disclosure that Lehman did not honestly believe its predictions about Sunrise or recommendations to "buy" Sunrise stock. Rather, as the District Court noted, plaintiffs affirmatively allege that their losses were caused by a "tangle of factors" *other than disclosure of Lehman's allegedly false predictions and recommendations*, including "[t]he plummeting market for Sunrise products." (SA11; A181 ¶¶ 122-23) The complaint does not allege—nor could it, in light of what it does allege—that anything Lehman said or did caused plaintiffs' economic losses. Under *Dura* and *Lentell*, that is fatal to their claims.

On appeal, plaintiffs try to re-characterize their allegations of loss causation to contend that Lehman's analyst reports purportedly "conceale[d]" certain "risks" about Sunrise's business, and that the "materialization of those very risks" caused

plaintiffs' losses. (Blue Br. 13) That is not the theory of loss causation pleaded in the complaint (*see* A181-84), and, for this reason alone, the Court should not consider it. Moreover, even if that were plaintiffs' theory, it is not viable for one simple reason: The facts that plaintiffs contend Lehman omitted from its analyst reports were *not* "concealed" from the market. They were disclosed, repeatedly and publicly, in Sunrise's SEC filings, the package of FDA documents that approved Sunrise's laser, and in the very Lehman analyst reports that plaintiffs contend were fraudulent.

II. The District Court also properly ruled that the complaint should be dismissed on the alternative ground that plaintiffs have failed to plead, with the particularity required by the Reform Act and Rule 9(b), that Lehman's purportedly fraudulent "buy" recommendations and "predictions" were false when made. Plaintiffs fail to allege a single fact to demonstrate that Lehman did not sincerely believe these predictions and opinions when they were made. Instead, plaintiffs make only a conclusory, boilerplate allegation that Lehman "knew or recklessly disregarded that their statements . . . and ratings system were false at the time they made these statements." (A188 ¶ 144) That bald allegation is insufficient to plead, with the requisite particularity, "the reason or reasons why the statement is misleading." 15 U.S.C. § 78u-4(b)(1)(B).

III. The District Court's order may also be affirmed on the ground that plaintiffs' claims are time-barred. Plaintiffs' claims are subject to a one-year limitations period that begins to run when they discovered, or with the exercise of reasonable diligence should have discovered, the alleged fraud. All of the "risks" that plaintiffs now contend Lehman "concealed"—specific shortcomings of the Sunrise laser and the existence of a product purchase agreement between Sunrise and a medical equipment supplier—were publicly disclosed by no later than April 6, 2001. Because plaintiffs did not file their complaint until more than three years later, on May 7, 2004, their claims are barred under the one-year limitations period.

The District Court ruled, on Lehman's motion to dismiss the Second Amended Complaint, that plaintiffs could not have known of Lehman's alleged fraud until April 28, 2003, when consent orders were entered against Lehman in connection with analyst conflict of interest charges brought by the SEC, the NASD, and the Attorneys General of various states. These consent orders do not, however, mention any activity by Lehman in connection with Sunrise securities. Thus, unlike in *Lentell*—where the Court held that plaintiffs were not on inquiry notice of their fraud claims until the New York Attorney General disclosed facts relating to Merrill Lynch's analyst coverage of the specific companies at issue—plaintiffs may not invoke the April 2003 consent orders to delay the onset of their limitations period. Moreover, as plaintiffs have now re-characterized their claims

in their brief on appeal, their losses allegedly were caused by Lehman's "misrepresentations" about Sunrise's business prospects, not Lehman's purportedly fraudulent "predictions." Because the facts necessary to discover *this* newly minted claim were publicly disclosed more than three years before plaintiffs commenced this action, plaintiffs' claims are time-barred.

STANDARD OF REVIEW

This Court reviews *de novo* a district court's dismissal of a complaint on a motion under Rule 12(b)(6). The standard in both the District Court and in this Court is the same: a motion to dismiss should be granted if the plaintiff's well-pleaded allegations, accepted as true, do not state a claim for relief. *See* Fed. R. Civ. P. 12(b)(6); *see also Sykes v. James*, 13 F.3d 515, 519 (2d Cir. 1993).

"Though all reasonable inferences are drawn in the plaintiff's favor on a motion to dismiss on the pleadings, 'conclusions of law or unwarranted deductions of fact are not admitted.'" *Lentell*, 396 F.3d at 174-75 (quoting *First Nationwide Bank v. Gelt Funding Corp.*, 27 F.3d 763, 771 (2d Cir. 1994)); *see also In re Am. Express Co. S'holder Litig.*, 39 F.3d 395, 400 n.3 (2d Cir. 1994) ("[C]onclusory allegations of the legal status of the defendants' acts need not be accepted as true."). In addition, for purposes of a motion to dismiss, the complaint is deemed to include "any statements or documents incorporated in [the complaint] by reference," public documents of record, and documents "upon which [plaintiffs]

relied in bringing the suit." *Rothman v. Gregor*, 220 F.3d 81, 88 (2d Cir. 2000); *see also Cortec Indus., Inc. v. Sum Holding L.P.*, 949 F.2d 42, 47 (2d Cir. 1991) ("[W]hen a district court decides a motion to dismiss a complaint alleging securities fraud, it may review and consider public disclosure documents required by law to be and which actually have been filed with the SEC, particularly where plaintiff has been put on notice by defendant's proffer of these public documents.").

ARGUMENT

I. THE DISTRICT COURT CORRECTLY RULED THAT PLAINTIFFS FAILED TO PLEAD LOSS CAUSATION

To state a claim for relief under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and SEC Rule 10b-5, 17 C.F.R. § 240.10b-5, plaintiffs must allege that Lehman:

> (1) made misstatements or omissions of material fact; (2) with scienter; (3) in connection with the purchase or sale of securities; (4) upon which plaintiffs relied; and (5) that plaintiffs' reliance was the proximate cause of their injury.

Lentell, 396 F.3d at 172 (quoting *In re IBM Corporate Sec. Litig.*, 163 F.3d 102, 106 (2d Cir. 1998)).

To establish proximate cause, or "loss causation," a plaintiff "must allege":

> "that the subject of the fraudulent statement or omission was the cause of the actual loss suffered," *i.e.*, *that the misstatement or omission concealed something from the*

> *market that, when disclosed, negatively affected the value of the security.*

Id. at 173 (emphasis added; quoting *Suez Equity Investors, L.P. v. Toronto-Dominion Bank*, 250 F.3d 87, 95 (2d Cir. 2001)). A plaintiff's claim "fails when 'it has not adequately pled facts which, if proven, would show that its loss was caused by the alleged misstatements as opposed to intervening events.'" *Id.* at 174 (quoting *First Nationwide Bank*, 27 F.3d at 771); *see also* 15 U.S.C. § 78u-4(b)(4) (Reform Act provision codifying the requirement to prove loss causation in a private securities fraud action; "the plaintiff shall have the burden of proving that the act or omission of the defendant alleged to violate this chapter caused the loss for which the plaintiff seeks to recover damages").

