

1 UNITED STATES COURT OF APPEALS
2 FOR THE SECOND CIRCUIT

3
4 August Term, 2006
5

6
7 (Argued: October 11, 2006 Decided: January 31, 2007)
8

9 Docket No. 05-5805-cv
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13 JOHN LATTANZIO, HERBERT BLACK, PETER C. KORNMAN, MARY
14 CHEASTY KORNMAN, HAROLD G. GOVE, HAROLD LEVINSON, on behalf
15 of themselves and all others similarly situated, R.M.F.
16 GLOBAL, INC., on behalf of itself and all others similarly
17 situated,
18

19 Consolidated-Plaintiffs-Appellants,
20

21 -v.-
22

23 DELOITTE & TOUCHE LLP,
24

25 Defendant-Appellee,
26

27 WARNACO GROUP INC., LINDA WACHNER, WILLIAM S. FINKELSTEIN,
28 STANLEY P. SILVERSTEIN,
29

30 Defendants.
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32 - - - - -x
33

34 Before: JACOBS, Chief Judge, WALKER, Circuit
35 Judge, O'CONNOR, Associate Justice
36 Retired.*
37

38 Appeal from a judgment of the District Court for the
39 Southern District of New York (Cedarbaum, J.) dismissing

1 * The Honorable Sandra Day O'Connor, Associate Justice
2 Retired of the Supreme Court of the United States, sitting
3 by designation pursuant to 28 U.S.C. § 294(a).

1 putative class action, which alleged that Deloitte & Touche
2 LLP, as accountants to the issuer, violated § 10(b) of the
3 Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and
4 Rule 10b-5, 17 C.F.R. § 240.10b-5. For the following
5 reasons, we affirm.

6 FREDERICK W. GERKENS, III,
7 Lovell Stewart Halebian LLP, New
8 York, NY (Christopher Lovell, on
9 the brief), for Plaintiffs-
10 Appellants.

11 DANIEL F. KOLB, Davis Polk &
12 Wardwell, New York, NY (Amelia
13 T.R. Starr, on the brief), for
14 Defendant-Appellee.

15
16
17 DENNIS JACOBS, Chief Judge:

18
19 Plaintiffs, representing a putative class of persons
20 that purchased the stock of Warnaco Group, Inc. ("Warnaco"),
21 appeal from the judgment of the United States District Court
22 for the Southern District of New York (Cedarbaum, J.)
23 dismissing their securities fraud claim against Warnaco's
24 outside accountant, Deloitte & Touche LLP ("Deloitte"),
25 under Fed. R. Civ. P. 12(b)(6). (Defendant Warnaco has
26 settled.) Plaintiffs allege that Deloitte made numerous
27 misstatements regarding Warnaco's financial condition and
28 failed to correct previous misstatements; that the risk of
29 Warnaco's financial collapse was thereby concealed; and that

1 plaintiffs lost the value of their shares when Warnaco filed
2 for bankruptcy on June 11, 2001.

3 In a thorough and well-reasoned opinion, the district
4 court concluded that:

5 [i] Deloitte was not liable for Warnaco's
6 quarterly statements, which it did not audit;

7 [ii] Deloitte had no duty during the class
8 period to correct statements or misstatements made
9 by Deloitte prior to the class period; and

10 [iii] Plaintiffs inadequately alleged loss
11 causation in connection with the statements that
12 Deloitte made during the class period.

13 For the following reasons, we reach the same conclusions as
14 the district court.

15
16 **I**

17 In the months leading up to its June 11, 2001
18 bankruptcy filing, Warnaco had defaulted on its credit
19 agreements, had failed to obtain waivers from its creditors,
20 and had seen its stock price plunge to "almost zero." (Am.
21 Class Action Compl. ¶ 5 [hereinafter "Compl."].) Plaintiffs
22 represent a putative class of persons that purchased Warnaco

1 common stock between August 15, 2000 and June 8, 2001 (the
2 "Class Period"). Throughout the Class Period, Deloitte
3 served as Warnaco's outside accountant, a role it had filled
4 since November 1999.

