

No. 09-1403

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IN THE  
**Supreme Court of the United States**

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ERICA P. JOHN FUND, INC.,

*Petitioner,*

*v.*

HALLIBURTON CO., DAVID J. LESAR,

*Respondents.*

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ON WRIT OF CERTIORARI TO THE UNITED STATES  
COURT OF APPEALS FOR THE FIFTH CIRCUIT

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**BRIEF OF THE AMERICAN INSTITUTE  
OF CERTIFIED PUBLIC ACCOUNTANTS  
AS *AMICUS CURIAE* IN SUPPORT OF  
RESPONDENTS**

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**INTEREST OF *AMICUS CURIAE*<sup>1</sup>**

The American Institute of Certified Public Accountants (“AICPA”) is the national organization of the certified public accounting profession with more than 350,000 members involved in public accounting, business and industry, government and academia. Its members involved in public accounting and their firms audit the financial statements of virtually every public company in the United States, and thus they are often drawn into securities litigation involving issues such as those presented in this case.

Although no member of the AICPA is involved in this case, the standards governing class certification decisions are of immense interest to the profession that the AICPA represents. As this Court has observed, the *in terrorem* effect of class certification is considerable. Curbing that effect in frivolous class actions was one of the main reasons that Congress passed the Private Securities Litigation Reform Act in 1995. That Act not only heightened pleading standards, but made clear that investors must prove loss causation to be successful in a Rule 10b-5 lawsuit.

The firms of AICPA members (as well as officers, directors and other professionals) are frequently named as defendants in securities litigation when investors allege that the audit report issued on a public company’s financial

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1. Pursuant to Rule 37.6, *amicus* affirms that no counsel for a party authored this brief in whole or in part, and that no person other than *amicus* and its counsel made a monetary contribution to the preparation or submission of this brief. The parties have filed letters giving blanket consent to the filing of amicus briefs in this case.

statements was false and misleading and thereby violated Section 10(b) of the Securities Exchange Act and Rule 10b-5. A fair number of these allegations survive a motion to dismiss despite the heightened pleading requirements of the Private Securities Litigation Reform Act of 1995. Although the auditors and the other defendants might well defeat the surviving allegations at a later stage of the proceedings (*e.g.*, summary judgment after discovery, or trial), the economic and reputational costs of reaching that point are extraordinarily high and the risk enormous where there is judicial certification of a large class of investors. The risk will be compounded by (i) the fact that many AICPA members (and their firms) audit in any given year the financial statements of many public companies and (ii) the possibility that a public company will declare bankruptcy and thus potentially shift its financial exposure to other defendants.

Further, certification based upon a presumption will invariably cause disclosures (assuming the class action claims are material to the financial statements ) that would not have otherwise been made. AICPA members who work as internal accountants for public companies, as well as AICPA members who serve as public company auditors, must consider the adequacy of public litigation contingency reporting, a task made more problematic by class certification. Certification necessarily creates an *in terrorem* effect that is exponentially magnified when companies are called upon, as they are by accounting standards, to disclose the risk in their financial statements and other public reporting. Accordingly, certifying a class, in many instances, can result in a company disclosing a substantial loss contingency which by itself can have a direct impact on the purchase and sale decisions of stock

market investors. A rule that permits a more studied decision regarding whether a class should be certified would allow companies to avoid unnecessary fluctuations in their stock price.

For all these reasons, the AICPA, on behalf of its members, therefore has a keen interest in assuring that its members and their firms, as well as all others involved in the financial reporting process, are able to raise, and have considered before the class certification decision is made, challenges to the underlying assumptions required for class treatment of a Rule 10b-5 case.

Considering at an early litigation stage issues related to whether alleged misrepresentations actually moved the market price would ensure that classes are certified only when those assumptions are valid. This would: (i) save judicial time and resources; (ii) save costs for all parties; (iii) better align litigation costs with real litigation risks; (iv) improve the financial accounting of public companies; and (v) control the *in terrorem* and adverse reputational effects of class actions and mitigate the tendency to file strike suits. That those early stage challenges may touch upon aspects of the loss causation or materiality element of an investor's claim in no way supports precluding defendants from seeking to protect themselves from the unjustifiable costs of erroneous class certification decisions.