A. Plaintiffs Did Not Plead That Their Economic Losses Are Attributable to Lehman's Alleged Fraud

The District Court correctly ruled that plaintiffs did not plead loss causation. The complaint itself acknowledges that plaintiffs' losses were *not* caused by Lehman's purportedly fraudulent opinions. While plaintiffs allege that Lehman's "predictions" "artificially inflated" the price of Sunrise stock (A181 ¶ 119), plaintiffs repeatedly assert that it was "***the plummeting market for Sunrise products [that] caused its business to fail.***" (A181 ¶ 122 (emphasis added); *see also* A181 ¶ 121, "[D]emand for the surgical procedures dropped and Sunrise's product sales plummeted.") And, as the complaint makes clear, the "plummeting

market" for Sunrise's products is what caused the decline in the price of Sunrise common stock:

> As sales of its LTK units plummeted, the common stock price of Sunrise plummeted throughout the Relevant Period, to the injury of Plaintiffs who purchased Sunrise stock at that time, relying upon the integrity of the Lehman Reports and the market price of the stock.

(A181 ¶ 123) *See also* A184 ¶ 128 ("[T]he failure of Sunrise's procedure and product caused the failure of the Sunrise's business [sic] and the loss of value of the common stock of Sunrise . . . ."); A176 ¶ 104 ("The failures of marketability of both the procedure and the product caused the business failure of Sunrise.").

As the District Court properly held, this theory of loss causation does not link plaintiffs' losses to Lehman's purportedly fraudulent "predictions" in *any* way. (SA11, "While Plaintiffs have now alleged that their losses were caused by a decline in demand for Sunrise products, they have failed to allege a causal connection between that decline and Lehman's representations or alleged omissions.") Lehman predicted that Sunrise's stock would rise and that its business would prosper. As it turned out, Lehman was wrong. But the complaint alleges that Sunrise's business failed, and its stock declined, not because of anything that *Lehman* did or said, but because opthalmologists did not buy in sufficient quantity the only product that Sunrise marketed—the Sunrise Hyperion Laser. (A181 ¶¶ 121-24)

Indeed, plaintiffs' theory of loss causation is precisely the type of theory that the Supreme Court held, in *Dura Pharmaceuticals*, does *not* state a claim for securities fraud. In *Dura*, the plaintiffs—like the plaintiffs in this case—pleaded that the defendant's allegedly fraudulent statements (concerning whether the FDA was likely to approve the issuer's asthmatic spray device) "artificially inflated" the price for the issuer's security, but did not try to link their economic losses to the issuer's statements in any other way. 544 U.S. at 342, 347. The Court held that "'artificially inflated purchase price' is not itself a relevant economic loss," and that plaintiffs had therefore failed to plead a claim for securities fraud. *Id.* at 347.

Here too, the only nexus between Sunrise's stock price and Lehman's allegedly fraudulent statements that plaintiffs have pleaded is that Sunrise stock was "artificially inflated" "as a result of" Lehman's predictions. (A173 ¶ 97(d), A181 ¶ 119) Under *Dura*, and this Court's prior opinion in *Emergent Capital Investment Management, LLC v. Stonepath Group, Inc.*, 343 F.3d 189 (2d Cir. 2003), an allegation of price inflation "standing alone, cannot satisfy the loss causation pleading requirement." *See Emergent*, 334 F.3d at 198; *see also Dura*, 544 U.S. at 347 ("[T]he 'artificially inflated purchase price' is not itself a relevant economic loss."). "Such an allegation—which is 'nothing more than a paraphrased allegation of transaction causation'—explains why a particular investment was

made, but does not speak to the relationship between the fraud and the loss of the investment." *Lentell*, 396 F.3d at 174 (quoting *Emergent*, 343 F.3d at 198).

In the complete absence of any allegation that plaintiffs' losses—as opposed to the alleged "artificial inflation" of Sunrise stock—were caused by Lehman's allegedly fraudulent predictions, the District Court properly ruled that plaintiffs have failed to plead a claim for securities fraud.

B. Plaintiffs Failed to Plead That Lehman's "Predictions" Caused Their Losses

Plaintiffs have not come to grips with what they must plead and prove to show that an allegedly fraudulent "prediction" caused their economic losses. This Court and others in this circuit have recently had the occasion to rule on a spate of "analyst fraud" cases, nearly all of which have been dismissed on the pleadings and, when appealed, affirmed.[4] Applying established principles of loss causation,

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[4]*See In re Initial Public Offering Sec. Litig.*, 399 F. Supp. 2d 298, 309 (S.D.N.Y. 2005) (dismissing complaint where plaintiffs failed to adequately allege loss causation), *aff'd sub nom*, *Tenney v. Credit Suisse First Boston Corp.*, *Inc.*, Nos. 05-3420-CV, 05-4759-CV, 05-4760-CV, 2006 WL 1423785 (2d Cir. May 19, 2006); *In re Alcatel Sec. Litig.*, 382 F. Supp. 2d 513, 530-31 (S.D.N.Y. 2005) (dismissing complaint for failure to plead with particularity why analyst statements were fraudulent); *In re Salomon Analyst Winstar Litig.*, 373 F. Supp. 2d 241, 245 (S.D.N.Y. 2005) (dismissing complaint on statute of limitations grounds), *reconsideration granted*, No. 02 Civ. 6171, 2006 WL 510526 (S.D.N.Y. Feb. 28, 2006) (reaffirming dismissal); *In re Salomon Analyst Metromedia Litig.*, 373 F. Supp. 2d 235, 238 (S.D.N.Y. 2005) (dismissing certain claims in complaint on, among other grounds, that analyst reports were not materially false and misleading); *In re JP Morgan Chase Sec. Litig.*, 363 F. Supp. 2d 595, 630 (S.D.N.Y. 2005) (dismissing complaint for failure to allege scienter with respect to

the courts have made clear that, for an allegedly fraudulent "prediction" to cause a loss, plaintiffs must plead that their losses were caused by a disclosure that the analyst did not truly believe his or her predictions when they were made. *See, e.g., In re Initial Public Offering Sec. Litig.*, 399 F. Supp. 2d 298, 307 (S.D.N.Y. 2005) ("[W]here the alleged misstatement is an intentionally false opinion, the market will not respond to the truth until the falsity is revealed—*i.e.*, a corrective

