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United States Court of Appeals,
Eleventh Circuit.

Rochelle PHILLIPS, on behalf of herself and all others similarly situated, Kalford C. Fadem, et al., Plaintiffs–Appellants,
v.
SCIENTIFIC–ATLANTA, INC., Wallace G. Haislip, et al., Defendants–Appellees.
No. 10–15910. | Sept. 6, 2012.

Attorneys and Law Firms

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Appeal from the United States District Court for the Northern District of Georgia. D.C. Docket No. 1:01–cv–01950–RWS.

Before WILSON, KRAVITCH and EDMONDSON, Circuit Judges.

Opinion

***1** This appeal is from the grant of summary judgment to Defendants. The case involves allegations of securities fraud—a fraud on the market—brought by private parties as part of a putative class action. Claims under the Securities Exchange Act of 1934 (“the Exchange Act”) and Rule 10b–5 as promulgated thereunder are involved.

Plaintiffs contend that Defendant Scientific–Atlanta, Inc. and certain members of the company's senior management issued materially false and misleading statements during the class period; that these statements caused Plaintiffs to purchase S–A securities at artificially-inflated prices; and that Plaintiffs experienced losses on their investments when S–A issued certain “corrective disclosures” in 2001. The district court granted summary judgment for Defendants based solely on Plaintiffs' failure to present sufficient evidence of “loss causation.” We affirm the judgment.

BACKGROUND

Defendant Scientific–Atlanta, Inc. (“S–A”) manufactures and sells products—such as digital set-top boxes—for use in the cable television industry. Defendants Wallace G. Haislip and James F. McDonald were S–A's CFO and CEO (together with S–A, “the Defendants”). This case pertains to S–A's financial performance in fiscal year 2001 (July 2000 to June 2001) and to certain statements made by the Defendants during the putative class period about S–A's financial performance.

In a nutshell, Plaintiffs' complaint contended that the Defendants engaged in “channel stuffing”[1] to cover up decreasing demand for S–As products; that Defendants issued materially false and misleading statements as part of the purported cover-up; that Plaintiffs relied upon these statements in purchasing their S–A securities; and that the eventual disclosure of the truth in Defendants' later issued “corrective disclosures” caused the price of Plaintiffs' S–A securities to fall and caused Plaintiffs to experience losses on their investments.

Plaintiffs' complaint contended that, even while S–A performed very well in the first fiscal quarter of 2001, S–A management became aware (and continued to learn over the course of the fiscal year) that various sales metrics for S–A products were declining or trending lower. Plaintiffs allege that Defendants responded by using discounts, warehousing credits, unusually liberal return policies, and extended repayment terms to bring sales of cable equipment to cable companies—referred to as Multiple System Operators (“MSOs”)—into earlier fiscal quarters and to hide the evidence of slowing sales and orders from shareholders, like Plaintiffs.

Plaintiffs' complaint contended that the alleged “channel stuffing” in this case was done specifically to hide a decrease in sales and orders from shareholders and to mislead investors about the company's strength and performance. In addition, Plaintiffs' complaint contended that Defendants—despite knowing that non-channel-stuffed sales were falling and that customer inventory was increasing—made materially false and misleading statements about S–A's financial performance during the second and third fiscal quarters, failed to disclose the slowdown in order volume, and failed to disclose the “channel stuffing” efforts being undertaken to advance sales from future fiscal quarters into S–A's second and third fiscal quarters.

***2** The series of allegedly materially false and misleading statements identified by Plaintiffs began on 18 January 2001—the start of the purported class period—with an S–A press release announcing “record financial results” for the second fiscal quarter of 2001 and a press release announcing an increase in manufacturing capacity “in response to the continuing acceleration in customer demand.” In an earnings-related conference call with analysts and the media, Defendant Haislip forecasted to the public continued growth in the set-top box business and subscriber sales in general. This tone continued when S–A issued a press release, in April 2001, reporting a large year-over-year increase[2] in sales in the third fiscal quarter and when Defendant McDonald—in a pair of interviews with the financial media-described rising customer demand and predicted strong performance in the upcoming fourth fiscal quarter.