## SUMMARY OF ARGUMENT

This Court allowed trial courts to grant investors, for purposes of class certification, a rebuttable presumption of reliance based on the fraud-on-the-market theory. *Basic v. Levinson*, 485 U.S. 224 (1988). Such a presumption allows class representatives to avoid proving that each class member relied on the alleged material misrepresentations.

A presumption based on the fraud-on-the-market theory depends on the premise that the alleged material misrepresentations moved the market price for the security. Thus, when investors invoke that theory to support class actions brought under Rule 10b-5, the class certification decision rests on the validity of that premise. Evidence regarding whether the alleged misrepresentations actually moved the market – either at the time they were made or at the time of their alleged correction – is central to whether a fraud-on-the-market based reliance presumption should be applied.

Whether submitted by investors in an effort to show that a reliance presumption applies, or by defendants in an effort to rebut that presumption, nothing within Rule 23 or this Court's jurisprudence, including *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156 (1974), precludes a trial court's consideration, at the class certification stage, of evidence regarding whether an alleged misrepresentation moved the market price. Such evidence is publicly available, and a claimed need for discovery cannot justify forcing defendants to wait until trial to submit evidence that, if sufficient to rebut the presumption, would mean that class certification was improper in the first instance.

The AICPA urges this Court not to impose a prohibition on defendants' ability to protect themselves by rebutting, at the class certification stage, a fraud-on-the-market based reliance presumption. Indeed, such a prohibition would be inconsistent with the recent revisions to Rule 23. Where defendants' evidence is not sufficient to rebut the presumption, class actions will continue to be certified. Where it is sufficient, however, defendants may be relieved of the unjustifiable costs and risks associated with an erroneous class certification decision.

## ARGUMENT

### **I. When Investors Invoke The Fraud-On-The-Market Theory, They Inject A Merits-Related Issue Into The Class Certification Decision**

This Court has held, and reaffirmed, that reliance is an element of a Rule 10b-5 claim. *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 159 (2008); *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 341-42 (2005); *Basic, Inc. v. Levinson*, 485 U.S. 224, 243 (1988). Tied to causation, the reliance element ensures that an investor cannot recover if he would have made the same investment decision with or without the alleged misrepresentation, *Stoneridge*, 522 U.S. at 159; *see also id.* at 160 (“[R]eliance is tied to causation, leading to the inquiry whether respondents’ acts were immediate or remote to the injury.”), or that the loss would have been incurred in spite of it.

But proving that each putative class member actually relied on an alleged misrepresentation would mean that “individual questions. . . would . . . overwhelm[] common

ones[,]” *Basic*, 485 U.S. at 242, rendering class actions in Rule 10b-5 cases virtually impossible. Thus, the Court’s decision in *Basic* allows a district court to apply a rebuttable presumption of reliance, based on the fraud-on-the-market theory, to permit the investor to meet the predominance requirement of Rule 23(b)(3).

The presumption at issue in *Basic* depends on a hypothesized connection between a defendant’s public statements and the price of a share of stock. The efficient market hypothesis – which underlies the fraud-on-the-market theory – posits that in open and developed securities markets, professional investors evaluate new information, and that if that information alters their perception of the value of the stock, their trading activity leads to changes in the market price. *West v. Prudential Secs., Inc.*, 282 F.3d 935, 937 (7th Cir. 2002). In short, the efficient market hypothesis predicts that the trading activity of professional investors leads to a market price for a security that reflects the value of a share of the defendant’s stock. “An investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price. Because most publicly available information is reflected in market price, an investor’s reliance on any public material misrepresentations, therefore, may be presumed for purposes of a Rule 10b-5 action.” *Basic*, 485 U.S. at 247.<sup>2</sup>

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2. Since *Basic* was decided, numerous studies have reported evidence failing to support the efficient market hypothesis’ predictions. See, e.g., Frederick C. Dunbar & Dana Heller, *Fraud on the Market Meets Behavioral Finance*, 31 DEL. J. CORP. L. 455, 471 (2006) (“The growing academic literature documenting violations of the efficient market hypothesis, along with the accumulated research on ‘irrationality’ of some investors, should