5 In reviewing a dismissal pursuant to Fed. R. Civ. P.
6 12(b)(6), we assume plaintiffs' allegations to be true.
7 Lentell v. Merrill Lynch & Co., 396 F.3d 161, 165 (2d Cir.
8 2005). We therefore recount the allegations of Deloitte's
9 misstatements (and failures to correct) contained in
10 plaintiffs' complaint.

11
12 The Allegations as to the 1999 Form 10-K

13 Warnaco's initial Form 10-K for the year 1999 was filed
14 on March 31, 2000. Amended forms were filed on April 3,
15 2000 and May 16, 2000 (collectively, the "1999 10-K"). Each
16 of these filings contained Deloitte's statement that it had
17 "audited the accompanying consolidated balance sheet of
18 [Warnaco] . . . in accordance with auditing standards
19 generally accepted In our opinion, [the]
20 consolidated financial statements present fairly, in all
21 material respects, the financial position of [Warnaco] as of
22 January 1, 2000." (Compl. ¶ 80.)

23 The allegation as to the 1999 10-K is that total

1 shareholder equity ("TSE") was stated as \$563 million
2 instead of \$533 million. Of the \$30 million overstatement,
3 \$26 million was attributed to Warnaco's failure to properly
4 account for charge-backs resulting from the return of goods
5 by retailers in the period from 1997 to 1999. Deloitte
6 allegedly became aware of the improper charge-back
7 accounting in February 2000, but did not correct Warnaco's
8 financial statements until March 2001 (the "Charge-back
9 Restatement").

10 The remaining \$4 million net overstatement was
11 attributed to erroneous inter-company accounting between
12 Warnaco and its wholly-owned subsidiary Designer Holdings
13 (including an understatement of accounts payable by \$18
14 million, which presumably was offset somehow in arriving at
15 the \$4 million net overstatement). According to plaintiffs,
16 these misstatements "occurred when Samuel Batraki,
17 Deloitte's senior auditor of Warnaco, became employed by
18 Warnaco . . . as a controller of Designer Holdings" in May
19 2000 (id. ¶¶ 2(c), 11)--although it appears that the 1999
20 10-K was filed before Batraki joined Warnaco. Deloitte
21 allegedly became aware of the errors in the inter-company
22 Designer Holdings accounting sometime in fall 2000, but did
23 not correct Warnaco's financial statements until August 22,

1 2001, after Warnaco was already in bankruptcy ("Designer
2 Holdings Restatement").

3
4 The Allegations as to Quarterly Statements

5 Warnaco filed three quarterly statements during the
6 Class Period: the August 15, 2000 Form 10-Q ("August 10-Q");
7 the November 16, 2000 Form 10-Q ("November 10-Q"); and the
8 May 26, 2001 Form 10-Q ("May 10-Q").

9 The allegation as to the August 10-Q is that TSE was
10 stated as \$480 million instead of \$334 million--a \$146
11 million error. As in the 1999 10-K, \$26 million of this
12 overstatement was attributed to the errors that were later
13 corrected in the Charge-back Restatement. Another \$17
14 million was attributed to the inter-company accounting
15 errors later corrected in the Designer Holdings Restatement.
16 Additionally, plaintiffs estimate that \$103 million of
17 inventory claimed by Warnaco in the August 10-Q was actually
18 worthless and unsaleable. Warnaco subsequently conceded a
19 \$13 million inventory overvaluation in an amended Form 10-
20 Q\A (the "April 2001 Restatement"); the remaining \$90
21 million has not been conceded by Warnaco or been the subject
22 of restatement. It is alleged that Deloitte knew of the
23 errors reflected in the April 2001 Restatement by (at least)

1 November 3, 2000--after the filing of the August 10-Q but
2 before the filing of the November 10-Q, discussed below.

3 The first allegation as to the November 10-Q is that
4 TSE was stated as \$348 million instead of \$198 million--a
5 \$150 million error. As with the August 10-Q, \$26 million
6 was attributed to the Charge-back Restatement and \$103
7 million was attributed to worthless inventory, which
8 included \$13 million attributed to the April 2001
9 Restatement. The Designer Holdings Restatement accounted
10 for the remaining \$20 million discrepancy.

