No. 09-1403

In the Supreme Court of the United States

ERICA P. JOHN FUND, INC., PETITIONER.

v.

HALLIBURTON CO.; DAVID J. LESAR, RESPONDENTS.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit.

REPLY BRIEF FOR PETITIONER

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RULE 29.6 STATEMENT

Petitioner hereby incorporates by reference the statement pursuant to Rule 29.6 included in the Petition for a Writ of Certiorari.

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REPLY BRIEF FOR PETITIONER

While Respondents seek to muddy the waters, one key fact remains crystal clear: No court outside of the Fifth Circuit requires a plaintiff in a securities fraud action to establish loss causation in order to certify a class. The Fifth Circuit's requirement violates Supreme Court precedent and Federal Rule of Civil Procedure 23, interjects a premature and improper merits examination into the certification inquiry, and has been rejected by every court outside of the Fifth Circuit that has addressed the issue, including the Second Circuit and, just days ago, the Seventh Circuit – which, in a unanimous decision authored by Chief Judge Easterbrook, called the Fifth's Circuit's requirement "a go-it-alone strategy" and expressly "disapprove[d]" of the Fifth Circuit's holding. *Schleicher v. Wendt*, No. 09-2154, 2010 WL 3271964, at *7 (7th Cir. Aug. 20, 2010). The conflict with the Second Circuit is not, as Respondents claim, a "shallow" one, and the conflict with the Seventh Circuit could not be more direct. Tellingly, Respondents are unable to provide a coherent justification for the Fifth Circuit's unique rule that a securities plaintiff must demonstrate loss causation—an element of a securities fraud claim separate from reliance—at class certification to invoke the fraud on the market presumption of reliance. Nor are Respondents correct that this case is an inapposite vehicle for resolving this circuit split. The issue here is a purely legal one, and but for the Fifth Circuit's rule, the district court stated it would have certified the class in this case. Pet. App. 4a.

I. THE FIFTH CIRCUIT IS AN OUTLIER IN REQUIRING PROOF OF LOSS CAUSATION AT CLASS CERTIFICATION

No other circuit requires proof of loss causation to certify a class under the fraud-on-the-market presumption of reliance. Defendants quibble with the degree and severity of conflict but cannot deny it. *All* cases outside the Fifth Circuit that have addressed the holding in *Oscar Private Equity Investments v. Allegiance Telecom, Inc.*, 487 F.3d 261 (5th Cir. 2007)—including the Second and Seventh Circuits and district courts in six other circuits—have affirmatively rejected *Oscar* or otherwise declined to follow it. *See, e.g.*, Pet. 13, 15-17. Even the circuit courts that have yet to expressly address *Oscar*—reaffirmed and further tightened by the Fifth Circuit in the case at bar—do not require proof of loss causation to invoke the fraud on the market presumption. *See, e.g.*, Pet. 15. It is irrelevant that some of those cases predate *Oscar* since they are still the controlling authority in their respective circuits. A conflict is a conflict even if other circuits have not expressly disavowed *Oscar*, as the Seven Circuit recently did, declaring: "*Oscar Private Equity* represents a go-it-alone strategy by the fifth circuit. It is not compatible with this circuit's decisional law . . . and we disapprove its holding. It has not been adopted by any other circuit, and it has been rejected implicitly by some." *Schleicher*, 2010 WL 3271964, at *7 (citing *In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474, 479, 483 (2d Cir. 2008), as rejecting *Oscar*).

Given the number of courts that have rejected *Oscar*, *see* Pet. 15-17, no further "percolation" is needed. Opp. 2. With the Seventh Circuit's opinion in *Schleicher*, the circuit split is wider than ever, and absent a ruling from this Court, the temptation to engage in forum shopping given the broad venue provision governing federal securities actions, *see* 15 U.S.C. § 78aa, will be nearly irresistible. The time has come for this Court to resolve this split of authority on an important and recurring issue, and this case is an apt vehicle for doing so. Because Petitioner would *not* have been required to prove loss causation at the class certification stage in any other circuit, and because that requirement is the *sole* reason the district court declined to certify a class here, Pet. App. 4a, the outcome of this case would clearly have been different in every other circuit.