The reliance presumption approved in *Basic* is based on three premises: (1) the market price of a share of stock has absorbed the alleged material misrepresentation; (2) investors relied on the market price in making their investment decisions; and (3) that reliance was reasonable. *Semerenko v. Cendant Corp.*, 223 F.3d 165, 178-79 (3d Cir. 2000). Thus, when an investor invokes the fraud-on-the-market theory in a Rule 10b-5 case, the issue of whether an alleged misrepresentation actually moved the market price is, under *Basic*, central to the class certification decision. The theory is based on the assumption that it did, and because it did, an investor who is assumed to rely on the market price can be said to have relied (indirectly) on the alleged misrepresentation.

The Court in *Basic* did not advocate a particular form of the fraud-on-the-market theory, and it did not describe the particular showings an investor would be required to make in order to gain the benefit of a reliance presumption

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prompt scholars, practitioners and regulators to examine the implications of these developments on securities law in general, and on the unchallenged applicability of fraud-on-the-market theory in particular.”). In addition, Congress enacted the Private Securities Litigation Reform Act of 1995, Pub. L. 104-67, 109 Stat. 737, seeking, among other things, to limit frivolous securities claims. Some have argued that the Act’s damages provisions show Congress’ skepticism regarding that hypothesis as a descriptor of how securities markets actually operate. Jeffrey L. Oldham, *Comment: Taking “Efficient Markets” Out of the Fraud-On-The-Market Doctrine After The Private Securities Litigation Reform Act*,” 97 Nw. U.L. REV. 995, 1027-28 (2003). Although these developments could be used as reasons for moving away from *Basic*’s acceptance of the fraud-on-the-market theory as a vehicle for a reliance presumption, this brief proceeds under the current jurisprudence.

based on that theory. Instead, it only listed what the Court of Appeals for the Sixth Circuit had described as to what an investor would need to “plead and prove.” 485 U.S. at 248 & n. 27. With no express statement as to what needed to be pleaded and proved for a fraud-on-the-market presumption to apply, lower courts have devised their own requirements. *See, e.g., In re Polymedica Corp.*, 432 F.3d 1, 12 (1st Cir. 2005) (noting that *Basic* provided no definition of an efficient market, leaving courts to define what was required); *Gariety v. Grant Thornton, LLP*, 368 F.3d 356, 368 (4th Cir. 2004) (same); *Abell v. Potomac Ins. Co.*, 858 F.2d 1104, 1120 (5th Cir. 1988), *vacated on other grounds sub. nom. Fryar v. Abell*, 492 U.S. 914 (1989) (“*Basic* essentially allows each of the circuits room to develop its own fraud-on-the-market rules.”).

Increasingly, courts have shown a willingness to consider, at the class certification stage, whether it can be shown that an alleged misrepresentation actually moved the market price for a share of stock. *See, e.g., In re DVI Inc. Securities Litig.*, 2011 U.S. App. LEXIS 6302 (3d Cir. Mar. 29, 2011); *In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474 (2d Cir. 2008); *Oscar Private Equity Invs. v. Allegiance Telecom, Inc.*, 487 F.3d 261 (5th Cir. 2007); *In re Xcelera.com Securities Litig.*, 430 F.3d 503, 513 (1st Cir. 2005).<sup>3</sup> That this is an issue related to the

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3. The Court of Appeals for the Third Circuit also requires that an investor relying on the efficient market hypothesis plead that the alleged false statement or omission moved the market price. *Oran v. Stafford*, 226 F.3d 275, 282 (3d Cir. 2000); *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1417 (3d Cir. 1997). That court has dismissed claims under Rule 12(b)(6) where an investor’s allegations (and public information that could be judicially noticed) do not show that the market price changed “in

merits of an investor's claim has not been a deterrent for these courts. Nor should it be. The Court in *Basic*, for example, acknowledged that materiality – an element of a Rule 10b-5 claim – would be relevant to the class certification decision. 485 U.S. at 248 & n. 27 (noting that one of the Sixth Circuit's prerequisites was materiality). In *In re LTV Securities Litigation* (a case the Court cited favorably in *Basic*), Judge Higginbotham – then a district court judge – stated:

Reliance is presumed once it is shown that a misrepresentation is material, or, what is substantially identical given the concept of materiality once it is established that the material misrepresentation affected the price of stock traded on the open market.

