No. 09-1403

IN THE

Supreme Court of the United States

ERICA P. JOHN FUND, INC., FKA ARCHDIOCESE OF MILWAUKEE SUPPORTING FUND, INC.,
Petitioner,

v.

HALLIBURTON CO. ET AL.,
Respondents.

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

RESPONDENTS' SUPPLEMENTAL BRIEF

ROBB L. VOYLES
JESSICA B. PULLIAM
BAKER BOTTS L.L.P.
2001 Ross Ave.
Dallas, Texas 75201
(214) 953-6500

DAVID D. STERLING
AARON M. STREETT
Counsel Of Record
BAKER BOTTS L.L.P.
910 Louisiana St.
Houston, Texas 77002
(713) 229-1234
aaron.streett@bakerbotts.com

Counsel for Respondent Halliburton Co.

DONALD E. GODWIN
GODWIN RONQUILLO P.C.
1201 Elm St.
Dallas, Texas 75270
(214) 939-4400

R. ALAN YORK
GODWIN RONQUILLO P.C.
1331 Lamar St.
Houston, Texas 77010
(713) 595-8300

Counsel for Respondent David Lesar

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RESPONDENTS' SUPPLEMENTAL BRIEF

The Government contends that the court of appeals erred by considering loss causation at the class-certification stage of a Rule 10b-5 case. But it was this Court in *Basic Inc.* v. *Levinson*, 485 U.S. 224, 247 (1988) that created a presumption of reliance "on the integrity of the market price" for the express purpose of class certification. And it was *Basic* that held that a defendant could rebut the presumption with "[a]ny showing that severs the link between the alleged misrepresentation and . . . the price received (or paid) by the plaintiff." *Id.* at 248. Under those principles, when the evidence shows

that a misrepresentation had no impact on the market price—and thus did not cause any loss—a court may refuse to certify a class under the fraud-on-the-market theory. The Government's position violates these principles and serves no purpose other than to certify cases that are, by definition, meritless. The *in terrorem* power of class certification under the fraud-on-the-market theory should not be deployed when the market price itself reveals that no fraud has occurred.

The Government compounds its misinterpretation of *Basic* by overselling the differences among the only three circuits to have addressed this issue. The Second Circuit joins the Fifth Circuit in considering loss causation at the class-certification stage. And the Seventh Circuit simply has not addressed whether a defendant can rebut the *Basic* presumption—and thus defeat class certification—by demonstrating the absence of loss causation. Certiorari should be denied.

I. No Division Of Authority Warrants Review

The Government asserts that three circuits take three different positions on whether loss causation is relevant to class certification. U.S. Br. 18-21. Any disagreement is not nearly as meaningful as the Government contends and is not implicated by the facts of this case.

The Second Circuit's decision in *In re Salomon Analyst Metromedia Litigation*, 544 F.3d 474 (2008) differs from the Fifth Circuit's approach only with respect to which party bears the initial burden to establish that the alleged misrepresentation distorted the price of the stock. See BIO 7-11; compare Pet. App. 115 (holding that plaintiff must show that the alleged misrepresentations "actually moved the market") with *Salomon*, 544 F.3d at 484 ("defendants are allowed to rebut the presumption . . . by showing . . . the absence of a price impact"). In both circuits, a class may not be certified if loss causation is not proven by a

preponderance of the evidence. BIO 9-10; *Salomon*, 544 F.3d at 484-485.

The Government argues that the Second Circuit does not consider loss causation when it allows a defendant to defeat class certification by showing that the misrepresentation did not distort the market price. U.S. Br. 20 n.2. To the contrary: a defendant who proves that a misrepresentation did not impact market price necessarily proves that the misrepresentation did not cause plaintiff's loss. *Dura Pharms., Inc.* v. *Broudo*, 544 U.S. 336, 343 (2005). And *Salomon* directed the district court on remand to consider, *inter alia*, whether "other statements in the sea of voices of market commentary were responsible for price discrepancies," instead of the alleged misrepresentation. 544 F.3d at 485.[1] That type of inquiry is at the heart of loss causation. *Dura*, 544 U.S. at 343, 344-345.

In any event, the Government does not dispute Halliburton's showing that this case would be decided the same way in either the Second or Fifth circuit, given the extensive record evidence that Halliburton's alleged misrepresentations had no impact on its stock price. See BIO 16-22. The Government's implicit concession demonstrates that any procedural differences between the circuits are immaterial here.

