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The *Halliburton* Oral Arguments: The Supreme Court Grapples with the Role of Loss Causation in Class Certification

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On April 25, the U.S. Supreme Court heard arguments in *Erica P. John Fund v. Halliburton*,[1] which promises to be the Court's most significant federal securities litigation decision since *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*[2] The main issue in *Halliburton* is whether defendants may rebut the "fraud-on-the-market" presumption of reliance—established by *Basic Inc. v. Levinson*[3] in 1988 that enables § 10b-5 plaintiffs to certify a plaintiff class—by pointing to the lack of evidence that the alleged misrepresentations had any impact on the market price of the security.

As the June issue of* Securities Litigation Report *went to press, the U.S. Supreme Court issued a unanimous decision in the Halliburton case, ruling that private federal securities fraud plaintiffs do not need to prove loss causation in order to obtain class certification.* SLR *will publish a full analysis of the Court's decision in its next issue.

The *Halliburton* case—stemming from the Fifth Circuit's decision last year in *Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*[4]—involves the interplay of Federal Rules of Civil Procedure Rule 23(b)(3) and *Basic*'s fraud-on-the-market presumption of reliance. Rule 23(b)(3) requires that, for a plaintiff class to be certified, common issues must predominate over individual issues. In *Basic*, the Supreme Court held that a putative class-action plaintiff would be entitled to a rebuttable presumption of class-wide reli-

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ance if it could "allege and prove" that: (i) the alleged misrepresentations were material; (ii) "the misrepresentations would induce a reasonable, relying investor to misjudge the value of the shares"; and (iii) the securities were traded in an efficient market.[5] To reach this result, *Basic* embraced the "fraud-on-the-market" theory, which holds that "where materially misleading statements have been disseminated into an impersonal, well-developed market for securities, the reliance of individual plaintiffs on the integrity of the market price may be presumed" because "an investor who buys and sells stock at the price set by the market does so in reliance on the integrity of that price."[6] The *Basic* court recognized that, in the absence of the fraud-on-the-market presumption, the predominance requirement of Rule 23(b)(3) could not be met because "[r]equiring proof of individualized reliance from each member of the proposed plaintiff class" would result in "individual issues… overwhelm[ing] the common ones."[7]

In recent years, a split in the Circuit Courts of Appeals had emerged over what plaintiffs are required to show to be entitled to the fraud-on-the-market presumption. In 2007, in *Oscar Private Equity Investments v. Allegiance Telecom Inc.*[8]—which the decision below in *Halliburton* followed—the Fifth Circuit required that, to prevail on class certification, plaintiff must also prove that "the [defendant's] misstatement actually moved the market" that is, plaintiffs must demonstrate "loss causation in order to trigger the fraud-on-the-market presumption of class reliance."[9] In contrast, three years later in *Schleicher v. Wendt*, the Seventh Circuit expressly rejected *Oscar* and held that a plaintiff class could be certified as long as a plaintiff could show that the market was efficient and that plaintiff traded shares between the time of the misstatement and when the truth came to light.[10] And in *In re Salomon Analyst Metromedia Litigation*, and *In re DVI, Inc. Securities Litigation*, the Second and Third Circuits, respectively, took a third approach, rejecting the Fifth Circuit's burden-shifting in *Oscar* but holding that *defendants* may rebut the fraud-on-the-market presumption at the class certification stage by showing that the information had no effect on the stock price.[11] With a decision in *Halliburton*, the Supreme Court is set to resolve this circuit split.

The *Halliburton* Oral Argument: Reframing the Fifth Circuit's Decision

At oral argument, Respondents (Defense side), represented by David Sterling of Baker & Botts LLP, did not advocate that the Supreme Court adopt the Fifth Circuit's burden-shifting rule of *Oscar* and *Halliburton* and require that plaintiffs prove loss causation at the class certification stage. Indeed, Mr. Sterling agreed with Justice Elena Kagan's statement that, if *Oscar*'s holding was that "loss causation needs to be shown at the certification stage," then "that is not a correct statement of the law."[12] Rather, Mr. Sterling advocated for a more nuanced interpretation of the Fifth Circuit's decision, arguing that loss causation, as construed in *Oscar* and in *Halliburton*, was "not loss causation as this Court knows it in *Dura*," but was an "easier, less rigorous showing of loss causation, because under the price impact test… all the plaintiff need show is that it's reasonable to infer that some portion of the decline was attributable to the revelation of the truth."[13] Mr. Sterling also acknowledged that, in contrast to the Fifth Circuit's holding in *Oscar* and in *Halliburton*, "*Basic* puts the initial burden on the defendant to show the absence of price impact," thereby retreating from the aspect of Fifth Circuit's decision that was most vulnerable to attack.[14]