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(continued…)

analysts' "buy" ratings, because there were no facts alleged suggesting that the analysts believed the ratings to be false when issued); *In re Salomon Analyst A T & T Litig.*, 350 F. Supp. 2d 455, 465-66 (S.D.N.Y. 2004) (dismissing analyst fraud claim on the ground, among others, that plaintiffs failed adequately to plead falsity and scienter); *In re Salomon Analyst Level 3 Litig.*, 350 F. Supp. 2d 477, 489-90 (S.D.N.Y. 2004) (dismissing complaint where there was no allegation that analyst's reports misstated analyst's truly held opinion), *reconsideration denied*, 373 F. Supp. 2d 248 (S.D.N.Y. 2005); *In re Citigroup Sec. Litig.*, 330 F. Supp. 2d 367, 379-80 (S.D.N.Y. 2004) (dismissing complaint where investors failed to plead scienter or falsity with sufficient particularity); *Shah v. Morgan Stanley*, No. 03 Civ. 8761, 2004 WL 2346716 (S.D.N.Y. Oct. 19, 2004), *aff'd sub nom.*, *Shah v. Meeker*, 435 F.3d 244 (2d Cir. 2006) (affirming dismissal on ground that plaintiff was on inquiry notice of alleged fraud more than two years before filing suit); *Podany v. Robertson Stephens, Inc.*, 318 F. Supp. 2d 146, 154 (S.D.N.Y. 2004); *In re Merrill Lynch Tyco Research Sec. Litig.*, No. 03 CV 4080, 2004 WL 305809, at *4-*5 (S.D.N.Y. Feb. 18, 2004) (granting motion to dismiss where investor failed to adequately plead loss causation, or to plead falsity with particularity); *In re Merrill Lynch & Co. Research Reports Sec. Litig.*, 273 F. Supp. 2d 351 (S.D.N.Y. 2003), *aff'd sub nom.*, *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161 (2d Cir.) (affirming dismissal on ground that complaint failed to properly allege loss causation), *cert. denied*, 126 S. Ct. 421 (2005). *See also DeMarco v. Lehman Bros. Inc.,* Nos. 03 Civ. 3470, 03 Civ. 3705, 03 Civ. 4511, 2004 WL 2674611, at *1-*2 (S.D.N.Y. Nov. 23, 2004) (granting motion for summary judgment because plaintiffs failed to make out *prima facie* case of either transaction causation or loss causation).

disclosure.") (citing, *inter alia*, *Lentell*, 396 F.3d at 173), *aff'd sub nom.*, *Tenney v. Credit Suisse First Boston Corp.*, *Inc.*, Nos. 05-3420-CV, 05-4759-CV, 05-4760-CV, 2006 WL 1423785 (2d Cir. May 19, 2006). Plaintiffs have failed to do this.

In *Lentell*, this Court addressed loss causation in the specific context of securities fraud claim predicated on allegedly "falsely optimistic" "predictions" in analyst reports. Like this case, the complaint in *Lentell* alleged that, in connection with certain securities covered by its analysts, Merrill Lynch issued "profoundly unrealistic price targets" and "false and misleading" "prediction[s] of growth potential." 396 F.3d at 165.[5] The analyst reports, according to the plaintiffs in *Lentell*, "artificially inflate[d]" the price of the covered stocks, which, as noted, is not sufficient to plead loss causation. *See id.* at 167, 174 ("It is not enough to allege that a defendant's misrepresentations and omissions induced a 'purchase-time value disparity' between the price paid for a security and its 'true investment quality.'").

The Court held that plaintiffs failed to plead loss causation because, *inter alia*, they did not allege a loss resulting from the market's "realization that the opinions were false":

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[5] In *Lentell*, plaintiffs' claims were based on what they alleged were "false and misleading" "Appreciation Potential Ratings." *Lentell*, 396 F.3d at 166. That rating was a "prediction of the investment's growth potential" over two different time periods. *Id.*

> The only misrepresentation that can inhere to the "buy" and "accumulate" recommendations is that they were not Merrill's true and sincere opinion. Yet plaintiffs allege no loss resulting from the market's realization that the opinions were false, or that Merrill concealed any risk that could plausibly (let alone foreseeably) have caused plaintiffs' loss.

396 F.3d at 176. "Merrill's concealed opinions regarding 24/7 Media and Interliant stock could not have caused a decrease in the value of those companies before the concealment was made public." *Id.* at 175 n.4.

This case is on the same footing as *Lentell*. Here, as in *Lentell*, plaintiffs allege that Lehman "touted Sunrise stock as a 'Strong Buy'" and "predicted a robust and growing market for Sunrise's products," which "artificially inflated" the market price of Sunrise stock. (A145 ¶ 2, A181 ¶¶ 119-20) But, as in *Lentell*, plaintiffs fail to allege that their economic losses were proximately caused by a disclosure to the market that Lehman's purportedly fraudulent "predictions" and "buy" recommendations were not "true and sincere." *Lentell*, 396 F.3d at 176. Indeed, plaintiffs' allegations of loss causation are even thinner than the allegations deemed insufficient in *Lentell*. Unlike in *Lentell*—where plaintiffs contended that "the falsity of Merrill Lynch's recommendations was made public no later than April 2002" (396 F.3d at 175 n.4), but failed to link this disclosure to their economic losses—plaintiffs here fail to allege that there has *ever* been a disclosure that Lehman did not believe its predictions.

For this reason alone, plaintiffs have failed to allege loss causation in this "false opinion" case. *See also, e.g., In re IPO*, 399 F. Supp. 2d at 308 ("Under *Lentell*, plaintiffs' failure to allege a corrective disclosure of the falsity of defendants' opinions precludes any claim that such falsity caused their losses.").

C. The District Court Did Not Impose a Heightened Pleading Burden on Plaintiffs

Plaintiffs try to sidestep their own failure to plead loss causation by accusing the District Court of imposing a *de facto* "heightened pleading requirement" that improperly required them to allege "more than the *bare minimum facts*" to establish loss causation. (Blue Br. 24, emphasis in original) The District Court did no such thing. It expressly applied a liberal pleading standard in ruling that plaintiffs' boilerplate proximate cause allegation, "repeated twenty-two times throughout the Complaint," "falls well short of what is required to demonstrate loss causation both under Rule 8 of the Federal Rules of Civil Procedure and under *Dura*." (SA18) In any event, plaintiffs' argument misses the point.

First, the fatal flaw in plaintiffs' complaint is that they have *not* pleaded the "bare minimum facts." As set forth above, they have failed to plead a "loss resulting from the market's realization that [Lehman's] opinions were false." *Lentell*, 396 F.3d at 176. Indeed, as the District Court correctly ruled, plaintiffs have failed to plead that there was *ever* a "market realization" that Lehman did not believe in its predictions for Sunrise. (SA15) *See generally First Nationwide*

Bank, 27 F.3d at 770 ("[Plaintiff] must allege loss causation with sufficient particularity such that we can determine whether the factual basis for its claim, if proven, could support an inference of proximate cause.").