11 The second allegation as to the November 10-Q is that
12 the figures for Warnaco's long-term debt and cash were
13 misstated to fake compliance with Warnaco's debt covenants.
14 Two weeks before the November 10-Q was filed, Warnaco issued
15 a press release stating that its long-term debt was \$1.79
16 billion and its TSE was \$348 million (including \$227 million
17 cash). According to plaintiffs, this debt-to-equity ratio
18 of over five-to-one violated Warnaco's debt covenants.
19 However, in the November 10-Q, Warnaco's cash and debt
20 figures were each reduced by \$190 million, leaving the
21 difference unaltered, but changing the ratio to an
22 acceptable 4.6-to-one, thus concealing Warnaco's non-
23 compliance with its covenants. Plaintiffs allege that

1 Deloitte was aware of the correct debt and equity
2 information in advance of Warnaco's November 2 press
3 release, and therefore knew that the information in the
4 November 10-Q was false.

5 The allegation as to the May 10-Q is that TSE was
6 stated as \$35 million instead of \$16 million in the red--a
7 \$51 million error. The entire discrepancy was attributed to
8 the inter-company accounting that was later corrected in the
9 Designer Holdings Restatement.

10 These quarterly statements (unlike the 1999 10-K) were
11 not audited by Deloitte, and were not accompanied by an
12 audit opinion. However, federal securities regulations
13 required that Deloitte "review" the statements, see 17
14 C.F.R. § 210.10-01(d), and plaintiffs allege that Deloitte
15 did.

16

17

18

19 The Allegations as to the 2000 Form 10-K

20 On April 17, 2001, Warnaco filed its Form 10-K for the
21 year 2000 (the "2000 10-K"). The 2000 10-K stated TSE as
22 \$77 million instead of \$27 million--a \$50 million net
23 discrepancy attributed to the inter-company accounting

1 corrected by the Designer Holdings Restatement, which later
2 conceded that the 2000 10-K understated accounts payable and
3 liabilities by \$97 million and overstated inventories by
4 \$1.2 million. The 2000 10-K (like the 1999 10-K) contained
5 Deloitte's statement that it had "audited the accompanying
6 consolidated balance sheet of [Warnaco] . . . in accordance
7 with auditing standards generally accepted In our
8 opinion, [the] consolidated financial statements present
9 fairly, in all material respects, the financial position of
10 [Warnaco] as of December 30, 2000." (Compl. ¶ 166.)

11 This audit opinion also delivered a "going concern"
12 warning that Warnaco "was not in compliance with certain
13 covenants of its long-term debt agreements as of December
14 30, 2000 as a result of losses in 2000, and [Warnaco] has a
15 working capital deficiency as of December 30, 2000. These
16 matters raise substantial doubt about its ability to
17 continue as a going concern."

18 19 II

20 We review a district court's grant of a motion to
21 dismiss de novo. Allaire Corp. v. Okumus, 433 F.3d 248,
22 249-50 (2d Cir. 2006). Plaintiffs assert two claims against

1 Deloitte: [i] violation of § 10(b) of the Securities
2 Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5, 17
3 C.F.R. § 240.10b-5, and [ii] breach of common law fiduciary
4 duty.

