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U.S. Supreme Court Issues Opinion in *Halliburton* Case

On June 6, 2011, the United States Supreme Court issued its much-anticipated opinion in *Erica P. John Fund, Inc. v. Halliburton Co.*, resolving a conflict among the circuits on whether plaintiffs alleging securities fraud must prove "loss causation"— *i.e.*, that the investment losses sought to be recovered were caused by the market's discovery of the "truth" allegedly obscured or concealed by the "fraud" — in order to obtain class certification. *See* 563 U.S. ___, No. 09-1403, Slip. Op. (June 6, 2011). In a unanimous opinion authored by Chief Justice Roberts, the Court issued a narrow ruling that securities fraud plaintiffs *do not* bear the burden to prove loss causation as a prerequisite to class certification.

As discussed herein, that much of the Court's opinion was not unexpected. Perhaps the greater significance of the *Halliburton* opinion lies in the matters the Court declined to decide. In practice, the holding should have limited impact outside of the Fifth Circuit, the only circuit that had required proof of loss causation as a prerequisite to class certification. Importantly, the Court's opinion leaves intact case law in other circuits permitting defendants to challenge class certification on grounds related to the lack of price impact associated with the alleged misrepresentation.

Halliburton involved claims that the Company defrauded investors by making false statements concerning (1) the scope of its potential liability in asbestos litigation; (2) revenues associated with certain construction contracts; and (3) the benefits of its merger with Dresser Industries. The issue before the Court was whether the plaintiff had demonstrated that a class could be certified because "questions of law or fact common to class members predominate over any questions affecting only individual members." Slip Op. at 3-4. Among other claim elements, a plaintiff asserting such securities fraud claims must ultimately prove reliance on the alleged misstatements. Were plaintiffs required to submit individualized proof of reliance as to each of the presumably thousands of investors in the putative class, such individualized issues would predominate over questions of law and fact common to all class members and certification would be precluded. Accordingly, as is typical in securities fraud class actions, the plaintiff's hope for certification hinged on whether it could invoke the judicially-created rebuttable presumption of reliance endorsed by the Court in *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988).

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The rebuttable presumption of reliance the Court first recognized in *Basic* is premised on the "fraud-on-the-market" theory, which postulates that "the market price of shares traded on well-developed markets reflects all publicly available information, and, hence, any material misrepresentations." 495 U.S. at 246. In order to invoke the presumption, plaintiffs must show that the subject stock traded on an "efficient" market (*i.e.*, the sort of well-developed market that can reasonably be presumed to incorporate available public information into the stock's price), that the alleged misrepresentations became public, and that plaintiffs traded the stock after the misrepresentations were made but before the truth was revealed. If a plaintiff is able to establish those conditions, the Court held, investors' reliance on any material misrepresentations may be presumed, since, at least in theory, the misrepresentations should be factored into the stock's market price. *Id.* at 247. Defendants, however, may rebut the presumption through "any showing that severs the link between the alleged misrepresentations and either the price received (or paid) by the plaintiff, or his decision to trade at a fair market price." *Id.* at 248.

In *Halliburton*, the Fifth Circuit held that the plaintiff was not entitled to *Basic's* reliance presumption under existing Fifth Circuit precedent which required plaintiffs to establish loss causation as a precondition to triggering the presumption. The Supreme Court held that this was error. Slip Op. at 8. Requiring proof of loss causation to invoke the reliance presumption, the Court held, "contravenes *Basic's* fundamental premise – that an investor presumptively relies on a misrepresentation so long as it was reflected in the market price at the time of his transaction." *Id.* at 7. Loss causation, the Court observed, addresses the conceptually distinct question of whether "a misrepresentation that affected the integrity of the market price *also* caused a subsequent economic loss." *Id.* Even if factors other than the market's discovery of the "truth" were responsible for some or all of the eventual loss, under *Basic*, so long as the prior misrepresentation distorted the market price, investors could still be presumed to have relied on the misrepresentation reflected in that price. *Id.* Thus, the Court held a securities fraud plaintiff cannot be required to prove loss causation in order to invoke *Basic's* reliance presumption at the class certification stage.

In that respect, the Court's opinion came as little surprise. The Fifth Circuit stood alone in applying the loss causation requirement at issue in *Halliburton*. The Second, Third, and Seventh Circuits had each expressly rejected the Fifth Circuit's approach. If that were not enough, at oral argument, Halliburton itself conceded that the Fifth Circuit ought not to have required the plaintiff to prove loss causation in order to invoke the presumption.