A. The Fifth Circuit Sets A Virtually Unattainable Bar

The Fifth Circuit's unique requirement that a plaintiff must prove loss causation at class certification by a preponderance of the evidence without merits discovery sets a virtually unattainable standard. The Seventh Circuit recently held that if plaintiffs had to demonstrate that "the contested statements actually caused material changes in stock prices," plaintiffs would be required to "prove everything (except falsity) required to win on the merits" before a class could be certified. *Schleicher*, 2010 WL 3271964, at *2. Imposing such a standard, the court noted, "would end the use of class actions in securities cases." *Id.* The court explained:

> The particular step that the fifth circuit took in *Oscar Private Equity* would do more than just "tighten" the requirements for class certification. It would make certification impossible in many securities suits, because when true and false statements are made together it is often impossible to disentangle the effects with any confidence.

Id. at *6.[1]

Respondents' contention that the Court should decline to hear this case because it involves review of an interlocutory order is likewise without merit and effectively insulates the Fifth Circuit rule from any review. Rule 23(f) was added precisely to authorize interlocutory review of class certification decisions where important issues are at stake, as is the case here. *See* FED. R. CIV. P. 23 Advisory Committee Notes, 1998 Amendments. Nor do this Court's rules and practices prohibit review of this case. "[W]here . . . there is some important and clear-cut issue of law that is fundamental to the further conduct of the case and that would otherwise qualify as a basis for

[1] Respondents invoke *Alaska Electrical Pension Fund v. Flowserve Corporation*, 572 F.3d 221 (5th Cir. 2009), to argue the Fifth Circuit "does not require a 'confession' of fraud in the negative disclosure." Opp. 27. The opinion in this case, however, "set a considerably more demanding test" than that in *Flowserve*. Pet. 11 n.5. In any event, *Flowsereve* requires proof of loss causation (and so conflicts with the Second and Seventh Circuits); it just establishes a slightly less onerous test for what is required to prove it.

certiorari, the case may be reviewed despite its interlocutory status. . . ." EUGENE GRESSMAN ET AL., SUPREME COURT PRACTICE § 4.18, 281 (9th ed. 2007).[2] Respondents offer no practical advantage to delaying review of this decision until after final judgment, and, indeed, no such justification exists. The questions presented here are purely questions of law, and it is undisputed that they are effectively dispositive of this case. Pet. 18 n.17. Moreover, because of the prohibitive cost of prosecuting a securities action for individual named plaintiffs only, the Fifth Circuit's rule, which "would end the use of class actions in securities cases," *Schleicher*, 2010 WL 3271964, at *2, is likely never to reach this Court except on an interlocutory basis.

B. The Second Circuit Does Not Require Proof Of Loss Causation At The Class Certification Stage

Respondents' contention that the conflict between the Fifth Circuit and Second Circuit is "illusory," Opp. 7, and that the Second Circuit's holding in *Salomon* is "substantively indistinguishable" from the Fifth Circuit's holdings in *Oscar* and the present case, Opp. 8, is patently untrue. Indeed, the two circuits reached virtually opposite conclusions. *Compare Salomon*, 544 F.3d at 483 ("[P]laintiffs do not bear the burden of showing an impact on price.") *with Oscar*, 487 F.3d at 265 ("[W]e require proof that the misstatement *actually*

[2] This action has been stayed virtually since the district court denied class certification, Pet. 18 n.17, which also weighs in favor of accepting this interlocutory appeal. *See* GRESSMAN, SUPREME COURT PRACTICE § 4.18, 283.

moved the market."). This conflict has been repeatedly recognized by courts and commentators alike. *See, e.g., Schleicher*, 2010 WL 3271964, at *7 (*Oscar* "rejected implicitly by" *Salomon*); *In re Am. Int'l Group, Inc. Sec. Litig.*, 265 F.R.D. 157, 181 (S.D.N.Y. 2010); *In re Initial Pub. Offering Sec. Litig.*, 260 F.R.D. 81, 106 n.214 (S.D.N.Y. 2009) ("At the class certification stage, plaintiffs need not demonstrate loss causation. It is sufficient for plaintiffs to prove only that loss causation can be shown on a class-wide basis."); *In re Boston Scientific Corp. Sec. Litig.*, 604 F. Supp. 2d 275, 285-86 (D. Mass. 2009); Martin Flumenbaum & Brad S. Karp, *Reach of 'Basic's' 'Fraud-on-the-Market Presumption'*, 240 N.Y.L.J. 3 (2008) (*Salomon* "is now squarely at odds with the Fifth Circuit's decision in *Oscar*.").