5 To state a claim under § 10(b) and Rule 10b-5,
6 plaintiffs must allege that Deloitte "(1) made misstatements
7 or omissions of material fact; (2) with scienter; (3) in
8 connection with the purchase or sale of securities; (4) upon
9 which plaintiffs relied; and (5) that plaintiffs' reliance
10 was the proximate cause of their injury." In re IBM Sec.
11 Litig., 163 F.3d 102, 106 (2d Cir. 1998). On this appeal,
12 the decisive questions are whether Deloitte made an
13 actionable misstatement and whether any such misstatement
14 was the proximate cause of plaintiffs' losses.

16 III

17 Plaintiffs allege that each of Warnaco's filings
18 discussed above was a misstatement by Deloitte, either
19 because Deloitte made a false statement in connection with
20 the filing or because Deloitte was silent despite a duty to
21 correct a false statement. Deloitte argues that [i] the 10-
22 Qs contained no statements by Deloitte within the scope of

1 § 10(b) because they were unaudited; and [ii] Deloitte is
2 not liable to plaintiffs for any alleged misstatements in
3 the 1999 10-K because it was filed before the Class Period.

4 The starting point for analysis is Central Bank of
5 Denver v. First Interstate Bank of Denver, 511 U.S. 164
6 (1994), which held that § 10(b) imposes liability only on a
7 person who makes a material misstatement or omission, and
8 that there is therefore no liability for aiding and
9 abetting. Id. at 177; see also Shapiro v. Cantor, 123 F.3d
10 717, 720-21 (2d Cir. 1997). Accordingly, to state a § 10(b)
11 claim against an issuer's accountant, a plaintiff must
12 allege a misstatement that is attributed to the accountant
13 "at the time of its dissemination," and cannot rely on the
14 accountant's alleged assistance in the drafting or
15 compilation of a filing. Wright v. Ernst & Young LLP, 152
16 F.3d 169, 174 (2d Cir. 1998).

17
18
19 The 1999 10-K

20 The allegations concerning the 1999 10-K easily satisfy
21 the standard: the filing contained an audit opinion,
22 attributed to Deloitte, attesting to the accuracy of the
23 allegedly false financial information. However, "[a]

1 defendant . . . is liable only for those statements made
2 during the class period," IBM Corp., 163 F.3d at 107, and
3 the latest 1999 10-K was filed on May 16, 2000--three months
4 before the start of the Class Period.

5 To surmount this hurdle, plaintiffs invoke Wright v.
6 Ernst & Young for the proposition that accountants have a
7 duty to correct misstatements in prior financial filings,
8 the breach of which "can constitute a false or misleading
9 statement within the meaning of § 10(b) and Rule 10b-5."

10 152 F.3d at 177. Thus, plaintiffs argue that Deloitte
11 breached a duty to correct Warnaco's misstatements in the
12 1999 10-K, and that this breach extended into the Class
13 Period. Even assuming that Wright says so much, Deloitte's
14 statement was made (if at all) when a duty to correct arose,
15 that is, when Deloitte learned that its prior statement (in
16 the form of the audit opinion) was untrue. Otherwise (i.e.,
17 if an accountant's breach of a duty to correct were not
18 fixed at a point in time), little would be left of the
19 limitation that "[a] defendant . . . is liable only for
20 those statements made during the class period." IBM Corp.,
21 163 F.3d at 107; see also In re The Warnaco Group, Inc. Sec.
22 Litig., 388 F. Supp. 2d 307, 315 (S.D.N.Y. 2005)
23 (recognizing that if we were to adopt plaintiffs' endless

1 breach argument, "all knowing misstatements made before the
2 class period, which remain uncorrected, would be actionable
3 within the class period on an omission theory").

4 It is alleged that Deloitte became aware of errors in
5 the 1999 10-K in February 2000 (as to the errors related to
6 the Charge-back Restatement) and in fall 2000 (as to the
7 errors related to the Designer Holdings Restatement). Thus
8 Deloitte's silence as to the Charge-back Restatement would
9 have become a false or misleading statement in February
10 2000; since February 2000 predates the Class Period, it
11 cannot be said that Deloitte's failure to correct
12 constituted a statement made during the Class Period.