Second, as the District Court also ruled, the problem for plaintiffs is that their complaint affirmatively alleges that their economic losses were caused by factors *other than* Lehman's purportedly misleading "predictions" and "buy" recommendations. (SA11) In this manner, plaintiffs' theory of loss causation was "anticipated by the Supreme Court in *Dura*." (SA11) They allege that Lehman's allegedly fraudulent "predictions" artificially inflated the price of Sunrise stock—as the plaintiffs did in *Dura*—but these plaintiffs attribute the later decline in the stock price to what can only be called a "tangle of factors" other than Lehman's predictions including "(1) a decline in demand for the Sunrise laser surgery procedure, (2) a decline in purchases of the Sunrise laser units by opthalmologists; and (3) unsatisfactory results of the surgical procedure." (SA11) *See Dura*, 544 U.S. at 342-43 (noting that, "as a matter of pure logic," a misrepresentation that allegedly brought about an inflated share price does not invariably cause an economic loss when the share price later declines, "[g]iven the tangle of factors affecting price").

Plaintiffs' complaint was thus properly dismissed not because they failed to meet a heightened pleading burden, but because they have expressly alleged that

their losses were caused by a decline in demand for Sunrise's products without making any allegations to establish "a causal connection between that decline and Lehman's representations or alleged omissions." (SA11) *See Dura*, 544 U.S. at 343-44; *cf. First Nationwide Bank*, 27 F.3d at 769 ("[W]hen factors other than the defendant's fraud are an intervening direct cause of a plaintiff's injury, that same injury cannot be said to have occurred by reason of the defendant's actions."); *Powers v. British Vita, P.L.C.*, 57 F.3d 176, 189-190 (2d Cir. 1995) (affirming dismissal of complaint for securities fraud where plaintiff failed sufficiently to allege loss causation due to "presence of a second direct intervening cause" of loss).

D. Plaintiffs Cannot Rely on Their Unpleaded Theory of "Concealed Risks" to Establish Loss Causation

Plaintiffs contend that they have pleaded around *Lentell* because they "allege the concealment and misstatement of risks" and "that the materialization of those very risks caused Sunrise's business to fail which, in turn, resulted in the Plaintiffs' losses." (Blue Br. 13) That is not, first of all, the theory of loss causation that plaintiffs actually pleaded in their complaint. Under a heading "Plaintiffs' Losses Were Caused By Defendants' Misrepresentations and Omissions," the complaint alleges—as set forth above—that Lehman made false "predictions" about Sunrise's business and that the failure of Sunrise's business to conform to those predictions caused plaintiffs' losses. (A181-84 ¶¶ 118-27)

Of course, plaintiffs should not be permitted to use their appeal brief to re-cast their theory of loss causation.[6] In any event, this unpleaded theory would not state a claim. According to plaintiffs' brief, Lehman "conceale[d] and misstate[d] [] risks associated with Sunrise securities." (Blue Br. 13) The alleged *facts* that underlay this abstraction are that Lehman purportedly failed to convey (i) the shortcomings of the Sunrise laser ("early regression of effect," "induced astigmatism," and variable "degree of vision correction"); and (ii) that a "slight adjustment" to Sunrise's sales projection was partially due to an agreement with U.S. Medical whereby U.S. Medical purchased 20 laser units from Sunrise. (A389; A174-75 ¶¶ 99-100, 102-03) Not one of these "risks" was concealed from the market. *They were all disclosed*.

Indeed, plaintiffs inexplicably *ignore* the District Court's ruling that "each of the matters that Plaintiffs claim Lehman failed to disclose had, in fact, been disclosed to the market in Sunrise's SEC filings, the Analyst Reports themselves, and in the FDA's letters approving the Sunrise laser for sale." (SA11) In June

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[6] *See Bouboulis v. Transp. Workers Union of Am.*, 442 F.3d 55, 66-67 (2d Cir. 2006) ("We will not consider" a "new claim not raised in the plaintiffs' complaint."); *Anderson v. Asset Corp.*, 329 F. Supp. 2d 380, 383 (W.D.N.Y. 2004) ("[Plaintiff's] complaint says what it says, and a memorandum of law is not a proper vehicle for rewriting or amending the complaint.") (citing *Dawson v. Bumble & Bumble*, 246 F. Supp. 2d 301, 316 (S.D.N.Y. 2003) ("Dawson's purported clarification effectively endeavors to rewrite or amend the Complaint through her opposition brief, a procedure not permitted by the Federal Rules."), *aff'd*, 416 F.3d 170 (2d Cir. 2005)).

2000, before Lehman purportedly "concealed" that certain physicians had made anecdotal oral reports of the shortcomings of the Sunrise laser at an October 2000 convention, the FDA publicly disclosed a package of documents approving the laser that expressly stated, among other things:

- "This device is indicated for: Temporary reduction of hyperopia . . . . The magnitude of correction with this treatment diminishes over time, with some patients retaining some or all of their refractive correction." (A293)

- "Prior to undergoing surgery, prospective patients must be informed that the treatment is probably temporary . . . ." (A294)

- "Warnings and Precautions: . . . [A]pproximately half of the effect seen at 6 months is gone at 2 years . . . .; Sunrise Technologies has found that the effect of LTK may dissipate in 3-5 years." (A303)

- "Revise the Indications for Use to state that the device is for temporary reduction of hyperopic error." (A319)

- "Add Warning: The treatment effect decreases over time." (A319)

- "Remember, the effect of LTK may not last and you may need glasses or contacts for good distance vision as you did before LTK." (A370)

- "**IMPORTANT: . . . Movement during the procedure could result in undercorrection (only a partial treatment) and/or astigmatism.**" (A372, emphasis in original)

- "One eye in 200 eyes had an increase in astigmatism after LTK surgery." (A371)

The FDA approval package also set forth detailed data from studies of the safety and efficacy of the Sunrise laser, which included tables disclosing the variable

duration of the vision correction, the side effects of the procedure, and polls of patient satisfaction. (A310-18, A322-27)

In addition, a Sunrise 8-K form filed with the SEC on July 17, 2000—and a Sunrise 10-Q filed on November 17, 2000—disclosed (i) the FDA approval, (ii) that the approval was "for the temporary reduction of hyperopia"; and (iii) "The magnitude of correction with this treatment diminishes over time . . . ." (A247; *see also* A259.) Further still, Sunrise's 10-K for the year 2000, filed on April 6, 2001, disclosed that "[p]otential complications and side effects" from the use of the laser include "unintended over or under corrections; regression of effect; and induced astigmatism." (A282) Indeed, in the very reports that plaintiffs contend "concealed" some doctors' views of the shortcomings of the Sunrise laser, Lehman expressly stated that (i) there were "skeptical doctors at this week's AAO"; (ii) "a number of opthalmologists had formed their opinion of the Sunrise LTK procedure by reading the financial pages which have been replete with negative investor sentiment"; and (iii) "[t]he FDA label for Sunrise Hyperion states that LTK is for 'the temporary reduction of hyperopia . . . .'" (A288, A291)

Finally, a Sunrise 8-K filed with the SEC on January 31, 2001 expressly disclosed Sunrise's agreement with U.S. Medical:

> The Company announced on January 2, 2001 that it had entered into agreements with U.S. Medical Corporation of Denver, Colorado that it believes will create expanded

> sales and distribution . . . and that U.S. Medical had agreed to purchase 15 units. . . .
>
> The Company also announced that the Company agreed to invest $2.4 million in the privately held U.S. Medical, giving the Company an approximate 4% ownership interest in U.S. Medical.