*In re LTV Securities Litig.*, 88 F.R.D. 134, 142 (N.D. Tex. 1980) (emphasis added).

In sum, an investor who invokes the fraud-on-the-market theory injects a merits-related issue into the class certification decision. A fraud-on-the-market theory based reliance presumption depends on the premise that an alleged material misrepresentation moved the market price. That premise can be rebutted in various ways (*e.g.*, a showing of no price effect at the time of the allegedly false statement's publication or at the time it was allegedly

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the period immediately following disclosure.” *Oran*, 226 F.3d at 282. *See, e.g., In re Merck & Co. Securities Litig.*, 432 F.3d 261 (3d Cir. 2005); *In re NAHC, Inc. Securities Litig.*, 306 F.3d 1314 (3d Cir. 2002). The disclosure in such cases is held to be immaterial as a matter of law. *See, e.g., In re Merck & Co. Securities Litig.*, 432 F.3d at 268-71.

corrected, a showing that the market is not efficient). There can be no dispute that whether that premise holds true in a particular case is now an issue the investor must prove to be successful in his Rule 10b-5 suit. At issue is whether courts are limited under *Basic* in deciding what evidence can be reviewed at the class certification stage to determine whether a reliance presumption will apply (and thus whether the predominance requirement has been met). Are they limited solely to a showing of an efficient market, or may they also consider evidence (*e.g.*, lack of materiality or loss causation) supporting a conclusion as to whether there was a change in market price associated with the alleged misrepresentation?

## **II. Courts Must Be Able To Consider At The Certification Stage Evidence Regarding The Alleged Misrepresentation's Effect On The Market Price**

Neither Rule 23 nor *Eisen* precludes a court, in its effort to satisfy itself that the requirements for class certification have been met, from considering evidence going to the heart of the major premise underlying the reliance presumption described in *Basic*, *i.e.*, that an alleged material misrepresentation has changed the market price of the investor's shares. Although other indicators are available, these indicators are, at best, indirect evidence – *e.g.*, a showing that the market price generally moves up or down on the basis of other public disclosures, or that a sufficient number of “market makers” follow the stock. There is no reason to exclude from the certification analysis direct evidence regarding whether an alleged misrepresentation moved the market price.

### **A. Rebuttal Of The Reliance Presumption Removes The Basis For Class Certification**

The Court in *Basic* made clear that defendants could rebut a fraud-on-the-market theory based reliance 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 247-48. As the Court described, evidence related to materiality (whether an alleged misrepresentation moved the price at the time made) or to loss causation (whether an alleged correction moved the price) is among the evidence that would sever the tie between the alleged misrepresentation and the market price. *Basic*, 485 U.S. at 248-49.

A defendant’s submission of reliable evidence supporting a conclusion that the alleged misrepresentation had no effect on market price would make the reliance presumption disappear, and would return the parties to the state that existed before the presumption was applied:

In all civil actions and proceedings not otherwise provided for by Act of Congress or by these rules, a presumption imposes on the party against whom it is directed the burden of going forward with evidence to rebut or meet the presumption, but does not shift to such party the burden of proof in the sense of the risk of nonpersuasion, which remains throughout the trial upon the party on whom it was originally cast.

Fed. R. Evid. 301 (emphasis added). Rule 301 reflects the “bursting bubble” theory of presumptions because a

presumption does not shift the ultimate burden of proof. *St. Mary's Honor Ctr. v. Hicks*, 509 U.S. 502, 506-07 (1993); *Texas Dept. of Community Affairs v. Burdine*, 450 U.S. 248, 255 & n. 10 (1981); *Sheridan v. E.I. duPont de Nemours and Co.*, 100 F.3d 1061, 1080-81 (3d Cir. 1996) (*en banc*) (Alito, J., concurring in part and dissenting in part; describing that Congress rejected the Advisory Committee's proposal that the burden of persuasion shift to the party against whom the presumption operated).<sup>4</sup>

With a presumption in favor of the party having the ultimate burden of proof, if the other party produces evidence meeting or rebutting the presumption, the presumption disappears. *Sheridan*, 100 F.3d at 1079 (Alito, J.; "Under [the "bursting bubble"] theory, 'the only effect of a presumption is to shift the burden of producing evidence with regard to the presumed fact. If that evidence is produced by the adversary, the presumption is spent and disappears.' . . . The case then proceeds 'as though there had never been a presumption at all.'" (internal citations omitted)).