13 Deloitte's alleged duty to correct the errors related
14 to the Designer Holdings Restatement arose in fall 2000,
15 which is within the Class Period; however, we need not
16 decide if Deloitte's failure to correct the 1999 10-K in
17 fall 2000 was a statement for purposes of § 10(b) and Rule
18 10b-5 because, as we explain below, plaintiffs have
19 insufficiently alleged that these errors caused their loss.

20 21 The Quarterly Statements

22 Warnaco's quarterly statements (the August 10-Q, the
23 November 10-Q, and the May 10-Q) were filed within the Class

1 Period, but they did not purport to be audited by Deloitte,
2 did not contain an audit opinion by Deloitte, and were not
3 attributed to Deloitte when they were disseminated. See
4 Wright, 152 F.3d at 174. Under Central Bank, Deloitte is
5 not liable for merely assisting in the drafting and filing
6 of the quarterly statements. Plaintiffs argue that
7 Deloitte's regulatory obligation to review Warnaco's
8 quarterly statements entails a duty to correct, and that the
9 failure to correct amounts to a statement by Deloitte that
10 Warnaco's statements are correct.

11 Absent an audit opinion, the existence of a duty to
12 correct cannot by itself translate Deloitte's silence
13 regarding the 10-Qs into an actionable misstatement. "[I]f
14 an accountant does not issue a public opinion about a
15 company[, it is not] responsible for the company's public
16 statements . . . merely because the accountant may know
17 those statements are likely untrue." Shapiro, 123 F.3d at
18 721. The accountant's duty extends only "to correct [an]
19 earlier financial statement which [the accountant] had
20 audited [it]self and upon which [the accountant] had issued
21 [its] certificate." United States v. Natelli, 527 F.2d 311,
22 319 (2d Cir. 1976); see also IIT v. Cornfeld, 619 F.2d 909,
23 927 (2d Cir. 1980) (an accountant has "no independent duty

1 to see to the correction of the portions of the prospectus
2 other than the financial statement it prepared”).

3 Plaintiffs accurately observe that a federal regulation
4 required Deloitte, as Warnaco’s outside accountant, to
5 conduct a review of Warnaco’s quarterly statements.

6 Plaintiffs thereby argue that an investor (understanding
7 Deloitte’s regulatory obligation) would construe Deloitte’s
8 silence as its imprimatur. This argument rests on 17 C.F.R.
9 § 210.10-01(d):

10 Prior to filing, interim financial statements
11 included in quarterly reports on Form 10-Q . . .
12 must be reviewed by an independent public
13 accountant using professional standards and
14 procedures for conducting such reviews, as
15 established by generally accepted auditing
16 standards If, in any filing, the company
17 states that interim financial statements have been
18 reviewed by an independent public accountant, a
19 report of the accountant on the review must be
20 filed with the interim financial statements.

21
22 It is alleged that Deloitte’s mandated review of Warnaco’s
23 quarterly statements associated Deloitte with those
24 statements to such a degree that they became Deloitte’s
25 statements, or that the review created a regulatory duty to
26 correct, the breach of which qualifies as a statement under
27 § 10(b). We disagree.

28 Wright declined to adopt a “substantial participation”
29 test for liability under § 10(b), instead holding that a

1 party can incur liability only if a misstatement is
2 attributed to it at the time of dissemination. 152 F.3d at
3 175. In so holding, we twice cited approvingly to In re
4 Kendall Square Research Group Corp. Sec. Litig., 868 F.
5 Supp. 26, 28 (D. Mass. 1994), for the proposition that an
6 accountant's review and approval of a company's financial
7 statement are insufficient to support the imposition of
8 liability on the accountant. Wright, 152 F.3d at 174, 175.