Plaintiffs' complaint contended that the fraud was only revealed to the public in July and August 2001. In July 2001, when S–A reported its fourth fiscal quarter results, it announced that sales had decreased during the fiscal quarter. SA attributed the year-over-year decline in total bookings for the fourth quarter to "the uncertain economic climate and reduced digital marketing efforts by cable operators during the slower summer vacation period, in addition to customer inventory levels and the slower than expected deployment of interactive applications." In an earnings-related conference call with analysts and the media, Defendant McDonald attributed part of the announced decline in new orders to the absorption of inventory by MSOs. After these announcements, S–A's stock price fell steeply.

The last of the alleged "corrective disclosures" was made on 16 August 2001—the end of the purported class period—when S–A filed its Form 10–K for fiscal year 2001 with the SEC. The 10–K reported reduced demand for S–A's products and noted the impact of customers having accumulated inventory. In a related press release, Defendant Haislip stated that S–A anticipated adverse impacts in the next fiscal year and attributed the decline in demand for S–A products to the slowing economy and to the effect of a correction in customer inventory levels. After these announcements, S–A's stock price again fell steeply.

The district court denied Defendants' motion to dismiss under Federal Rule of Civil Procedure 12(b)(6) and Rule 9(b) of the PSLRA (requiring the pleading of fraud with particularity); allowed discovery; and then granted Defendants' Motion for Summary Judgment. The summary judgment was based on Plaintiffs' having failed to demonstrate a genuine issue of material fact about "loss causation." The district court explained that Plaintiffs' failure "to disentangle the effect of the new information regarding customer inventory levels from S–A's new, negative characterization of how industry-wide trends were affecting it specifically" was "fatal" to Plaintiffs' case: "the record evidence provides no method by which a jury can determine how much, if any, of Plaintiffs' loss is attributable to Defendants' failure to disclose its [sic] alleged channel stuffing activities."

DISCUSSION

***3** "Private federal securities fraud actions are based upon federal securities statutes and their implementing regulations," as interpreted by the courts. And "[i]n cases involving publicly traded securities and purchases or sales in public securities markets, the action's basic elements include: (1) a material misrepresentation (or omission); (2) scienter, i.e., a wrongful state of mind; (3) a connection with the purchase or sale of a security; (4) reliance ...; (5) economic loss; (6) 'loss causation,' i.e., a causal connection between the material misrepresentation and the loss." *Dura Pharms., Inc. v. Broudo*, 125 S.Ct. 1627, 1631 (2005) (citations omitted) (emphasis omitted); see also *Mizzaro v. Home Depot, Inc.*, 544 F.3d 1230, 1236–37 (11th Cir.2008).

The district court determined that Plaintiffs had presented genuine issues of material fact on all of the required elements of their claim, except for "loss causation." While a genuine issue of material fact must exist for each element of a claim to overcome a motion for summary judgment, we need only address the "loss causation" element here because our decision on that element—reviewing the record de novo—determines the outcome of this case.

About “loss causation” in fraud-on-the-market cases (like this case), we have said that “[t]he loss causation element of a Rule 10b–5 claim requires that the defendant's fraud be both the but—for and proximate cause of the plaintiff's later losses[:]” at least a “‘substantial’ or ‘significant contributing cause.’”[3] *FindWhat Investor Group v. FindWhat.com*, 658 F.3d 1282, 1309 (11th Cir.2011) (quoting *Robbins v. Kroger Properties, Inc.*, 116 F.3d 1441, 1447 (11th Cir.1997)). This principle means that, where plaintiffs in fraud-on-the-market cases attempt to demonstrate loss causation circumstantially by identifying a “corrective disclosure” and “showing that the stock price dropped soon after the corrective disclosure,” plaintiffs must also “eliminat[e] other possible explanations for this price drop, so that the factfinder can infer that it is more probable than not that it was the corrective disclosure—as opposed to other possible depressive factors—that caused at least a ‘substantial’ amount of the price drop.” *Id.* at 1311–12.

The press releases and interviews that Plaintiffs have identified as presenting the “corrective disclosures” in this case include multiple pieces of nonfraud-related information (for example, the uncertain economic climate, reduced marketing by S–A's customers, unexpectedly slow deployment of interactive digital cable services) that qualify as “other possible depressive factors”: revelations not about the supposed “channel stuffing.” The other factors could have caused some amount of the identified price drop. Absent sufficient disaggregation of the relative price effects of these different pieces of information, no fact-finder would be able to determine that the revelation of the supposed “channel stuffing” activities in this case satisfied the pertinent causation requirement.