### **B. Oscar's Requirement**

In *Oscar*, Judge Higginbotham, writing for the Court of Appeals for the Fifth Circuit, required an investor asserting a Rule 10b-5 claim involving multiple simultaneous disclosures to produce evidence that the alleged misrepresentation actually "moved the market"

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4. See also *Nunley v. City of Los Angeles*, 52 F.3d 792, 796 (9th Cir. 1995); *McKenna v. Pacific Rail Serv.*, 32 F.3d 820, 829-30 (3d Cir. 1994); *A.C. Aukerman Co. v. R.L. Chaides Constr.*, 960 F.2d 1020, 1037-38 (Fed. Cir. 1992); *In re Yoder Co.*, 758 F.2d 1114, 1120 & n.13 (6th Cir. 1985); *Legille v. Dann*, 178 U.S. App. D.C. 78, 544 F.2d 1, 5-7 (D.C. Cir. 1976).

before it was given the benefit of a reliance presumption. *Oscar*, 487 F.3d at 265. As Judge Higginbotham explained, this did not lift the defendant’s burden of rebuttal because “[a]s a matter of practice, the oft-chosen defensive move is to make ‘*any* showing that severs the link’ between the misrepresentation and the plaintiff’s loss; to do so rebuts on arrival the plaintiff’s fraud-on-the-market theory.” *Id.*

As both the district court and court of appeals in this case understood, *Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*, 597 F.3d 330, 335 (5th Cir. 2010); *Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*, 2008 U.S. Dist. LEXIS 89598 (N.D. Tex. Nov. 4, 2008), at \*13, *Oscar*’s requirement means that an investor could produce evidence showing either that the price moved as a result of the alleged misrepresentation (*e.g.*, to cause the price to be distorted as a result of a false statement), or that the price moved as a result of a correction of the alleged misrepresentation.<sup>5</sup> Thus, before being given the benefit of a fraud-on-the-market based reliance presumption, *Oscar* requires that the investor produce evidence showing that the alleged material misrepresentation changed the price of the purchased or sold security, as the fraud-on-the-market theory predicts.<sup>6</sup> Judge Higginbotham in *Oscar* also noted that consideration of the issue at class certification did not

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5. In this case, the investor chose to submit the latter type of evidence. *Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*, 2008 U.S. Dist. LEXIS 89598 (Nov. 4, 2008), at \*13.

6. The Court of Appeals for the First Circuit’s approach appears to permit (although it does not require) empirical evidence regarding the effect of the alleged misrepresentation on market price in the context of an investor’s “efficient market” showing. *In re Xcelera.com Securities Litig.*, 430 F.3d at 513.

preclude its reconsideration later in the proceedings (*e.g.*, summary judgment). 487 F.3d at 269 n. 40; *see also Gariety*, 368 F.3d at 366 (concluding that determinations for purposes of class certification are not binding on the trier of fact).

### **C. Current Rule 23 Permits Consideration Of Evidence Regarding Whether An Alleged Misrepresentation Moved The Market Price**

Before a trial court certifies a class, the court must be satisfied that each of Rule 23's requirements have been met. *General Tel. Co. v. Falcon*, 457 U.S. 147, 161 (1982). As a result, the court must conduct a "rigorous analysis" of the particular claims, defenses, and applicable law. *Falcon*, 457 U.S. at 161; *Castano v. Am. Tobacco Co.*, 84 F.3d 734, 744 (5th Cir. 1996). It cannot in all cases simply take the pleadings as true. *See, e.g., Gariety*, 368 F.3d at 365; *Szabo v. Bridgeport Machs., Inc.*, 249 F.3d 672, 675-76 (7th Cir. 2001). Instead, it must address factual and legal disputes relevant to Rule 23's requirements and make findings, determinations, or rulings with respect to those disputes. *See, e.g., In re Hydrogen Peroxide Antitrust Litig.*, 552 F.3d 305, 319 (3d Cir. 2008) ("To summarize: because each requirement of Rule 23 must be met, a district court errs as a matter of law when it fails to resolve a genuine legal or factual dispute relevant to determining the requirements."); *In re Initial Pub. Offering Sec. Litig.* [*In re IPO*], 471 F.3d 24, 41 (2d Cir. 2006) ("[Class certification] determinations can be made only if the judge resolves factual disputes relevant to each Rule 23 requirement . . ."). This is true even if Rule 23 issues overlap with the merits of the plaintiff's claims.