9 As plaintiffs contend, a requirement that an issuer's
10 accountant review interim financial statements supports an
11 understanding among the investing public that such reviews
12 are in fact conducted. Wright declined to impose accountant
13 liability under § 10(b) notwithstanding public awareness of
14 an accountant's review of its client's statements. True, §
15 210.10-01(d) is a federal regulation promulgated by the SEC.
16 As plaintiffs admit, however, that regulation is merely a
17 codification of prior accounting standards, which would have
18 supported the same public understanding.

19 The plaintiffs in Wright claimed that "the market
20 understood" the company's allegedly false press release "as
21 an implied assertion" of accuracy by the defendant
22 accountant. Id. at 176. That argument failed because,
23 notwithstanding what the public may have understood, the

1 accountant's "assurances were never communicated to the
2 public." Id. Public understanding that an accountant is at
3 work behind the scenes does not create an exception to the
4 requirement that an actionable misstatement be made by the
5 accountant. See Central Bank, 511 U.S. at 177. Unless the
6 public's understanding is based on the accountant's
7 articulated statement, the source for that understanding--
8 whether it be a regulation, an accounting practice, or
9 something else--does not matter.

10 Alternatively, plaintiffs argue that § 210.10-01(d)
11 imposes on accountants an actionable duty under § 10(b) to
12 correct unaudited interim financial statements, i.e., that
13 the regulation required Deloitte to review Warnaco's
14 quarterly statements; that this review implies a duty to
15 correct the statements if they are false; and that a breach
16 of the duty to correct amounts to a statement for purposes
17 of § 10(b). We reject this argument.

18 The private right of action under § 10(b) and Rule 10b-
19 5 is a "judicial oak which has grown from little more than a
20 legislative acorn." Blue Chip Stamps v. Manor Drug Stores,
21 421 U.S. 723, 737 (1975). "It is inconsistent with settled
22 methodology in § 10(b) cases to extend liability beyond the
23 scope of conduct prohibited by the statutory text." Central

1 Bank, 511 U.S. at 177.

2 When filing an interim financial report, § 210.10-01(d)
3 affords a company two options: [i] it can affirmatively
4 state that the filing was reviewed by its accountant in
5 accordance with the regulation, and include a report from
6 the accountant; or [ii] it can omit mention of the mandated
7 review, in which event no accountant's report is required.
8 This binary choice is consistent with the emphasis that
9 Central Bank and Wright place on attribution at the time of
10 dissemination as a determinant of whether a defendant has
11 made a statement for purposes of § 10(b). If § 210.10-01(d)
12 and the public's knowledge of what § 210.10-01(d) requires
13 were sufficient to support liability, the option afforded by
14 the regulation would be elided, which would be problematic
15 because we generally avoid interpreting a regulation in a
16 way that renders one of its provisions meaningless. See
17 Anderson v. Rochester-Genesee Reg'l Transp. Auth., 337 F.3d
18 201, 216 (2d Cir. 2003).

19 The importance plaintiffs place on an accountant's
20 review of interim financial statements is further eroded by
21 the numerous duties and requirements associated with an
22 accountant's audit of annual financials. See 15 U.S.C. §
23 78j-1, et seq. (outlining audit procedures, duties to

1 report, required responses, and possible duties to notify).
2 Clearly Congress knows how to impose duties on accountants,
3 and expose them to liability, when it wants to do so. Cf.
4 Central Bank, 511 U.S. at 176-77.

5 What purpose then does the review requirement serve?
6 Plaintiffs argue with some force that “[n]ondisclosure to
7 the public cannot be what is intended under the federal
8 securities laws.” However, the review requirement serves at
9 least one purpose other than to expand the liability of
10 accountants. As plaintiffs themselves explain: “One of the
11 primary reasons the SEC has mandated the [interim review] is
12 to minimize large year-end adjustments to quarterly
13 financial statements that historically have been uncovered
14 in the annual audit process. . . . [Interim review] should
15 reduce the likelihood of quarterly restatements.” (Compl. ¶
16 276, quoting Professionals Issues Task Practice Alert 2000-
17 4, Quality Review Procedures for Public Companies.) Thus
18 the regulation serves a useful purpose apart from any
19 opportunity afforded to detect fraud: the rolling quarterly
20 review is procedurally integrated into the company’s year-
21 end audit and thereby tends to reduce sharp variations and
22 year-end surprises by spreading corrections throughout the
23 year.