(A269)

In the face of these public disclosures, plaintiffs would not be able to allege, as they would have to in order to withstand a motion to dismiss on their unpleaded theory of loss causation by "materialization of concealed risks," that Lehman's purported "misstatement or omission *concealed something from the market* that, when disclosed, negatively affected the value of the security." 396 F.3d at 173 (emphasis added). The information that plaintiffs contend Lehman "omitted" from its analyst reports was, quite simply, not "concealed from the market." *See In re Sybase, Inc. Sec. Litig.*, 48 F. Supp. 2d 958, 961 (N.D. Cal. 1999) ("[D]efendants could not have concealed from the market that which was already known."). It was publicly disclosed and therefore, as plaintiffs themselves allege, reflected in the price of Sunrise stock regardless of whether Lehman "omitted" this information from its analyst reports. *See* A187 ¶ 139 ("[T]he markets digested all information with respect to Sunrise from all publicly-available sources and reflected such information in Sunrise's stock price.").

Indeed, plaintiffs tellingly do not allege that the *market* was unaware of the "risks that materialized." Instead, they allege only that "*Plaintiffs* were unaware" of the "risks that materialized and thereby caused the failure of Sunrise and the loss of value of its stock." (A189 ¶ 148, emphasis added)[7] While such an allegation may bear on "transaction causation"—*i.e.*, explain why plaintiffs purchased Sunrise securities—it does not establish loss causation. *See Lentell*, 396 F.3d at 174. Regardless of whether *plaintiffs* were aware of the risks that they say Lehman "concealed," these risks were disclosed to the market. Plaintiffs therefore cannot establish that Lehman proximately caused a decline in the value of Sunrise stock that they acknowledge is attributable to "the materialization of those very risks." (Blue Br. 13) *See, e.g.*, *Lentell*, 396 F.3d at 173; *Swack v. Lehman Bros., Inc.*, No. 03-10907-NMG, slip op. at 8 (D. Mass. Aug. 17, 2005) (in Appendix at A463-71)

[7] This allegation is nearly identical to one that this Court, in *Lentell*, held was insufficient to plead loss causation. *See Lentell*, 396 F.3d at 176 (allegation that "plaintiffs were injured 'because the risks that materialized were risks of which they were unaware as a result of Defendants' scheme to defraud'" did not plead loss causation because plaintiffs "allege no loss resulting from the market's realization that [Merrill Lynch's] opinions were false"). Plaintiffs are apparently aware of this problem. As a footnote to the sentence in their brief that cites it, plaintiffs request that this Court give them "permission to amend any deficiencies" in their complaint. (Blue Br. 13 n.3) Plaintiffs did not, however, move the District Court for leave to submit a Fourth Amended Complaint. They are therefore not permitted to seek leave to amend in this Court. *See Singleton v. Wulff*, 428 U.S. 106, 120 (1976) ("It is the general rule, of course, that a federal appellate court does not consider an issue not passed upon below."); *cf. McLaughlin v. Anderson*, 962 F.2d 187, 195 (2d Cir. 1992) (plaintiffs "never moved to amend" in the district court by asking for leave to re-plead in a footnote).

(dismissing securities fraud claim predicated on analyst reports; "the 'truth' . . . could not have leaked out and caused damage because it was never concealed. At all times, the market had access to both Lehman's opinions and facts about Razorfish and both were, therefore, incorporated into the stock price."); *see generally Basic Inc. v. Levinson*, 485 U.S. 224, 246-47 (1988) ("[T]he market price of shares traded on well-developed markets reflects all publicly available information.").

II. THE DISTRICT COURT PROPERLY DISMISSED THE COMPLAINT ON THE ALTERNATIVE GROUND THAT PLAINTIFFS FAILED TO PLEAD FALSITY

The District Court's order may also be affirmed on the independent ground that plaintiffs failed to plead the "falsity" element of their claims. That is, plaintiffs have not alleged facts demonstrating that Lehman's opinions about Sunrise were not truly held by its analysts. The District Court summarily dismissed the complaint on this alternative ground, and its ruling was correct. (SA8, "[T]he Complaint fails to plead facts necessary to demonstrate: (a) loss causation . . .; or (b) the falsity of the Analyst Reports.")

As the complaint makes clear, plaintiffs' claim is predicated on what plaintiffs claim are Lehman's misleading recommendations to buy Sunrise stock and misleading predictions about Sunrise's business. (A145 ¶ 2, A181 ¶¶ 120-23) All of the "False and Misleading Statements" (A170) that plaintiffs plead in their

complaint are expressions of opinion and optimism such as: "[w]e reiterate our 1-Buy rating" (A172 ¶ 96); "[i]nterest among opthalmologists remains high" (A172 ¶ 96); "potential for explosive growth seems achievable" (A172 ¶ 96); and "[w]e have seen doctors who already own Sunrise Hyperion lasers . . . appearing enthusiastic about Sunrise LTK." (A173 ¶ 96)

These statements of opinion are actionable, if at all, only if plaintiffs plead with particularity that Lehman believed them to be false when made. *See Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1095-96 (1991); *see also San Leandro Emergency Med. Group Profit Sharing Plan v. Philip Morris Cos.*, 75 F.3d 801, 813 n.13 (2d Cir. 1996) (affirming dismissal of securities fraud claim predicated, in part, on "optimistic projections" because complaint failed to plead facts showing that the issuer did not believe its projections were attainable). As one court in this circuit has aptly described plaintiffs' pleading obligation in a "false opinion" case such as this one:

> The *sine qua non* of a securities fraud claim based on false opinion is that defendants deliberately misrepresented a truly held opinion . . . . "[P]laintiffs who charge that a statement of opinion is materially misleading must 'allege with particularity' 'provable facts' to demonstrate that the statement of opinion . . . is both objectively and subjectively false."