*Vallarino v. Vandehey*, 554 F.3d 1259, 1266-67 (10th Cir. 2009); *In re Polymedica Corp.*, 432 F.3d at 6.<sup>7</sup>

The 2003 amendments to Rule 23 greatly facilitated courts' agreement on the extent to which merits-related issues could be addressed when making the class certification decision. Among other changes, those amendments removed reference to "conditional" certification orders. No longer may courts grant orders on a tentative basis. *In re Hydrogen Peroxide Antitrust Litig.*, 552 F.3d at 319-20 (quoting Committee Report of the Standing Committee on Rules of Practice and Procedures). Courts are now expressly advised to refuse certification until they satisfy themselves that the requirements of certification have been met. Advisory Comm. Notes on Fed. R. Civ. P. 23 (2003 amends.), 28 U.S.C. App., p. 144 (2006 ed.). They no longer need to make a certification decision "as soon as practicable;" a decision "at an early practicable time" is sufficient. Fed. R. Civ. P. 23(c)(1)(A). Trial courts may permit "controlled discovery into the 'merits'" to facilitate the class certification decision. Advisory Comm. Notes on Fed. R. Civ. P. 23 (2003 amends.), 28 U.S.C. App., p. 144. Such changes gave a trial court more freedom to conduct a rigorous inquiry

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7. See also *In re IPO*, 471 F.3d at 41; *Unger v. Amedisys Inc.*, 401 F.3d 316, 320-21 (5th Cir. 2005); *Gariety*, 368 F.3d at 365; *Newton v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 259 F.3d 154, 168 (3d Cir. 2001); *Szabo*, 249 F.3d at 676; *Love v. Turlington*, 733 F.2d 1562, 1564 (11th Cir. 1984); *Blackie v. Barrack*, 524 F.2d 891, 897 (9th Cir. 1975). As the Court has noted, overlap with merits-related issues is a normal situation when a plaintiff requests certification under Rule 23(b)(3). *Coopers & Lybrand v. Livesay*, 437 U.S. 463, 469 n. 12 (1978).

into whether the requirements of Rule 23 have been met. *In re IPO*, 471 F.3d at 39.

Nothing within the amended Rule 23 precludes consideration at the class certification stage of whether an alleged misrepresentation moved the market price. Nor does the pre-amendment *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156 (1974), impose a limitation. In fact, courts are virtually unanimous in concluding that *Eisen* does not preclude consideration of merits-related issues that are relevant to the class certification decision.<sup>8</sup>

This is because *Eisen* did not address whether a court could consider merits-related issues that were relevant to the class-certification decision. The district court in *Eisen* had concluded that the defendant should pay for notice to class members if the plaintiff could make a showing of a strong likelihood of success on the merits. 417 U.S. at 168. It conducted a preliminary hearing on the likelihood of success for this reason, and, concluding that the plaintiff was likely to prevail on his claims, imposed on the defendant the cost of notice. *Id.* Analyzing old Rule 23, this Court decided a very narrow issue, holding the district court had erred in evaluating the likelihood of success, and saying that “[n]othing in either the language or history of Rule 23 that gives a court any authority to conduct a preliminary inquiry into the merits of a suit

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8. *Dukes v. Wal-Mart Stores, Inc.*, 603 F.3d 571, 582 (9th Cir.), petition for cert. granted in part, 131 S. Ct. 795 (2010); *Shook v. Bd. of County Comm’rs*, 543 F.3d 597, 612 (10th Cir. 2008); *In re IPO*, 471 F.3d at 33; *Gariety*, 368 F.3d at 365-66; *Newton*, 259 F.3d at 166-67; *Szabo*, 249 F.3d at 677; *Waste Management Holdings, Inc. v. Mowbray*, 208 F.3d 288, 298 (1st Cir. 2000); *Castano*, 84 F.3d at 744.

in order to determine whether it may be maintained as a class action.” *Id.* at 177. *Eisen*’s oft-quoted statement, therefore, was not a ruling as to whether a district court could address merits-related issues where those issues overlapped the requirements for class certification. *In re IPO*, 471 F.3d at 33.