Respondents' claim that the conflict between the Fifth and Second Circuits is a shallow one rests solely on their assertion that the showing to rebut the fraud-on-the-market presumption is minimal. That assertion—now largely irrelevant following the Seventh Circuit's opinion in *Schleicher*—is incorrect. In *Salomon*, the Second Circuit held that "defendants are allowed to rebut the [fraud-on-the-market] presumption," and remanded the case for presentation of rebuttal evidence. 544 F.3d at 484-86. In *Basic Inc. v. Levinson*, 485 U.S. 224, 248 (1988), this Court stated that "[a]ny 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, will be sufficient to rebut the presumption of reliance." Respondents seize on the

word "any" to argue that defendants bear a "relatively light burden", Opp. 9, but the key word is "sever." By requiring evidence that *severs* the link, this Court made clear that the presumption is not a bubble bursting one and does not dissolve in the face of *any* contrary evidence. Consistent with *Basic*, to rebut the presumption, defendants in *Salomon* must make a substantial evidentiary showing. In the Fifth Circuit, by contrast, it was Petitioner who bore the burden of establishing loss causation by the preponderance of the evidence. Thus, a real and substantial difference exists between the Fifth and Second Circuit's requirements. In any event, there can be no doubt that controlling precedent in the Fifth and Seventh Circuits are now diametrically opposed.

The Respondents have not "severed" the basis for the application of the fraud-on-the-market presumption in this case. They did not even attempt to make such a rebuttal showing, and the district court did not purport to determine whether they had, because under controlling Fifth Circuit precedent, the burden is improperly shifted squarely to the plaintiff to establish loss causation. *See* Pet. App. 115a, 136a. Respondents did not show that the price of Halliburton stock did not incorporate the relevant information or that the plaintiffs did not rely on the integrity of the market price. In fact, Respondents admitted that Halliburton trades on an efficient market. Pet. App. 115a.[3] Respondents also

[3] Accordingly, this class would have been certified in the Seventh Circuit. *See Schleicher*, 2010 WL 3271964, at *1 ("When a company's stock trades in a large and efficient

failed to show that the stock price dropped for reasons other than the corrective disclosure. Rather, the court of appeals concluded that even though Petitioner showed that the price of Halliburton's stock dropped following corrective disclosures (after accounting for market and industry factors through an event study, Pet. App. 5a), Petitioner failed to establish loss causation, either because the corrective disclosure did not reveal the fraud or because Petitioner did not separate the effect of simultaneously released culpable and negative, but non-culpable, disclosures. *See, e.g.*, Pet. App. 15a, 19a, 23a, 26a, 29a, 31a, 36a, 41a, 48a, 52a-53a, 125a-135a.[4]

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market, the contestable elements of the Rule 10b-5 claim reduce to falsehood, scienter, materiality, and loss. Because each investor's loss usually can be established mechanically, common questions predominate and class certification is routine, if a suitable representative steps forward.").

[4] Respondents' claim that *In re Flag Telecom Holdings, Ltd. Securities Litigation*, 574 F.3d 29 (2d Cir. 2009), "confirms that the absence of loss causation defeats class certification within the Second Circuit," Opp. 11 n.2, lacks merit. The *Flag* case involved an unusual set of facts where the plaintiffs in that case were frequent traders. The Second Circuit held that the issue of loss causation was relevant to the district court's determination of whether the Class Representative was "both an adequate and typical representative of the class." 574 F.3d at 40. The issue of loss causation was "relevant to [Federal] Rule [of Civil Procedure] 23(a) for reasons that [did] not implicate either predominance or *Basic*." *Id.* at 39-40.

C. The Third Circuit Does Not Require Proof Of Loss Causation At The Class Certification Stage

Nor does the discussion of materiality in *In re Burlington Coat Factory Securities Litigation*, 114 F.3d 1410 (3d Cir. 1997), support the Fifth Circuit's holding, as Respondents contend. Opp. 13. The Third Circuit did not and could not redefine materiality in contravention of this Court's definition in *Basic*. *See Basic*, 485 U.S. at 231-32; Pet. 21 n.19. Rather, in ruling on an appeal from an order granting a motion to dismiss, the Third Circuit made the limited point that if the complaint itself alleges that a statement did not affect the price of the stock, the complaint demonstrates the statement was not material. *Burlington*, 114 F.3d at 1425. Respondents' citation, Opp. 13, to *Newton v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 259 F.3d 154 (3d Cir. 2001), is equally misplaced. In *Newton*, investors sued their broker-dealers for allegedly breaching their duty of best execution by failing to investigate other alternatives that offered lower prices to investors. 259 F.3d at 162. The fraud on the market theory had no application to that claim because defendants did not make any public assertions to the market place, a prerequisite for invoking the theory. *See id.* at 173, 180.