Instead, Halliburton argued that, even where *Basic's* presumption of reliance is triggered, defendants may rebut the presumption by showing that the alleged misrepresentations never affected the market price of the stock in the first place. Halliburton argued that, in effect, the Fifth Circuit had used the label of "loss causation" as a shorthand to refer to precisely that sort of "price impact" analysis, and not as an element the plaintiff must prove to trigger the *Basic* reliance presumption but rather as a way the defendant can rebut that presumption once triggered. Further, Halliburton argued, evidence that an alleged misrepresentation failed to impact market price at the time it was made *or* evidence that a subsequent corrective disclosure failed to impact the stock's market price can be relevant and even dispositive in a "price impact" analysis.

Halliburton's "price impact" argument echoes recent decisions from the Second and Third Circuits discussing ways in which defendants may rebut *Basic's* reliance presumption and thereby defeat class certification. In *In re Salomon Analyst Metromedia Litigation*, the Second Circuit held that, although "the burden of showing that there was no price impact is properly placed on defendants" at the class certification stage, "*Basic* made clear that defendants could rebut proof of the elements giving rise to the presumption, or show that the misrepresentation in fact did not lead to a distortion of price." 544 F.3d 474, 483 (2d Cir. 2008). Along similar lines, the Third Circuit recently observed that evidence of a lack of price impact, either at the time an alleged misrepresentation is made *or* at the time of a later disclosure correcting it, may rebut *Basic's* reliance presumption in one of two ways — either by undercutting market efficiency or demonstrating that the alleged misrepresentation was in fact not material. *In re DVI, Inc. Securities Litigation*,--- F.3d ----, Nos. 08-8033, 08-8045, (3d Cir. Mar. 29, 2011).

The good news for defendants is that the Supreme Court declined to address Halliburton's "price impact" argument. The Court construed the Fifth Circuit's opinion as requiring the plaintiff to prove loss causation to trigger the *Basic* reliance presumption — a rule of law that, as noted, Halliburton disavowed — and was not persuaded by Halliburton's attempts to reinterpret the opinion as dealing instead with the defendant's ability to rebut the presumption by focusing on price impact. The Court framed the narrow issue before it as whether the Fifth Circuit erred in holding that the plaintiff was required to prove loss causation in order to invoke *Basic's* rebuttable presumption of reliance. The Court answered that question in the affirmative and expressly declined to go further: "we need not, and do not, address any other question about *Basic*, its presumption, or how and when it may be rebutted." *Halliburton* Slip. Op. at 9.

The *Halliburton* decision thus did not disturb lower court precedent holding that *Basic's* presumption (and class certification) may be defeated by evidence showing that challenged misrepresentations had no "price impact." Accordingly, defendants can and should continue to raise "price impact" arguments to resist class certification, though it is clear after *Halliburton* that defendants will bear the burden of persuasion in showing a lack of price impact.

Another significant silver lining for defendants in the *Halliburton* opinion is that the Court declined the invitations of the plaintiff and the United States as *amicus curiae* to roll back recent appellate decisions that have allowed or required trial courts to examine "merits" issues before granting certification where those issues overlap with the elements the plaintiff must show to satisfy Rule 23. For example, the Second, Third, Seventh and Eighth Circuits have held (outside the specific context of securities fraud) that courts are required to resolve disputes among expert witnesses to the extent the dispute is relevant to a requirement that the plaintiff must show to obtain class certification. The Seventh Circuit recently held that the district court must conduct "a full *Daubert*" analysis and "conclusively" rule on challenges to the qualifications and reliability of expert testimony proffered to attempt to demonstrate a requirement for class certification. *See Am. Honda Motor Co. v. Allen*, 600 F.3d 813, 816 (7th Cir. 2010). Before this recent favorable precedent — and to some extent even now — many district courts mistakenly believed that if an issue related to the ultimate merits of the plaintiff's claim, the court was not permitted to consider it at the certification stage. In truth, this "certification issue vs. merits issue" dichotomy is misleading, because many issues go to both the certification requirements and the merits.

The plaintiff in *Halliburton* and the United States as *amicus curiae* framed their argument in part in such "certification vs. merits issues" terms, contending that the Fifth Circuit's loss causation rule represented an improper inquiry into a "merits" issue. Some observers thus expressed concern that *Halliburton* could result in an opinion that overturned or limited the favorable circuit case law discussed above and made it significantly harder for defendants to avoid class certification in many cases.

The Court carefully steered clear of this debate and this loaded terminology. Its short and unanimous opinion hands securities fraud defendants an unsurprising loss on a narrow issue, but preserves important avenues for defendants in all types of cases to resist class certification on other grounds and to ensure that putative class representatives make the required rigorous showing to satisfy Rule 23.