Because an investor invoking the fraud-on-the-market theory to gain a reliance presumption depends on the premise that the alleged misrepresentations moved the market price, he makes that issue central to the class certification decision.

**D. Trial Courts Must Be Allowed To Consider At The Certification Stage Evidence Regarding Whether An Alleged Misrepresentation Moved The Market Price**

The Court in *Basic* noted that a defendant’s showing that severed the link between the misrepresentation and price could be made at trial, “throughout which the District Court retains the authority to amend the certification order as may be appropriate. See Fed. Rule Civ. Proc. 23(c)(1) and (c)(4).” *Basic*, 485 U.S. at 249, n. 29. Any argument that consideration of such evidence must be deferred until trial has been vitiated given the fundamental changes to Rule 23(c)(1) that have been made since *Basic* was decided. Class certification decisions are no longer to be viewed as tentative, *see* 5 Moore’s Federal Practice § 23.80[2] (“The 2003 amendment clarifies that courts should not grant certification except after searching inquiry, and that courts should not rely on later developments to determine whether certification is appropriate.”), and the Rule now makes absolutely clear

that courts may address issues related to the merits in making their certification decisions.

The potential need for some limited discovery does not justify delaying consideration of evidence regarding whether an alleged misrepresentation moved the market price. Producing support for (or rebutting) the fraud-on-the-market theory's predictions regarding price effects typically relies on readily available data, with some of it, as the Court of Appeals for the Third Circuit has recognized, being subject to judicial notice. *In re NAHC, Inc. Securities Litig.*, 306 F.3d 1314, 1330-31 (3d Cir. 2002).<sup>9</sup> Even if discovery is necessary given the nature of the investor's claims, courts now have the ability to permit it to the extent necessary to reach a class certification decision. Advisory Comm. Notes on Fed. R. Civ. P. 23 (2003 amends.), 28 U.S.C. App., p. 144..

In short, there is no conceivable reason to preclude the parties from submitting, and trial courts from considering, evidence regarding whether the assumptions underlying a fraud-on-the-market theory based reliance presumption are valid with respect to the alleged misrepresentations. The Court of Appeals for the Fifth Circuit concluded that the class certification stage was a proper time for defendants to rebut a fraud-on-the-market based

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9. Given investors relying on the fraud-on-the-market theory must base their allegations on public statements, the Court of Appeals for the Third Circuit is not alone in using publicly available information to assess the investor's claims, even where that assessment occurs in the context of a motion to dismiss. *See, e.g., Lattanzio v. Deloitte*, 476 F.3d 147, 157-58 (2d Cir. 2007) (dismissing claims because allegations were insufficient to show loss causation in light of other defendant statements).

presumption, rejecting the argument that *Eisen* precluded consideration of that evidence. *Oscar*, 487 F.3d at 268, 270. The Courts of Appeals for the Second Circuit and for the Third Circuit agree that a defendant's rebuttal evidence is properly weighed at the class certification stage. *In re DVI Inc. Securities Litig.*, 2011 U.S. App. LEXIS 6302, at \*36 (concluding that "rebuttal of the presumption of reliance falls within the ambit of issues that, if relevant, should be addressed by district courts at the class certification stage. "); *In re Salomon*, 544 F.3d at 485 ("[T]he [trial] court must permit defendants to present their rebuttal arguments 'before certifying a class . . . .'"). One difference between the Second Circuit's and Third Circuit's approach and that of the Fifth Circuit as currently applied appears to be that the latter requires investors to be first in producing price effect evidence. *In re DVI Inc. Securities Litig.*, 2011 U.S. App. LEXIS 6302, at \*33-\*37; *In re Salomon*, 544 F.3d at 486 n. 9.