II. THE FIFTH CIRCUIT'S HOLDING CONFLICTS WITH SUPREME COURT PRECEDENT AND THE FEDERAL RULES OF CIVIL PROCEDURE

A. The Fifth Circuit's Holding Conflicts With *Basic* and Related Cases

Contrary to Respondents' claims, the decision below does *not* "faithfully interpret[] *Basic*." Opp. 22. While *Basic might* arguably give lower courts *some* room to develop the fraud on the market doctrine, it does not allow them to negate the presumption established in that case. *See Schleicher*, 2010 WL 3271964, at *6 ("Unlike the fifth circuit, we do not understand *Basic* to license each court of appeals to set up its own criteria for certification of securities class actions or to 'tighten' Rule 23's requirements."). Respondents invoke the language from *Basic* that the fraud-on-the-market presumption may be rebutted by "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." *See Basic*, 485 U.S. at 248; *supra* Section I.B. Respondents read that phrase to require plaintiffs to prove loss causation at class certification, but that language cannot support such an expansive reading, and *no* court outside the Fifth Circuit has found that phrase permits or requires such a seismic doctrinal shift.[5]

[5] Respondents also claim that *Basic* "made clear" that defendants can "rebut proof of the elements giving rise to the presumption, *or show that the misrepresentation in fact did not*

Likewise, Respondents' contention that the Fifth Circuit's holding is consistent with *Stoneridge Investment Partners LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148 (2008), and *Merck & Co. v. Reynolds*, 130 S. Ct. 1784 (2010), Opp. 26, is without merit. Respondents cannot negate the fact that the *Stoneridge* Court endorsed the holding in *Basic* without indicating plaintiffs were also required to prove loss causation in order to invoke the *Basic* presumption. *See* 552 U.S. at 159; Pet. 20. As to *Merck*, Respondents claim the Fifth Circuit does not require proof of scienter without discovery, Opp. 26, but ignore the repeated assertions to the contrary in the Fifth Circuit's opinion. *See, e.g.*, Pet. 6-7, 11, 24-25; Pet. App. 121a, 122a, 125a-127a.

B. The Fifth Circuit's Holding Is Inconsistent With *Eisen* And The Federal Rules Of Civil Procedure

The Fifth Circuit rule requires an improper merits analysis—beyond that which is necessary for certification under Federal Rule of Civil Procedure 23 because loss causation turns on common evidence—and so is incompatible with *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156 (1974), and Rule 23. *See* Pet. 34-37. As the Seventh Circuit observed,

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lead to a distortion of price." Opp. 23-24. That language is from the *Basic* Court's description of the holding of the lower court in that case and is not part of the Court's holding. *See Basic*, 485 U.S. at 248. Respondents' broad reading of that phrase is also inconsistent with the lower court opinion, which this Court was merely describing in that sentence. *See Levinson v. Basic Inc.*, 786 F.2d 741, 750 n.6 (6th Cir. 1986).

the Fifth Circuit's rule is driven by an apparent concern that class certification will create undue settlement pressure on defendants. *Schleicher*, 2010 WL 3271964, at *5 (citing *Oscar,* 487 F.3d at 266-70). The Seventh Circuit correctly rejected the view, implicitly endorsed by the Fifth Circuit, that "class certification is proper only when the class is sure to prevail on the merits." *Id.* Indeed, the Seventh Circuit noted:

> To the extent [*Oscar*] holds that class certification is proper only after the representative plaintiffs establish by a preponderance of the evidence everything necessary to prevail, *Oscar Private Equity* contradicts the decision, made in 1966, to separate class certification from the decision on the merits.

Schleicher, 2010 WL 3271964, at *6 (citing *Eisen*, 417 U.S. 156). The Seventh Circuit further explained that Congress had addressed concerns about securities class actions by imposing enhanced pleading requirements and ensuring securities litigation "occurs in federal court under these special standards." *Id.* The court said that any further measures required legislation and should be addressed by Congress, not the judiciary, declaring: "We do not think it appropriate for the judiciary to make its own further adjustments by reinterpreting Rule 23 to make likely success on the merits essential to class certification in securities-fraud suits." *Id.* As the Seventh Circuit recognized, the

Fifth Circuit overstepped its bounds and infringed on the prerogative of Congress and of this Court.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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