



SECURITIES FRAUD CLASS ACTION ALERT:
THE SUPREME COURT TO HEAR ARGUMENTS ON WHETHER LOSS CAUSATION
MUST BE ESTABLISHED FOR CLASS CERTIFICATION

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On Monday, April 25, 2011, the Supreme Court will hear arguments in the *Halliburton* case,¹ a case whose outcome may have a profound impact on future securities fraud class actions filed in the United States. Indeed, the Court may decide whether proof of loss causation prior to merits-based discovery is necessary to certify a securities class action brought under Rule 10b-5, and may also address to what extent a district court may consider, at the class certification stage, evidence that attempts to disprove the impact of allegedly corrective disclosures on stock price.

The *Halliburton* case was brought as a putative securities fraud class action against the Halliburton Company and David J. Lesar, its former president and chief operating officer (collectively, “Halliburton,” “Defendants” or “Respondents,” as appropriate). The plaintiff Erica P. John Fund, Inc. (formerly the Archdiocese of Milwaukee Supporting Fund, Inc.) (hereinafter, the “Plaintiff” or the “Petitioner,” as appropriate) claimed that Halliburton made false statements concerning three areas of business: (1) Halliburton’s potential liability in asbestos litigation; (2) Halliburton’s accounting of revenue in its engineering and construction business; and (3) the benefits to Halliburton of a merger with Dresser Industries.² Investors lost money, the Plaintiff alleged, when Halliburton issued subsequent disclosures that corrected the false statements and the market declined following the negative news.³ The Plaintiff filed a motion to certify the class, the district court denied the motion and was affirmed by the Fifth Circuit.

The district court, following Fifth Circuit precedent, held that Plaintiff had to demonstrate loss causation by a preponderance of all admissible evidence in order to trigger the fraud-on-the-market presumption of class reliance,⁴ and that such loss causation had to be established at the class certification stage.⁵ “Loss causation is a ‘direct causal link between the misstatement and the claimant’s economic loss.’” *Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*, 597 F.3d 330, 335 n.11 (5th Cir. 2010) (quoting *Nathenson v. Zonagen, Inc.*, 267 F.3d 400, 413 (5th Cir. 2001)). In other words, to prove loss causation in the context of the case below

¹ The Court granted a petition for a writ of certiorari in *Erica P. John Fund, Inc. v. Halliburton Co.*, which stems from a decision of the Fifth Circuit Court of Appeals affirming the District Court for the Northern District of Texas’ denial of class certification. See *Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*, No. 3:02-CV-1152-M, 2008 WL 4791492 (N.D. Tex. Nov. 4, 2008), *aff’d*, 597 F.3d 330 (5th Cir. 2010).

² *Archdiocese of Milwaukee Supporting Fund v. Halliburton Co.*, 597 F.3d 330, 334 (5th Cir. 2010).

³ *Id.*

⁴ Under the fraud-on-the-market theory, it is assumed that in an efficient, well-developed market all public information about a company is known to the market and reflected in the stock price. When a company makes material misrepresentations about its business, it may be presumed that a person who buys the company’s stock relied on the false information. The stockholder then suffers losses if the falsity becomes known and the stock declines in price. The response of the market to the correction proves the effect of the false information and measures the stockholder’s loss. 597 F.3d at 334.

⁵ 2008 WL 4791492, at *2.

required proof “that the corrected truth of the former falsehoods actually caused the stock price to fall and resulted in the losses.”⁶

In explaining the governing law in the Fifth Circuit, the district court acknowledged that “the bar is now extremely high for all plaintiffs seeking class certification in securities litigation,”⁷ and noted that “[e]ven though the Court finds that all other elements required for class certification under Rule 23 have been met in this case, it is unable to certify the class because of Plaintiffs failure to meet this stringent loss causation requirement.”⁸

On review of the district court decision, the Fifth Circuit noted that it was bound by a prior Fifth Circuit Panel decision, and therefore summarily rejected Plaintiff’s arguments that the loss causation requirement was inconsistent with Supreme Court precedent and the law in other circuits without analyzing those arguments on the merits.⁹ Instead, the Fifth Circuit reviewed the alleged misrepresentations and corrective disclosures and concluded “that Plaintiff has failed to meet this court’s requirements for proving loss causation at the class certification stage.”¹⁰

Plaintiff Erica P. John Fund, now a Petitioner, sought review by the Supreme Court, which granted certiorari.

In its initial brief, Petitioner argued, *inter alia*, that the Fifth Circuit’s rule, requiring proof of loss causation at the class certification stage in order to invoke the fraud-on-the-market presumption of reliance set forth in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), violated *Basic*, other Supreme Court jurisprudence, and Rule 23 of the Federal Rules of Civil Procedure.¹¹ Among other arguments, Petitioner reasoned that *Basic* was violated by the imposition by the Fifth Circuit of the additional and substantial prerequisite of a showing of loss causation in addition to the factors set forth in *Basic* for the application of the fraud-on-the-market presumption.¹² Additionally, Petitioner argued that *Basic* stands for the proposition that the presumption is rebuttable at trial, not at the class certification stage.¹³

In response, the Halliburton Defendants, now Respondents, rejected the Petitioner’s characterization of Fifth Circuit precedent, arguing that it was “incorrect” to assert that the Fifth Circuit “require[ed] plaintiffs to prove the merits of ‘loss causation’ as a prerequisite to class certification,” and distinguishing “loss causation” from “price impact,” while acknowledging overlap between the two.¹⁴ Respondents then argued, among other things, that a recent decision by the Seventh Circuit rejecting consideration of price impact at the class certification stage was inconsistent with not only the Fifth, but also the Second Circuit’s jurisprudence, and that the

⁶ 597 F.3d at 334.

⁷ 2008 WL 4791492, at *2.

⁸ *Id.* at *20.

⁹ 597 F.3d at 334 n.2.

¹⁰ *Id.* at 339-44.

¹¹ Brief of Petitioner, 2011 WL 704667, at *3, (U.S. Feb. 22, 2011).

¹² *Id.* at * 27.

¹³ *Id.* at *45-46.

¹⁴ Brief for Respondents, 2011 WL 1149040, at *17-18 (U.S. Mar. 24, 2011).

rebuttable presumption of reliance set forth in *Basic* could be rebutted at the class certification stage.¹⁵

Respondents also argued that they had presented evidence below allegedly demonstrating that Halliburton's alleged misrepresentations did not affect the market price.¹⁶ Accordingly, in Respondents' view, they had properly overcome the rebuttable presumption of reliance under the fraud-on-the-market theory set forth in *Basic* by "sever[ing] the link between Halliburton's alleged misrepresentations and that market price."¹⁷

In its reply brief, Petitioner emphasized that the Fifth Circuit itself acknowledges that it requires proof of loss causation, and does so as part of a "merit inquiry" at the class certification stage, while attacking Respondents' "revisionism."¹⁸ Petitioner also argued that the Fifth Circuit did not simply allow defendants to make a rebuttal showing, but affirmatively placed the burden on the plaintiff in the first instance.¹⁹ Petitioner concluded that "because the issue of loss causation is a merits issue common to the class, it was wrong to use it to deny class certification under Rule 23."²⁰

¹⁵ *Id.* at *27-30.

¹⁶ *Id.* at *23-24.

¹⁷ *Id.* at *23.

¹⁸ Reply Brief for Petitioner, at 1-3 (U.S. Apr. 18, 2011) (at the time of publication, the Westlaw version of the Reply Brief was not available).

¹⁹ *Id.* at 14.

²⁰ *Id.* at 24-25.