Although these concessions may have improved Respondents' chance of success before the Court, other than a predictable split between the so-called "conservative" Justices (John Roberts, Antonin Scalia, Samuel Alito, and Clarence Thomas) who tended to show a defense lean in their questioning, and the so-called "liberal" Justices (Stephen Breyer, Ruth Bader Ginsburg, Sonia Sotomayor and Kagan), who tended to show a plaintiff's lean, the Justices' questions did not reveal much about how their ruling here will shape the law of class certification beyond suggesting that the Court may overturn at least part of the Fifth Circuit's decision. Most notably, Justice Anthony Kennedy—whose vote was instrumental in

Stoneridge, one of the most significant securities defense bar victories of the last few years—asked relatively few questions, and the questions he asked revealed little about his view of the case.

Petitioner's *Argument: Loss Causation Is a Merits Issue, Not a Class Certification Issue*

Petitioner (Plaintiff side), represented by David Boies of Boies Schiller & Flexner, LLP, argued that the requirement that plaintiff prove loss causation at the class certification stage impermissibly conflates a merits question—loss causation—with a class certification question. Mr. Boies also argued that, because evidence of loss causation would necessarily be the same for all members of the plaintiff class, loss causation had no bearing on whether individual issues predominated over common ones. Mr. Boies, relying on dicta in footnote 29 of the *Basic* opinion, also argued that *Basic* relegated rebuttal of the fraud-on-the-market presumption to trial, not the class certification stage. Justice Alito pressed counsel on this point, noting that Petitioner's argument was based on "dictum in a footnote in an opinion issued at a time when conditional class certification was permitted."[15] Mr. Boies responded that evidence that the market was inefficient as to a particular misstatement should be presented at summary judgment or trial, not class certification, because it involved proof common to the class.

Not surprisingly, the most vigorous questioning was by Justice Scalia, who suggested by his questions that one potential outcome could be that "we agree with you that the requirement to prove loss causation is—is no good, and sen[d] it back to the Fifth Circuit and then let the Fifth Circuit adopt the theory that Respondent assert they have already adopted," which Justice Scalia characterized as "sort of a Pyrrhic victory."[16] In response, Mr. Boies made clear that Petitioner sought a ruling barring consideration of any evidence tending to show the lack of, not just loss causation, but any market price impact at the class certification stage.[17]

Respondents' *Argument: Price Impact Is Key*

As noted above, counsel for Respondents reframed the Fifth Circuit's decision, arguing principally that evidence negating price impact, not a full-blown evidentiary hearing on loss causation, should be considered at the class certification stage to rebut the fraud-on-the-market presumption. Critically, Mr. Sterling emphasized that Respondents were not arguing that the Supreme Court uphold the Fifth Circuit's decision insofar as it placed the initial burden to prove loss causation on the plaintiff. Mr. Sterling addressed Petitioner's argument that loss causation was not relevant to the Rule 23(b)(3) determination because it was susceptible to class-wide common proof by contending that the other elements required to be established by plaintiffs to claim the benefit of the presumption—market efficiency, materiality, a public misrepresentation—were also susceptible to common proof. Mr. Sterling also argued that, in effect, Petitioner was asking the Court to extend *Basic*, which he described as "a judicially created presumption designed to make a judicially created cause of action easier to be maintained as a class action."[18]

Mr. Sterling then honed in on language from the *Basic* decision that "any showing that severs the link between the alleged misrepresentation and… the price received (or paid) by the plaintiff… will be sufficient to rebut the presumption of reliance."[19] Relying on that language, Mr. Sterling argued that, under *Basic*, defendant may rebut the fraud-on-the-market presumption at the class certification stage by showing the lack of any market price impact as a result of the misrepresentation.

Justice Ginsburg and Justice Kagan both pressed counsel on whether, if Respondents were correct, the entire case would be resolved at the class certification stage. Justice Ginsburg observed that: "you leave almost nothing over… if you've won the class action certification on your basis… what else is left on the merits? You win on the merits if you win certification."[20] Counsel responded that, under the rule for which Respondents are advocating, plaintiffs would not be required to present any evidence of market impact unless defendants

had already successfully rebutted the presumption by showing a lack of market impact, and that the showing required of plaintiffs would be less rigorous than would be required to prove loss causation merits at trial.