Podany v. Robertson Stephens, Inc., 318 F. Supp. 2d 146, 153-54 (S.D.N.Y. 2004) (Lynch, J.) (quoting *Bond Opportunity Fund v. Unilab Corp.*, No. 99 Civ. 11074,

2003 WL 21058251, at *5 (S.D.N.Y. May 9, 2003), *aff'd*, 87 F. App'x 772 (2d Cir. 2004)).

Plaintiffs did not meet this standard. Their claims are based on the thinly disguised notion that, with the benefit of hindsight and in light of information that was available to the entire market, they have now found reasons to disagree with Lehman's recommendations. (*See, e.g.*, A173 ¶ 97(d), Lehman's "analysts issued more positive reports and ratings than were justified"; A145 ¶ 2, "Defendants touted Sunrise stock as a 'Strong Buy' with a projected 'target' price of $19.00 per share, which, as Defendants well knew, was totally unsupported by any objective facts or analysis.") The Court has consistently and repeatedly held that this type of "fraud by hindsight" claim is not actionable. *See, e.g.*, *Stevelman v. Alias Research, Inc.*, 174 F.3d 79, 85 (2d Cir. 1999) ("[O]verly optimistic disclosures . . . amount to allegations of 'fraud by hindsight,' which this Court has rejected as a basis for a securities fraud complaint."); *Shields v. Citytrust Bancorp, Inc.*, 25 F.3d 1124, 1129 (2d Cir. 1994) ("[M]isguided optimism is not a cause of action, and does not support an inference of fraud. We have rejected the legitimacy of 'alleging fraud by hindsight.'") (quoting *Denny v. Barber*, 576 F.2d 465, 470 (2d Cir. 1978) (Friendly, J.)); *see also In re Salomon Analyst A T & T Litig.*, 350 F. Supp. 2d at 466 ("It is not sufficient . . . to allege that an opinion was unreasonable,

irrational, excessively optimistic, not borne out by subsequent events, or any other characterization that relies on hindsight . . . .").

Plaintiffs must plead *facts* to support an inference that Lehman believed its expressions of optimism and statements of opinion to be false when they were made. *See, e.g., Rombach*, 355 F.3d at 174 ("[P]laintiffs must do more than say that the statements . . . were false and misleading; they must demonstrate with specificity why and how that is so."). They have failed to do so. Instead, the complaint makes a boilerplate allegation, not supported by any facts, that "Defendants . . . knew or recklessly disregarded that their statements . . . and rating system were false at the time they made these statements." (A188 ¶ 144) This conclusory allegation is insufficient to plead falsity with the particularity required by Rule 9(b) and the Reform Act. *See In re Credit Suisse First Boston Corp.*, 431 F.3d 36, 49 (1st Cir. 2005) ("[C]onclusory allegations regarding an analyst's hidden beliefs are not sufficient to ground an assertion of subjective falsity."); *In re Salomon Analyst A T& T Litig.*, 350 F. Supp. 2d at 467 ("Plaintiffs' bald conclusory assertion that [the analyst] did, in fact, misrepresent his true opinion of AWE is likewise insufficient."); *Pfeiffer v. Goldman, Sachs & Co.*, No. 02 Civ. 6912, 2003 WL 21505876, at *5 (S.D.N.Y. July 1, 2003) ("The fatal flaw of the pleadings is that nowhere does the Amended Complaint state *why* the recommendations were false or misleading. . . . Lacking is any specific allegation

that the ratings were false, as opposed to overly optimistic or unwise . . . .") (emphasis in original), *aff'd*, 93 F. App'x 326 (2d Cir. 2004).[8]

Plaintiffs attempt to hide their inability to plead falsity by making generalized allegations concerning analyst conflicts at Lehman, even though not one of these allegations relates to Lehman's views about Sunrise. (A157 ¶¶ 34-84) These allegations do not satisfy plaintiffs' obligation to plead with particularity that the opinions at issue in *this* case were false when made. "[A]lleging the existence of such *other* schemes does not sufficiently plead that the opinions in *these* cases were fraudulent. The PSLRA requires that each separate instance of fraud be pled with particularity." *Podany*, 318 F. Supp. 2d at 157-58 (emphasis in original; dismissing securities fraud claims predicated on analyst reports); *see also In re Credit Suisse First Boston Corp.*, 431 F.3d at 49 ("[A] plaintiff cannot succeed in pleading subjective falsity merely by identifying an overarching

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[8] Indeed, the pre-*Lentell* district court decision on which plaintiffs rely, *Fogarazzo v. Lehman Brothers, Inc.*, 341 F. Supp. 2d 274 (S.D.N.Y. 2004), is distinguishable for this reason. In *Fogarazzo*, unlike in this case, plaintiffs at least attempted to allege falsity with specific facts that the analyst at issue did not believe his recommendations. *See id.* at 282 (citing paragraphs from plaintiffs' complaint). Also, Judge Scheindlin—the author of the *Fogarazzo* decision—has subsequently acknowledged that, after *Lentell*, a plaintiff claiming that an analyst made "omissions or misrepresentations" to increase the price of a stock must allege, to show loss causation, "that, at some point, the concealed scheme was disclosed to the public." *See In re IPO*, 399 F. Supp. 2d at 266. As noted above, there has *never* been a disclosure that Lehman engaged in any "scheme" concerning Sunrise.

fraudulent scheme or corrupt environment."); *In re Salomon Analyst Level 3 Litig.*, 350 F. Supp. 2d at 492 ("[G]eneralized allegations about conflicts of interest, incentives to increase compensation, or internal pressure on analysts that is not tied to the particular stock at issue are not sufficient, standing alone, to satisfy the particularity requirements.").

Plaintiffs' conclusory, non-specific averments are insufficient to satisfy the Reform Act's requirement that plaintiffs plead the falsity of allegedly fraudulent statements with particularity. *See also, e.g.*, *In re JP Morgan Chase Secs. Litig.*, 363 F. Supp. 2d at 633 (dismissing analyst fraud claim because "[t]here are no particular facts alleged suggesting that JPM Chase or the individual analysts believed these 'buy' ratings to be false at the time they were issued"). For this independent reason, the District Court's order should be affirmed.[9]

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[9] *See also San Leandro*, 75 F.3d at 813 n.13; *Podany*, 318 F. Supp. 2d at 156 (dismissing securities fraud claims based on allegedly false opinions because plaintiffs failed to make "particularized allegations of 'provable facts' supporting an inference that the opinions were not truly held"); *Serova v. Teplen*, No. 05 Civ. 6748, 2006 WL 349624, at *6 (S.D.N.Y. Feb. 16, 2006) (dismissing securities fraud claim where plaintiff "fails to allege—let alone allege with particularity—that [defendant] did not sincerely believe" his "expression of opinion" when made); *Dresner v. Utility.com, Inc.*, 371 F. Supp. 2d 476, 496 (S.D.N.Y. 2005) (dismissing complaint where plaintiffs had "not alleged facts indicating that the statements were false at the time they were made"); *In re Merrill Lynch*, 273 F. Supp. 2d at 373 (plaintiffs made no allegation that analysts made false statements in their reports; "the pleading of a motive to issue false statements does not establish that false statements were in fact issued").

