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Client Memorandum
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Supreme Court Hears Oral Arguments in *Erica P. John Fund v. Halliburton*

On April 25, 2011, the US Supreme Court heard oral arguments in *Erica P. John Fund v. Halliburton* (No. 09-1403), a private securities fraud case that may have lasting impact on class action lawsuits in the United States. One of the key questions in the case is whether plaintiffs in a securities fraud class action can obtain class certification without showing that the defendant's alleged fraud actually impacted the price of the relevant security. This is an important question in securities class actions. More broadly, this question raises the issue of when the underlying merits of a claim may be considered at the class certification stage — an issue that applies in all class actions.

Halliburton is one of four class action cases before the Supreme Court this term, and one of two related to class certification (the other is *Wal-Mart v. Dukes*, (No. 10-277)). These cases promise to provide substantial guidance regarding the application of the rules for class certification.

Background

Broadly stated, a plaintiff in a federal securities fraud action must prove (i) a material misrepresentation or omission; (ii) intent to defraud; (iii) a connection with the purchase or sale of a security; (iv) reliance; (v) economic loss; and (vi) loss causation. To aggregate securities fraud claims into a class action, plaintiffs must satisfy Federal Rule of Civil Procedure 23, which requires that legal or factual questions "common" to all class members "predominate" over questions unique to each individual plaintiff.

Of the above elements, "reliance" generally focuses on individual questions of whether or not each plaintiff depended upon a defendant's misleading statement to his or her detriment. In *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988), however, the Supreme Court held that plaintiffs can establish reliance as a common question by showing that the securities trade on an efficient market. The premise of the "fraud on the market" presumption is that the price of shares traded on an efficient, well-developed market reflects all publicly available information, including material misrepresentations. Where a defendant's shares trade on an efficient market, courts may presume that plaintiffs who bought or sold the defendant's stock during the relevant time period did so in reliance on the defendant's alleged misrepresentations. Defendants can rebut the presumption with "any showing that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff, or his decision to trade at a fair market price."

The US courts of appeals have disagreed about what evidence, if any, may be considered at the class certification stage to satisfy the "fraud on the market" presumption. The Seventh Circuit considers efficiency alone as the proxy for establishing that reliance is a common issue. *See Schleicher v. Wendt*, 618 F.3d 679 (7th Cir. 2010). The Fifth Circuit has held that other factors are relevant. In 2007, the Fifth Circuit held in *Oscar Private Equity Investors v. Allegiance Telecom, Inc.*, 487 F.3d 261 (5th Cir. 2007), that to invoke the fraud on the market presumption, plaintiffs must prove not only market efficiency, but also "loss causation." The loss causation element of a securities fraud claim requires

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that a defendant's later truthful statement correcting a previous misrepresentation actually cause the relevant stock price to decline. One year after *Oscar*, the Second Circuit held that defendants can rebut the fraud on the market presumption at certification by showing that the alleged misrepresentations did not impact the market price of the security. *See In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474 (2d Cir. 2008). The Third Circuit adopted a similar position in March 2011. *See In re DVI Sec. Litig.*, 2011 WL 1125926, at *8 (3d Cir. Mar. 29, 2011).

The Facts

In June 2002, a group of Halliburton shareholders ("Plaintiffs") filed a securities fraud class action against the Halliburton Company and a former Halliburton executive ("Defendants"). Plaintiffs alleged that Defendants made a series of public misstatements about (i) potential litigation liabilities; (ii) projected revenues; and (iii) the benefits of a merger. The complaint identified eight subsequent "corrective" disclosures that allegedly caused Halliburton's stock price to fall.

Plaintiffs moved to certify the class — purchasers of Halliburton common stock during the relevant period — on the basis of the "fraud on the market" presumption. To support their motion, Plaintiffs submitted expert testimony that the market for Defendants' stock was efficient, and Defendants did not contest the issue of efficiency.

The district court denied class certification, concluding that Plaintiffs did not establish loss causation by a preponderance of the evidence. The court stated that it was bound to follow the Fifth Circuit's loss causation standard, which it acknowledged was "stringent," and "extremely high." Under that standard, Plaintiffs did not establish that Defendants' alleged fraud actually affected the price of Halliburton stock, because they did not establish that any of the eight subsequent disclosures actually corrected any of the allegedly fraudulent acts. The Fifth Circuit affirmed the district court's decision. Plaintiffs petitioned the Supreme Court for review of the Fifth Circuit's decision.

Arguments Before the Supreme Court

In their briefs to the Supreme Court, Plaintiffs argued that the Fifth Circuit's class certification standard violates the Court's precedent and the Federal Rules of Civil Procedure by requiring plaintiffs to prove an additional element unrelated to reliance. Plaintiffs asserted that because the fraud on the market presumption turns on efficiency as a proxy for reliance, efficiency is the only determination relevant to certification. Plaintiffs claimed that the Fifth Circuit standard is incorrect because it improperly looks to the merits of the case at class certification. Plaintiffs argued that under Rule 23, the only relevant question at the class certification stage is whether common issues predominate over individual ones — and not, for example, the allegedly common question whether a corrective disclosure caused a change in the price of a stock.

Defendants argued that the Fifth Circuit's standard requires only that the plaintiff show the alleged misrepresentation distorted the market — because, if it did not, there is no link between the representation and the price. Defendants cited the Supreme Court's decision in *Basic*, stating that defendants could rebut the fraud on the market presumption with "*any* showing that severs the link between alleged misrepresentation and price paid." Defendants reasoned that if the alleged misrepresentation did not impact the stock price, it is wrong for courts to presume that each plaintiff relied on the misrepresentation in purchasing or selling the stock.

Oral Argument

During oral argument, several justices (Chief Justice Roberts, Justices Kagan and Alito) asked Plaintiffs why the only element subject to rebuttal at the class certification stage was the efficiency of the market, and not other elements of a plaintiff's case. Plaintiffs argued that efficiency goes to the heart of whether reliance is a common issue, and that loss causation in particular is a common element. Plaintiffs cited the language of Rule 23 and a footnote in *Basic* to support their claim that all other matters aside from predominance must be examined at trial.

During Defendants' argument, several Justices appeared to criticize the Fifth Circuit's *Oscar* standard. Justice Kagan appeared to contend that the Fifth Circuit violates *Basic* by placing the initial burden on plaintiffs to prove loss causation rather than defendants to rebut it. Justice Kagan later asked how defendants might rebut the fraud on the market presumption. When Defendants suggested expert testimony, Justice Kagan replied "[t]hat suggests that the *Basic* presumption isn't worth much in [Defendants'] world." Justice Ginsburg further commented that Defendants' argument requires plaintiffs to prove virtually their entire case at class certification.

Ramifications

It is of course difficult to predict how the Court will rule in any case. But it is clear from oral argument that several Justices have concerns that placing the burden on plaintiffs to affirmatively show loss causation at class certification accelerates the proof of the merits of plaintiffs' case to the class certification stage. Other Justices appear open to permitting courts to inquire at class certification whether an alleged misrepresentation affected the security's price. The decision in this case may affect not only the timing and nature of proof in securities class actions, but also the inquiry into the merits that will be required or tolerated in class action cases of all kinds. These are significant questions in class action litigation, as the more rigorous the inquiry into the elements of plaintiffs' claims at the class certification stage, the less likely it is that the class will be certified.

A decision is anticipated by the end of the Court's term in July 2011.