Does Loss Causation Have a Future in the Class Certification Decision?

In the wake of the *Halliburton* oral argument, some have observed that the Fifth Circuit's ruling below, insofar as it imposes a requirement on plaintiffs to prove loss causation in order to certify a plaintiff class, may well be overturned at least in part. What is less clear is whether the Court will adopt a rule akin to that of the Second and Third Circuits, which permit defendants to rebut the fraud-on-the-market presumption with evidence disproving a market price impact, or whether the Court will rule as Petitioner and its amici, including the U.S. Government, have requested and hold that the rebuttal of the fraud-on-the-market presumption is a matter best left for trial. If one goes strictly by the questions asked at oral argument (a notoriously unreliable proxy), the Justices seem evenly aligned between permitting defendants to rebut the presumption at the class certification stage and requiring any rebuttal evidence to be considered at a later stage, including summary judgment or trial. The tie-breaking vote here may well belong to Justice Kennedy, whose questions at oral argument (all two of which were directed at counsel for Petitioner) were not particularly informative of his views of the case, but whose past § 10b-5 opinions, most notably in *Central Bank* and *Stoneridge*, show receptivity to the argument, made subtly but assertively by Respondents and their *amici*, that failing to permit defendants to rebut the fraud-on-the-market presumption at the class certification stage would work an unwarranted expansion of *Basic* and the judge-made § 10b-5 cause of action.[21]

NOTES

1. *Erica P. John Fund, Inc. v. Halliburton Co.*, 2011 WL 1440864 (U.S. 2011) (*Halliburton*).
2. *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta*, 552 U.S. 148, 128 S. Ct. 761, 169 L. Ed. 2d 627, Fed. Sec. L. Rep. (CCH) P 94556 (2008).
3. *Basic Inc. v. Levinson*, 485 U.S. 224, 108 S. Ct. 978, 99 L. Ed. 2d 194, Fed. Sec. L. Rep. (CCH) P 93645, 24 Fed. R. Evid. Serv. 961, 10 Fed. R. Serv. 3d 308 (1988).
4. *Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*, 597 F.3d 330, Fed. Sec. L. Rep. (CCH) P 95611 (5th Cir. 2010), cert. granted, 131 S. Ct. 856, 178 L. Ed. 2d 622 (2011) (*Archdiocese II*).
5. *Basic*, 485 U.S. at 248, n. 27.
6. *Basic*, 485 U.S. at 247.
7. *Basic*, 485 U.S. at 242.
8. *Oscar Private Equity Investments v. Allegiance Telecom, Inc.*, 487 F.3d 26, 265, 2691 (5th Cir. 2007).
9. *Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*, Fed. Sec. L. Rep. (CCH) P 95002, 2008 WL 479149, *22 (N.D. Tex. 2008), judgment aff'd, 597 F.3d 330, Fed. Sec. L. Rep. (CCH) P 95611 (5th Cir. 2010), cert. granted, 131 S. Ct. 856, 178 L. Ed. 2d 622 (2011) (citing *Oscar*); see also *Archdiocese II*.
10. *Schleicher v. Wendt*, 618 F.3d 679, Fed. Sec. L. Rep. (CCH) P 95932 (7th Cir. 2010).
11. *In re Salomon Analyst Metromedia Litigation*, 544 F.3d 474, 484-485, Fed. Sec. L. Rep. (CCH) P 94861, 71 Fed. R. Serv. 3d 1144 (2d Cir. 2008), and *In re DVI, Inc. Securities Litigation*, Fed. Sec. L. Rep. (CCH) P 96261, 2011 WL 1125926, *9 (3d Cir. 2011).
12. Transcript of Oral Argument (Tr.) at 26, *Halliburton*.
13. Tr. at 27 (citing *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336, 125 S. Ct. 1627, 161 L. Ed. 2d 577, Blue Sky L. Rep. (CCH) P 74529, Fed. Sec. L. Rep. (CCH) P 93218 (2005)).
14. Tr. at 28.
15. Tr. at 6.
16. Tr. at 9.
17. Tr. at 11.
18. Tr. at 35.
19. *Basic*, 485 U.S. at 248.
20. Tr. at 36.
21. *Stoneridge*, 552 U.S. at 165, (2008)(Kennedy, J.)("the § 10(b) private right should not be extended beyond its present boundaries"); *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 191, 114 S. Ct. 1439, 128 L. Ed. 2d 119, Fed. Sec. L. Rep. (CCH) P 98178 (1994)(Kennedy, J.).