III. THE DISTRICT COURT'S ORDER MAY BE AFFIRMED ON THE ALTERNATIVE GROUND THAT PLAINTIFFS' CLAIMS ARE TIME-BARRED

The District Court's order may also be affirmed on the alternative ground that plaintiffs' claims are time-barred. As re-characterized in their appellate brief—though not pleaded in their complaint—the basis for plaintiffs' claims is Lehman's purportedly fraudulent "omissions" of certain "material risks" in their analyst reports for Sunrise securities. The facts underlying these re-characterized claims were disclosed no later than April 6, 2001. They are therefore barred under the applicable one-year statute of limitations, because plaintiffs did not file their complaint until more than three years later, on May 7, 2004.

A. The One-Year Limitations Period Accrues When Plaintiffs Knew, or Objectively Should Have Known, of the Alleged Fraud

Under § 10(b), claims of securities fraud must be "brought within one year after the discovery of the facts constituting the violation." 15 U.S.C. § 78i(e). The Sarbanes-Oxley Act of 2002 extended this limitations period to two years. *See* Pub. L. No. 107-204, § 804(a), 116 Stat. 745, 801 (2002) (codified at 28 U.S.C. § 1658). However, under this Court's decision in *In re Enterprise Mortgage Acceptance Co. L.L.C. Securities Litigation*, 391 F.3d 401, 411 (2d Cir. 2004), that extension does not revive claims that were already time-barred as of July 30, 2002 (the effective date of Sarbanes-Oxley) under the prior one-year limitations period. *See also Shah v. Meeker*, 435 F.3d 244, 248-49 (2d Cir. 2006). As set forth below,

plaintiffs' claims accrued no later than April 6, 2001, and were thus barred by April 6, 2002, before the enactment of Sarbanes-Oxley. Accordingly, the prior one-year limitations period applies to their claims. *See In re Enterprise Mortgage*, 391 F.3d at 411. Regardless of whether the applicable limitations period is one or two years, however, plaintiffs' claims are time-barred because they did not commence this action until May 7, 2004, more than three years after their claims accrued.

A securities fraud claim accrues when a plaintiff has actual or constructive notice of the facts giving rise to her claims:

> The one-year limitations period applicable to discovery of the violation begins to run after the plaintiff "obtains actual knowledge of the facts giving rise to the action *or notice of facts which in the exercise of reasonable diligence, would have led to actual knowledge*." The emphasized words have been referred to as "constructive or inquiry notice."

LC Capital Partners, LP v. Frontier Ins. Group, Inc., 318 F.3d 148, 154 (2d Cir. 2003) (emphasis in original; quoting *Kahn v. Kohlberg, Kravis, Roberts & Co.*, 970 F.2d 1030, 1042 (2d Cir. 1992), and *Menowitz v. Brown*, 991 F.2d 36, 41-42 (2d Cir. 1993), respectively). The test as to when the facts giving rise to a claim should have been discovered is "an objective one": "The means of knowledge are the same thing in effect as knowledge itself." *Dodds v. Cigna Sec., Inc.*, 12 F.3d 346, 352 (2d Cir. 1993) (internal punctuation omitted). "If the investor makes no

inquiry once the duty arises, knowledge will be imputed as of the date the duty arose." *LC Capital Partners*, 318 F.3d at 154.

Also, "[a]n investor does not have to have notice of the entire fraud being perpetrated to be on inquiry notice." *Newman v. Warnaco Group, Inc.*, 335 F.3d 187, 193 (2d Cir. 2003) (quoting *Dodds*, 12 F.3d at 351-52). "Storm warnings" that would alert a reasonable person "to the probability that there were either misleading statements or significant omissions involved" will trigger the duty of inquiry and start the prescriptive clock. *Id.* at 193 (internal quotation marks omitted). And, as the Court has repeatedly stated, the issue of inquiry notice may be resolved on a motion to dismiss "'[w]here . . . the facts needed for determination of when a reasonable investor of ordinary intelligence would have been aware of the existence of fraud can be gleaned from the complaint and papers . . . integral to the complaint.'" *LC Capital Partners*, 318 F.3d at 156 (ellipsis in original; quoting *Dodds*, 12 F.3d at 352 n.3). Indeed, the Court has "done so in a 'vast number of cases.'" *Id.* (quoting *Dodds*, 12 F.3d at 352 n.3).

B. Plaintiffs Were on Inquiry Notice of Their Claims More Than Three Years Before They Filed Their Complaint

Plaintiffs were on inquiry notice of the probability of Lehman's supposed "misleading statements or significant omissions" (*Newman*, 335 F.3d at 193) for more than three years before they brought their complaint. According to plaintiffs'

brief on appeal, Lehman failed to state two categories of "risks" about Sunrise's business and the materialization of these risks caused their losses.

First, plaintiffs contend that Lehman's analyst reports omitted certain shortcomings of the Sunrise laser:

> Sunrise's Hyperion laser procedure, when used in accordance with the FDA approved protocol: (i) often resulted in patients experiencing induced astigmatism as an unintended negative side effect of treatment; (ii) that patients experienced early regression of effect; and (iii) that many treating opthalmologists were unable to consistently pre-determine the degree of vision correction patients would experience after undergoing a procedure.

(Blue Br. 6) All of these shortcomings were disclosed in the FDA approval package as early as June 30, 2000. (A293, laser is for "[t]emporary reduction of hyperopia"; A303, "approximately half of the effect seen at 6 months is gone at 2 years"; A333, possibility of induced astigmatism) Moreover, a Sunrise 10-K filed on April 6, 2001 expressly disclosed as "risk factors" to investing in Sunrise securities that "WE ARE A ONE-PRODUCT COMPANY" and that "[p]otential complications and side effects" of the Sunrise laser procedure include "regression of effect"; "induced astigmatism"; and "unintended over or under correction." (A281-82)

Second, plaintiffs contend that Lehman's predictions for Sunrise's year 2000 sales failed to mention the agreement between Sunrise and U.S. Medical. (Blue Br. 5-6) The facts underlying this contention were disclosed in a Sunrise 8-K filed

on January 31, 2001. (A269, "The Company announced on January 2, 2001 that it had entered into agreements with U.S. Medical Corporation . . . and that U.S. Medical had agreed to purchase 15 units. The purchase increased the number of units shipped in the fourth quarter of 2000 . . . .")

Accordingly, by no later than April 6, 2001 plaintiffs were on inquiry notice of the facts supporting their notion that Lehman's analyst reports were fraudulent due to Lehman's purported "misrepresentations" about Sunrise's business. *See Arduini / Messina P'ship v. Nat'l Med. Fin. Servs. Corp.*, 74 F. Supp. 2d 352, 358-59 (S.D.N.Y. 1999) (facts in SEC filings "raised a red flag" sufficient to put a reasonable investor on inquiry notice). And, because plaintiffs do not allege that they undertook any reasonable diligence, knowledge of this claim is imputed to plaintiffs as of no later than April 6, 2001. *See LC Capital Partners*, 318 F.3d at 154, 156. Plaintiffs' claims are thus barred under the one-year limitations period, because they did not file their complaint until more than three years later, on May 7, 2004. *See, e.g.*, *id.* at 155 (affirming dismissal of securities fraud claim when "storm warnings" of alleged fraud in, *inter alia*, "publicly filed documents" gave rise to a duty of inquiry more than a year and half before plaintiffs commenced the action); *Dodds*, 12 F.3d at 351-52.