Nor is it clear that the Fund's class could be certified in the Seventh Circuit. Although that court recently held that "*plaintiffs* need not establish loss causation" in order to invoke the *Basic* presumption of reliance, *Schleicher* v. *Wendt*, 618 F.3d 679, 687 (7th Cir. 2010) (emphasis added), the defendant in *Schleicher* did not

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[1] See also *In re Flag Telecom Holdings, Ltd. Sec. Litig.*, 574 F.3d 29, 41 (2d Cir. 2009) ("Plaintiffs have not put forth sufficient evidence on which the in-and-out traders could establish loss causation, and they must therefore be excluded from the certified class.")

attempt to rebut the fraud-on-the-market presumption. *Id.* at 684. Thus, *Schleicher* did not even mention *Basic*'s holding that a defendant may "rebut the presumption" with "[a]ny showing that severs the link between the alleged misrepresentation and . . . the price received (or paid) by the plaintiff." *Basic*, 485 U.S. at 248. Nor did it consider *Salomon*'s holding that a defendant who rebuts the *Basic* presumption defeats class certification. Consequently, it remains an open question in the Seventh Circuit whether a defendant may defeat class certification by showing that the alleged misrepresentation did not cause plaintiff's loss. See Michelle D. Johnson et al., Schleicher v. Wendt *and Fraud-on-the-Market Doctrine*, Law360 (Oct. 25, 2010), *available at* www.law360.com/web/articles/204036 ("[t]he Seventh Circuit's silence on the Second Circuit's *Salomon* approach leaves room for further development of Section 10(b) class certification standards").

At the very least, it is uncertain whether any circuit would certify a class where, as here, the evidence indisputably shows that the alleged misrepresentations did not cause any loss, thus "sever[ing] the link between the alleged misrepresentation and . . . the price received (or paid) by the plaintiff." *Basic*, 485 U.S. at 248. Because there is no clear division of authority implicated by the facts of this case, certiorari is not warranted.

At most, there is a recently created and exceedingly shallow split. Time will reveal whether the Seventh Circuit's position is as extreme as the Government believes, or whether that court will allow defendants to defeat class certification by proving that the alleged misrepresentation did not distort market price. If a meaningful divergence arises among the circuits, this Court will have ample opportunity to offer guidance with the benefit of additional analysis by the courts of appeals.

Tolerance of minor intercircuit differences is commended not only because they are not clearly implicated here, but also by *Basic* itself. The Government does not contest that this Court gave lower courts leeway to implement the fraud-on-the-market presumption. See BIO 15-16 (collecting authorities). And there is no great doctrinal dispute here; only the procedural question whether certain meritless class actions should be certified. That circuits have accepted this Court's invitation to develop their own fraud-on-the-market procedures is no reason to grant review, especially in the absence of a significant and well-developed division of authority.

II. THE DECISION BELOW IS CONSISTENT WITH THIS COURT'S PRECEDENTS AND RULE 23

Basic's fraud-on-the-market presumption is founded on the belief that an efficient market reflects all "public material misrepresentations" and that "[a]n investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price." 485 U.S. at 247. *Basic* thereby allows certification of classes that otherwise could not be certified because individual proof of reliance on the alleged misrepresentations would be required. *Id.* at 242. In exchange for this presumption of reliance on defendant's misrepresentations (via the market price), *Basic* requires assurances that the market price was actually affected by the alleged misrepresentations. *Id.* at 248. Without such evidence, "the causal connection" between the misrepresentation and the plaintiff's reliance "[w]ould be broken" because "the basis for finding that the fraud had been transmitted through market price would be gone." *Ibid.* Thus, *Basic* allows defendants to "rebut the presumption of reliance" with "[a]ny showing that severs the link between the alleged misrepresentation and . . . the price received (or paid) by the plaintiff." *Ibid.* In other words, if the record

shows that the alleged misrepresentation did not distort the market price—and thus did not cause any loss—then a class cannot be certified based upon the fraud-on-the-market presumption.

A. Loss Causation Is Central To The Fraud-On-The-Market Presumption

The Government strains to avoid this straightforward reading of *Basic*. It contends that the absence of loss causation does not rebut the presumption of reliance because "reliance and loss causation are distinct elements of a securities-fraud claim." U.S. Br. 16. That is a non sequitur. While reliance (or transaction causation) and loss causation are distinct elements of a 10(b) claim, *Basic* holds that the absence of *either one* of these elements destroys the fraud-on-the-market presumption. Specifically, *Basic* allows defendants to rebut the presumption by "show[ing] that the misrepresentation in fact did not lead to a distortion of price *or* that an individual plaintiff traded or would have traded despite his knowing the statement was false." 485 U.S. at 248 (emphasis added).

