

Inside the Courts An Update From Skadden Securities Litigators

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In Affirming Dismissal of Securities Fraud Suit, Ninth Circuit Highlights How Stock Price Recovery Can Prevent Pleading of Loss Causation

On January 26, 2021, the Ninth U.S. Circuit Court of Appeals affirmed the dismissal of a putative securities fraud class action, holding that: (i) the plaintiffs could not plead loss causation for an alleged misstatement because the company's stock price recovered shortly after the supposed falsity of that statement came to light; and (ii) the remaining statements the plaintiffs challenged were protected by the Private Securities Litigation Reform Act's (PSLRA) safe harbor provision for forward-looking statements. See *Wochos v. Tesla, Inc.*, No. 19-15672 (9th Cir. Jan. 26, 2021).

In 2017, Tesla began increasing mass production of its Model 3 sedan. Throughout that year, Tesla made various statements suggesting or stating outright that it had started automated production of the Model 3 and was "on track" to be able to produce 5,000 Model 3s per week by the end of 2017. After those statements were made, *The Wall Street Journal* reported that Tesla was experiencing various production setbacks and that significant portions of the Model 3 were still being manufactured by hand late into the year. Subsequently, Tesla announced that it would not be able to meet its production goals. Following that announcement, purported Tesla investors brought a putative securities fraud class action under Section 10(b) of the Securities Exchange Act of 1934, alleging that Tesla had defrauded investors by expressing confidence in its ability to meet its 5,000-car-per-week production goal while hiding various production setbacks that made that goal unattainable. The district court dismissed the plaintiffs' claims with prejudice for failure to sufficiently plead that any Tesla statement was false or misleading when made.

The Ninth Circuit affirmed. The court rejected the plaintiffs' claim that Tesla's statements about having started production on the Model 3 were actionable in light of *The Wall Street Journal* article. The court noted that while Tesla's stock price dropped the day after the article was published, the price had almost entirely recovered a mere two days later. The court held that the "quick and sustained price recovery after the modest [initial] drop" refuted the inference that the revelation of Tesla's purported fraud "caused any material drop in the stock price." The court therefore held that the plaintiffs could not plead loss causation for this claim.

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The court further held that Tesla’s statements that it was “on track” to meet its production goals were forward-looking, and thus subject to the PSLRA’s safe harbor provision for forward-looking statements accompanied by meaningful cautionary language. The court rejected the plaintiffs’ argument that the “on track” statements were not subject to the PSLRA safe harbor because they contained implied representations about present facts — namely, that Tesla was not experiencing any production difficulties that could prevent it from meeting its goals. Rather, the court reasoned that a “statement that a company is ‘on track’ to achieve an announced objective” is merely another way “of declaring or reaffirming the objective itself,” and amounts to nothing more than a prediction “about how various future events will play out over the timeframe

defined by” the statement. Because statements about management’s future plans or objectives are explicitly protected by the PSLRA’s safe harbor, the court held that the “on track” statements were not actionable.

The court’s holding that a defendant can defeat loss causation at the pleading stage by pointing to a rapid stock price recovery shortly after a purported corrective disclosure may, depending on the circumstances, give defendants an additional tool to obtain early dismissals of securities fraud suits. Moreover, the court’s view that statements about planned timelines are generally forward-looking and thus subject to the PSLRA safe harbor if accompanied by meaningful cautionary language provides helpful guidance to companies discussing the status of future plans.