C. Plaintiffs' Anticipated Counterarguments Are Meritless

In light of its ruling that plaintiffs failed to allege loss causation, the District Court did not address Lehman's argument that the Third Amended Complaint should be dismissed as untimely. In opposition to Lehman's motion to dismiss the Second Amended Complaint, however, plaintiffs persuaded the District Court to rule that their action was timely because, they claimed, they could not have known of Lehman's alleged fraud until April 28, 2003, when consent orders were entered in connection with charges brought against Lehman by the SEC, the NASD, and the Attorneys General of various states. *See Joffee*, 2005 WL 1492101, at *7. These charges, according to the complaint, asserted that Lehman issued "false and misleading analyst reports" on "numerous companies" and that Lehman's positive ratings and research reports on "numerous companies" were contrary to Lehman's "internal assessments of the true value and prospects of such companies." (A146 ¶ 4)

Sunrise was not, however, among the issuers mentioned in the SEC complaints against Lehman. Nor does the complaint so allege. The April 28, 2003 consent orders thus do not, as plaintiffs contend, support their fraud claim or trigger their limitations period. As this Court has held in other analyst fraud cases, the "'triggering . . . data must be such that it relates *directly* to the misrepresentations and omissions the Plaintiffs allege in their action against the

defendants.'" *Lentell*, 396 F.3d at 168 (emphasis in original; quoting *Newman*, 335 F.3d at 193); *see also Shah*, 435 F.3d at 251.

Indeed, in an attempt to escape the grasp of *Lentell*, plaintiffs are at pains to characterize their claim as centering on specific facts that Lehman purportedly "misrepresented" or "concealed"—and *not* on the sort of analyst conflicts of interest that plaintiffs glean from the April 2003 consent orders and were at issue in *Lentell* and *Shah*. (Blue Br. 17, "[T]he true nature of the problems defendants misstated, concealed, and distorted ultimately caused the collapse of Sunrise, resulting in plaintiffs' losses.") But the one-year limitations period on this claim was triggered years before the April 2003 consent orders, when the facts that Lehman had purportedly "misstated" or "concealed" in its analyst reports were publicly disclosed. *See, e.g.*, *LC Capital Partners*, 318 F.3d at 155 (press releases and SEC filings gave plaintiffs adequate "storm warnings" of alleged fraud).

It is no answer to contend, as plaintiffs likely will, that their claims did not accrue in April 2001 because they could not have adequately alleged Lehman's fraudulent intent until the disclosure of the consent orders in April 2003. Again, nothing in the consent orders relates to Lehman's alleged fraudulent intent in connection with Sunrise securities. Rather, according to the complaint, the consent orders described the purportedly "undue pressures or influences" under which Lehman's analysts operated. (A179-80 ¶¶ 114-15) As this Court stated in *Lentell*,

however, "[c]onflicts of interest present opportunities for fraud, but they do not, standing alone, evidence fraud—let alone furnish a basis sufficiently particular to support a fraud complaint." 396 F.3d at 170; *see also Miller v. Champion Enters., Inc.*, 346 F.3d 660, 674 (6th Cir. 2003) ("[A]llegations of scienter were not asserted in relation to a statement or omission of a material fact, but rather with respect to [defendant's] actions throughout the underlying situation, and thus do not allege scienter sufficient as a basis for a securities fraud action."); *Podany*, 318 F. Supp. 2d at 157-58.

The only averments in the complaint that could bear on Lehman's scienter in connection with Sunrise securities is that Lehman was an investor in Sunrise, performed investment banking services for Sunrise, participated in an $11.7 million private placement for Sunrise securities, and that an employee of Lehman served as a director for Sunrise. (A156 ¶ 31; A170 ¶¶ 86-87; A177 ¶ 107) While these facts would not suffice to show scienter in connection with the non-existent fraud alleged here, they were all disclosed in Sunrise's SEC filings and the challenged analyst reports by no later than August 10, 2000—more than two years before plaintiffs filed their complaint.[10]

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[10] *See* A213, Sunrise 8-K, filed on January 14, 2000, disclosing LBI Group, Inc.'s participation in the $11.7 million private placement; *see also, e.g.*, A390, Lehman analyst report dated August 10, 2000 disclosing that "Lehman Brothers Inc. managed or co-managed within the past three years a public offering of securities for this company [Sunrise]," "[a]n employee of Lehman Brothers is a

* * *

Plaintiffs' claims thus accrued by no later than April 6, 2001—the date Sunrise filed a 10-K disclosing the precise shortcomings with the Sunrise laser that plaintiffs allege Lehman "concealed" in its analyst reports. Because plaintiffs did not file their complaint until more than three years later, their claims are barred under the applicable one-year statute of limitations. *See, e.g., Shah*, 435 F.3d at 251; *LC Capital*, 318 F.3d at 156-57; *Dodds*, 12 F.3d at 352. The Court may affirm the District Court's order on this alternative ground.

(continued…)

director of this company," and "Lehman Brothers makes a market in the securities of this company."

CONCLUSION

The District Court's order granting Lehman's motion to dismiss the Third Amended Complaint should be affirmed.

Dated: August 15, 2006
New York, New York

Respectfully submitted,
JONES DAY

By: /s/ Todd R. Geremia
Jayant W. Tambe
Aviva Warter Sisitsky
Todd R. Geremia
222 East 41st Street
New York, New York 10017-6702
(212) 326-3939

Attorneys for Defendants-Appellees, Lehman Brothers Inc., Kenneth N. Goldman, M.D., and David A. Gruber, M.D.

CERTIFICATE OF COMPLIANCE

This brief complies with the type-volume limitation in Federal Rule of Appellate Procedure 32(a)(7)(B)(i). It contains 11,614 words as counted by the word-processing system used to prepare the brief, exclusive of the parts of the brief exempted from the type-volume limitation by Federal Rule of Appellate Procedure 32(a)(7)(B)(iii).

Dated: August 15, 2006

/s/ Todd R. Geremia
Todd R. Geremia
Attorney for Appellees

ANTI-VIRUS CERTIFICATION

Case Name: Joffee v. Lehman

Docket Number: 06-0903-cv

I, Natasha R. Monell, hereby certify that the Appellee's Brief submitted in PDF form as an e-mail attachment to **briefs@ca2.uscourts.gov** in the above referenced case, was scanned using Norton Antivirus Professional Edition 2003 (with updated virus definition file as of 8/15/2006) and found to be VIRUS FREE.

/s/ Natasha R. Monell
Natasha R. Monell, Esq.
Staff Counsel
Record Press, Inc.

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