The next sentence in *Basic* drives this point home: a defendant "rebut[s] the presumption" of reliance with "[a]ny showing that severs the link between the alleged misrepresentation and *either* [1] the price received (or paid) by the plaintiff, *or* [2] his decision to trade at a fair market price." *Ibid.* (bracketed numbers and emphases added). The second part of this sentence clearly refers to transaction causation—whether the misrepresentation caused the plaintiff to purchase the stock. But the first part of the sentence just as clearly refers to loss causation—whether the misrepresentation caused the plaintiff to pay too much for the stock. This Court well understood that loss causation and reliance are different, but it "explicitly set up the presumption so that defendants could rebut it by disproving either loss

causation or reliance." Jeffrey L. Oldham, *Taking "Efficient Markets" Out of the Fraud-on-the-Market Doctrine After the Private Securities Litigation Reform Act*, 97 NW. U. L. REV. 995, 997 (2003). And that makes perfect sense: there is no basis for presuming that the entire class relied upon alleged misrepresentations via the market price if the evidence shows that the misrepresentation did not in fact distort that price.

As a fallback, the Government argues that even if "market distortion" can be considered under *Basic*, loss causation cannot. U.S. Br. 16-17. There may be a theoretical difference between price distortion and loss causation. *Dura*, 544 U.S. at 342-343. But when it comes to determining whether the evidence shows that the misrepresentation disorted the market price, as *Basic* requires, the inquiries converge. A court assessing whether a misrepresentation affected market price would first look to see whether prices rose shortly after the misrepresentation. Cf. *id.* at 343 (noting that price inflation "may prove to be a necessary condition" of loss causation). If such proof is lacking (as here), the court would then look to see whether prices declined after the truth of the alleged misrepresentation was revealed. Cf. *id.* at 344-345, 347 (setting forth identical test for loss causation). If neither finding can be made, "the misrepresentation in fact did not lead to a distortion of price" and the defendant has "rebut[ted] the presumption of reliance." *Basic*, 485 U.S. at 248. Likewise, if the evidence shows that something other than the misrepresentation caused either the initial price inflation or the later price decline, the defendant has "sever[ed] the link between the alleged misrepresentation and . . . the price received (or paid) by the plaintiff." *Ibid.* Loss-causation evidence is therefore directly relevant to class certification under the fraud-on-the-market theory.

B. Loss Causation Is Appropriately Considered At Class Certification

The Government next argues that the court of appeals erred "by considering loss causation at the class-certification stage without determining that it was relevant to any of the prerequisites for class certification under Federal Rule of Civil Procedure 23." U.S. Br. 5, 6-10. That has it exactly backwards. *Basic* created an artificial construct to allow plaintiffs to overcome the otherwise insuperable Rule 23(b)(3) hurdle of proving reliance on a classwide basis. 485 U.S. at 242. But *Basic* recognized that if an alleged misrepresentation does not affect market price, then the presumption falls away, with the logical consequence that plaintiffs cannot satisfy Rule 23(b)(3)'s predominance requirement. *Id.* at 248; *Salomon*, 544 F.3d at 485 (a "successful rebuttal *defeats* certification by defeating the Rule 23(b)(3) predominance requirement"). The court of appeals thus correctly considered loss causation to determine whether plaintiffs could invoke the fraud-on-the-market presumption and thereby satisfy Rule 23(b)(3).[2]

Conceding the obvious, the Government admits that "the fraud-on-the-market theory is relevant to the district court's class-certification decision." U.S. Br. 8. But it argues that in order to invoke the fraud-on-the-market presumption the plaintiff need only show that the misrepresentations were made publicly, that the stock traded in an efficient market, and that the plaintiff traded shares between the time of the misrepresentation

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[2] The Government's related complaint that the court of appeals improperly considered "the merits" at the class-certification stage rings hollow for the same reason. U.S. Br. 10-11. The Government correctly acknowledges that courts may consider merits issues to the extent they overlap with Rule 23 requirements. *Id.* at 10. As explained above, loss causation is just such an issue here.

and the revelation of the truth. *Id.* at 9. The Government asserts that this showing is relevant to class certification because it establishes "that common questions predominate on the question of reliance." *Ibid.* By contrast, the Government believes that the *classwide* absence of proof with respect to loss causation is irrelevant to whether a class can be certified under *Basic*. *Id.* at 9-10, 14-15.

The Government's dichotomy is directly contrary to *Basic*. The Court explained that a defendant may rebut the presumption by "show[ing] that the misrepresentation in fact did not lead to a distortion of price." *Basic*, 485 U.S. at 248. Such proof would both preclude class certification by rebutting the fraud-on-the-market presumption and defeat loss causation on a classwide basis. This makes sense: if an alleged misrepresentation did not affect market price, "the causal connection" between the misrepresentation and plaintiff's reliance "[w]ould be broken" because "the basis for finding that the fraud had been transmitted through market price would be gone." *Ibid.* The fact that loss causation stands or falls on a classwide basis hardly makes it less relevant to whether a plaintiff may invoke the fraud-on-the-market presumption and thereby achieve class certification.