1 In sum, misstatements contained in Warnaco's interim
2 financial statements cannot be attributed to Deloitte, and
3 therefore they cannot form the basis for liability under §
4 10(b).

5
6 The 2000 10-K

7 It is alleged that the 2000 10-K was audited by
8 Deloitte, that it contained Deloitte's audit opinion, that
9 it contained false financial information, and that it was
10 filed within the Class Period (on April 17, 2001).
11 Accordingly, plaintiffs have sufficiently alleged that the
12 misstatements in the 2000 10-K were Deloitte's statements
13 under § 10(b).

14
15 **IV**

16 Plaintiffs sufficiently allege that Deloitte made the
17 following misstatements within the class period: those in
18 the 1999 10-K that related to the Designer Holdings
19 Restatement and those in the 2000 10-K. However, to state a
20 claim under § 10(b), plaintiffs must also allege that these
21 particular misstatements caused their alleged loss.²

² Plaintiffs must allege both transaction and loss causation in order to plead a claim under § 10(b).

1 "Loss causation is the causal link between the alleged
2 misconduct and the economic harm ultimately suffered by the
3 plaintiff." Lentell, 396 F.3d at 172 (internal quotation
4 marks omitted). Loss causation is related to the tort law
5 concept of proximate cause: [i] it "is intended 'to fix a
6 legal limit on a person's responsibility even for wrongful
7 acts,'" and [iii] it requires that the plaintiff's loss be
8 foreseeable. Id. at 174 (quoting Castellano v. Young &
9 Rubicam, 257 F.3d 171, 186 (2d Cir. 2001); see also First
10 Nationwide Bank v. Gelt Funding Corp., 27 F.3d 763, 769-70
11 (2d Cir. 1994)). A misstatement "is the 'proximate cause'
12 of an investment loss if the risk that caused the loss was
13 within the zone of risk concealed by the misrepresentations
14 . . . alleged by a disappointed investor." Lentell, 396
15 F.3d at 173 (emphasis omitted).

16 Plaintiffs here have failed to allege a sufficient

"Transaction causation is akin to reliance, and requires only an allegation that 'but for the claimed misrepresentations or omissions, the plaintiff would not have entered into the detrimental securities transaction.'" Lentell, 396 F.3d at 172 (quoting Emergent Capital Inv. Mgmt., LLC v. Stonepath Group, Inc., 343 F.3d 189, 197 (2d Cir. 2003)). Here, plaintiffs rely on the fraud-on-the-market presumption to allege transaction causation. See Basic Inc. v. Levinson, 485 U.S. 224, 247 (1988). There is no need to decide whether Deloitte's alleged misstatements amounted to a fraud on the market because we conclude that the complaint fails to adequately allege loss causation.

1 connection between Deloitte's misstatements and the losses
2 suffered as a result of Warnaco's bankruptcy. Plaintiffs
3 argue that the relevant risk--the risk that was concealed by
4 Deloitte's misstatements and that materialized to cause
5 their loss--was not the risk of Warnaco's bankruptcy, but
6 the risk that Deloitte's audits were not conducted in
7 accordance with generally accepted accounting practices.
8 But if Lentell's "zone of risk" could include the risk that
9 an accountant would make a misstatement (by conducting an
10 improper audit), then loss causation as an element of §
11 10(b) liability would be completely subsumed by the element
12 of misstatement.

13 Therefore, to state a claim, plaintiffs had to allege
14 that Deloitte's misstatements concealed the risk of
15 Warnaco's bankruptcy. The following circumstances support
16 our conclusion that plaintiffs alleged an insufficient
17 connection between Deloitte's misstatements and the
18 bankruptcy.