***4** In opposing summary judgment, Plaintiffs offered the expert report and deposition of Dr. Scott Hakala. Dr. Hakala's report included an “event study” and other analysis that attempted to disaggregate the effects of some of the confounding factors.

Dr. Hakala sufficiently accounted for “industry-wide” confounding factors—such as the general slowing economy and the reduced digital marketing efforts made by cable operators during the slower summer vacation period—through the use of an industry index and his analytics. In effect, he separated (and dropped out of pricing consideration) S–A statements—in their entirety (that is, information related to the supposed fraud, as well as other information affecting stock price)—from general industry factors. And then Dr. Hakala concluded that general industry factors alone could not explain the price decline. But he did not dissaggregate (and made no attempt to dissaggregate) the impact of Defendants' statements that accurately presented the industry-wide factors that had—in fact—specifically impacted *on* S–A during the fourth fiscal quarter.

S–A's new, negative characterization of how industry-wide trends and the generally slowing economy were *affecting it specifically* during the fourth fiscal quarter of 2001 was new information when released to the market in July 2001 and August 2001: confounding information. And analyst reports that came out after pertinent releases included at least some discussion of this new impact of industry trends and the weakened economy on S–A. Given that the impact of this new, confounding information—an “other possible depressive factor”—was not disaggregated at all by Plaintiffs, no basis exists in the record by which any factfinder could sufficiently determine that the revelation of the supposed “channel stuffing” in this case satisfied the pertinent causation requirement.[4]

CONCLUSION

We see no reversible error. Plaintiffs have failed to eliminate sufficiently other possible explanations for the identified price drop. We therefore conclude no genuine issue of material fact exists on "loss causation"—a required element of Plaintiffs' claim—and AFFIRM the grant of summary judgment to Defendants.

AFFIRMED.

Footnotes

1 Broadly speaking, "channel stuffing" is the practice of pulling sales from future fiscal periods into the present fiscal period—by way of encouragement, discounts, or incentives—to increase current fiscal period performance: taking from the future to embellish the present. While "channel stuffing" is not per se illegal or fraudulent, it "may amount to fraudulent conduct when it is done to mislead investors." *Garfield v. NDC Health Corp.*, 466 F.3d 1255, 1262 (11th Cir.2006). One particular way "channel stuffing" can mislead investors is by creating the impression that sales for a product are strong, and will continue to be strong, when—in fact—"stuffed" product is stacking up at customers; and the product backlog will likely cause a slowing of future orders.

2 Used here, "year-over-year increase" means an increase from the previous year's third fiscal quarter to the pertinent third fiscal quarter. This concept is different from an increase from one fiscal quarter to the next fiscal quarter that immediately, temporally follows.

3 A "fraud on the market" theory of causation in securities cases is based on the idea that the pertinent securities market is "efficient" and properly prices in—that is, takes right account of—all available material information for the prices of its securities. In such a market, a material misrepresentation disseminated into the market will be translated into the price of all relevant securities. Likewise, when the misrepresentation is revealed for its true nature, the market will remove the effect of the misrepresentation from the price of the relevant securities. In the case of misrepresentations that positively impacted on the price of certain securities, the later revelation will cause a drop in price and a loss for anyone who purchased the securities when the price was elevated based on the positive misrepresentation. For further background, *see FindWhat*, 658 F.3d at 1309–10.

4 For the first time on appeal, Plaintiffs advance the argument that the new, negative characterization of how industry-wide trends and the slowing economy were affecting S–A specifically during the fourth fiscal quarter of 2001 was actually part and parcel with the revelation of the supposed "channel stuffing" activities; they say the new, negative characterizations need not be disaggregated because they are part of the revelation of the fraud. This argument—that S–A's talk about industry trends impacting negatively on S–A specifically was a "new characterization" that was part of the fraud disclosure—was not put to the district court. The district judge's job is to decide the case actually presented, based on the arguments actually and properly presented. District judges are not obliged to tweezer out or imaginatively to reframe the parties' arguments. Because this argument was first raised on appeal and was not presented to the district court at summary

judgment, we will not consider it now. *See, e.g., Ledford v. Peeples*, 657 F.3d 1222, 1258 (11th Cir.2011).