The Government next contends that it is wrong to require plaintiffs to prove loss causation at the class-certification stage by preponderance of the evidence. U.S. Br. 12-13. But even if the plaintiff does not have the *initial* burden to prove loss causation in order to invoke the presumption of reliance, *Basic* provides that defendants can "rebut the presumption" with "[a]ny showing that severs the link between the alleged misrepresentation and . . . the price received (or paid) by the plaintiff." 485 U.S. at 248. *Basic*'s creation of a rebuttable presumption in favor of plaintiffs "does not

shift to [the defendant] the burden of proof." Fed. R. Evid. 301 (cited in *Basic*, 485 U.S. at 245). Thus, once the defendant makes its rebuttal showing, the ultimate burden of proof would remain on the plaintiff to show that he can satisfy Rule 23's requirements by a preponderance of the evidence. See *ibid.*[3]

The Government urges that defendant's rebuttal evidence may only be considered at trial. U.S. Br. 16, 20 n.3. That cannot be the case. *Basic* created a *rebuttable* presumption to assist plaintiffs in overcoming the predominance hurdle of Rule 23(b)(3). Thus, a "successful rebuttal *defeats* certification by defeating the Rule 23(b)(3) predominance requirement." *Salomon*, 544 F.3d at 485 (citing *Basic*, 485 U.S. at 249 n.29). It would be incongruous to allow plaintiffs to achieve class certification based upon a minimal showing—immediately imposing huge *in terrorem* costs upon defendants—while requiring defendants to wait until trial to prove that the class should not have been certified in the first place.

The Government worries that expert testimony and event studies may be necessary to prove loss causation at the class-certification stage. U.S. Br. 11-12. But that is no less true of proving market efficiency, which all parties agree must be proven in order to invoke the presumption. In fact, the event studies used to show market efficiency are often proffered to show loss causation as well. See, *e.g.*, William O. Fisher, *Does the Efficient Market Theory Help Us Do Justice in a Time*

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[3] The Government does not dispute that plaintiffs must satisfy Rule 23's requirements by preponderance of the evidence. Since the fraud-on-the-market theory is the usual way Section 10(b) plaintiffs achieve class certification, courts must weigh evidence and determine whether plaintiffs have the right to invoke that theory. *E.g.*, *Salomon*, 544 F.3d at 484.

of Madness?, 54 EMORY L.J. 843, 871, 878 (2005). In this very case, the Fund used the same event study to address both market efficiency and loss causation. Under the Government's view, the courts below were apparently required to accept the event study's proof of market efficiency, but ignore that the event study revealed a total absence of loss causation.

The alleged need for discovery is similarly a red herring. See U.S. Br. 12. Loss causation is proven by public documents, *Oscar Private Equity Invs.* v. *Allegiance Telecom, Inc.*, 487 F.3d 261, 267 (5th Cir. 2007), and the Fund has never identified any discovery that was necessary to prove loss causation here. Finally, determining loss causation by a preponderance of the evidence at the class-certification stage is not inconsistent with either summary judgment or jury-trial principles. See U.S. Br. 13-14. *Basic*'s unique presumption requires consideration of certain issues at the class-certification stage, such as materiality, market efficiency, and loss causation. The need for a district judge to make findings on these issues in order to assess whether a plaintiff can satisfy Rule 23 does not preclude a jury from reaching a different conclusion to the extent they are also relevant to the merits. *Alaska Elec. Pension Fund* v. *Flowserve Corp.*, 572 F.3d 221, 229 (5th Cir. 2009) (per curiam; panel including O'Connor, J).

In sum, the court of appeals' reasoning is consistent with *Basic*. The Government's approach, by contrast, would allow class certification through the fraud-on-the-market theory even where the evidence shows that no "fraud had been transmitted through [the] market price." *Basic*, 485 U.S. at 248.

CONCLUSION

The petition for certiorari should be denied.

Respectfully submitted.

ROBB L. VOYLES
JESSICA B. PULLIAM
BAKER BOTTS L.L.P.
2001 Ross Ave.
Dallas, Texas 75201
(214) 953-6500

DAVID D. STERLING
AARON M. STREETT
Counsel of Record
BAKER BOTTS L.L.P.
910 Louisiana St.
Houston, Texas 77002
(713) 229-1234
aaron.streett@bakerbotts.com

Counsel for Respondent Halliburton Co.

DONALD E. GODWIN
GODWIN RONQUILLO P.C.
1201 Elm St.
Dallas, Texas 75270
(214) 939-4400

R. ALAN YORK
GODWIN RONQUILLO P.C.
1331 Lamar St.
Houston, Texas 77010
(713) 595-8300

Counsel for Respondent David Lesar

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