19 Even taking Warnaco's misstated financial
20 statements at face value, it cannot be said that
21 the risk of bankruptcy was altogether concealed.
22 In May 2000, Warnaco reported a TSE of \$563
23 million; twelve months later that number had

1 dropped to \$35 million--a 94% loss in one year.
2 Clearly, Warnaco could not continue for very long
3 in this direction.

4 The misstatements attributed to Deloitte are
5 fewer (two), more sporadic (over fifteen months)
6 and less egregious than Warnaco's misstatements to
7 the same or similar effect. Deloitte's \$4 million
8 overstatement of TSE in the 1999 10-K and its \$50
9 million overstatement of TSE in the 2000 10-K are
10 by no means trivial; but as a cause of Warnaco's
11 bankruptcy, they are to be compared with the
12 misstatements totaling \$373 million of TSE that
13 were made in the interim financial statements or
14 made before the Class Period--statements that
15 cannot be attributed to Deloitte. And the \$373
16 million does not reflect the impact of the single
17 misstatement that is perhaps most closely related
18 to Warnaco's eventual bankruptcy: the November 10-
19 Q's misstatement of \$190 million to conceal
20 Warnaco's non-compliance with its debt covenants.

21 Deloitte warned in the 2000 10-K that Warnaco
22 was "not in compliance with certain covenants of
23 its long-term debt agreements," and that there was

1 "substantial doubt" regarding Warnaco's "ability
2 to continue as a going concern." This ominous
3 alarm, accompanied as it was by data showing the
4 precipitous drop in Warnaco's TSE, certainly
5 provided "substantial indicia of the risk that"
6 Warnaco would file for bankruptcy. Lentell, 396
7 F.3d at 177.

8 This case is not a perfect analog to Lentell, but it is
9 in one respect Lentell's mirror image. In Lentell, the
10 defendant's normative "buy" or "accumulate" stock
11 recommendations were insincere, but were accompanied by the
12 underlying, accurate financial data, id. at 177, so that the
13 plaintiffs could review the financial information and
14 evaluate the risk for themselves. Here, Deloitte's
15 normative statement (the "going concern" warning) was
16 accurate, but the accompanying data (the financial
17 information in the 2000 10-K) were not, so that plaintiffs
18 were made aware of the risk, but could not rely on the
19 company's financial data to evaluate its precise gravity.

20 This factual distinction does not impair the
21 applicability of Lentell. In light of Deloitte's "going
22 concern" warning--and the disclosed (if understated)
23 collapse of value--it was "unambiguously apparent" that

1 Warnaco was in need of desperate measures and faced a risk
2 of bankruptcy. Id. Plaintiffs have not alleged facts to
3 show that Deloitte's misstatements, among others (made by
4 Warnaco) that were much more consequential and numerous,
5 were the proximate cause of plaintiffs' loss; nor have they
6 alleged facts that would allow a factfinder to ascribe some
7 rough proportion of the whole loss to Deloitte's
8 misstatements. Id. Accordingly, plaintiffs have not
9 alleged loss causation.

10
11 **V**

12 We affirm the district court's dismissal of plaintiffs'
13 breach of fiduciary duty claim for the reasons stated by the
14 district court. On appeal, plaintiffs argue that the
15 district court ignored two cases that show Deloitte, as
16 Warnaco's outside accountant, owed a fiduciary duty to
17 Warnaco's shareholders under Connecticut law. In one case,
18 a student slipped on ice in a school courtyard, Burns v. Bd.
19 of Educ., 638 A.2d 1 (Conn. 1994); in the other, the
20 defendant in a civil suit sued the plaintiff's attorney for
21 malpractice, Mozzochi v. Beck, 529 A.2d 171 (Conn. 1987).
22 Neither case conspicuously supports the proposition advanced

1 by plaintiffs here.

2

3

CONCLUSION

4 For the foregoing reasons, we affirm the judgment of
5 the district court.