Giving trial courts the ability to test the fraud-on-the-market theory's price predictions at the class certification stage allows them to satisfy themselves that the requirements for class certification have indeed been met. Even where a court initially looks to only indirect evidence of an effect on price for a reliance presumption to apply (*e.g.*, through a showing of "objective" materiality or that the market for the security at issue is, in general, efficient), a defendant must be allowed to submit rebuttal evidence, which may take the form of direct evidence of no price effect (either at the time of the alleged misrepresentation or at the time of the alleged correction). *See, e.g., In re American Int'l Group, Inc. Securities Litig.*, 265 F.R.D. 167, 182 (S.D.N.Y. 2010) (rejecting argument that rebuttal evidence was limited to a showing regarding the initial

misrepresentation and could not address the effects of a correction). If this evidence is reliable, the trial court must be allowed to refuse to certify a class because the presumption no longer applies, unless the investor can provide reasons for disregarding defendant's evidence or can come forth with additional support for a conclusion that the market price for the security reflected the alleged misrepresentation.

That it may sometimes be difficult to disentangle the effects of various forces affecting price from the effect of an alleged misstatement or its correction is also no reason to avoid the issue at the class certification stage. Because much of the evidence that would be presented relies largely on publicly available data, it is likely that such difficulties in proving price effects will be present both at the certification stage and at trial; additional discovery will not, in general, make disentangling the effects of multiple disclosures go away. Those difficulties, in short, are part and parcel of what an investor accepts when it decides to initiate a Rule 10b-5 class action and what a defendant accepts if it chooses to challenge the premise that an alleged misrepresentation changed the market price.

In sum, issues related to whether a central premise underlying a reliance presumption holds go hand in hand with an investor's invocation of the fraud-on-the-market theory. It makes no sense to limit the proofs that defendants may submit, or to limit a court's consideration of those proofs, simply because merits-related issues may be implicated. *Eisen* does not require this. Rule 23 now expressly permits it. Accepting investors' circumstantial evidence of an effect on market price (*e.g.* that the

market for a defendant's shares is generally efficient) and rejecting defendant's direct evidence that the alleged misrepresentation did not move that price, *e.g.*, *In re Boston Scientific Corp. Securities Litig.*, 604 F. Supp. 2d 275, 284-87 (D. Mass. 2009), means only that classes will be certified despite the fact that it cannot be assumed that investors, as a class, relied on the alleged misrepresentation.

**E. The Fact That Price Effects Are Susceptible To Class-Wide Proof Is Irrelevant To The Class Certification Inquiry In A Fraud-on-the-Market Case**

When an investor invokes the fraud-on-the-market theory to gain a presumption of reliance, the first question that must be addressed is whether that presumption is appropriately applied under the circumstances. The fact that an answer to that question may be supported or rebutted with class-wide evidence that addresses subsidiary class-wide issues does not mean common questions predominate for purposes of Rule 23(b)(3). The applicability of the presumption is the issue, not whether threshold facts can be proved with class-wide evidence.

For example, a number of courts require that investors show that the market for the security at issue is efficient before applying a reliance presumption, as Petitioner readily admits (Petitioner's Brief, pp. 35, 48). Whether the market for a security is efficient is a class-wide issue. That fact does not mean that an investor is entitled to class certification without satisfying the prerequisite. By the same token, the fact that the existence (or nonexistence) of a price effect associated with an alleged misrepresentation

– an issue that goes to the heart of a fraud-on-the-market based reliance presumption – is a “class-wide issue” that, virtually by definition, is provable on a class-wide basis does not mean that class certification is appropriate.

Unlike most other types of class actions, certification in Rule 10b-5 cases rests on a presumption. Class certification is therefore not simply a matter of looking at claims and possible defenses; applicability of the presumption is an issue that must be squarely addressed and decided. Applying a fraud-on-the-market based presumption is appropriate if its underlying premises are, more likely than not, valid in a particular case. If they are not valid, the reliance presumption should not be applied. Without the presumption, individual issues would predominate (each investor would have to be shown to have relied on the alleged misstatement), and the class should not be certified. Whether an alleged misrepresentation moved the market price is an issue that falls squarely within the assessment necessary to make sure that the requirements of Rule 23 have been met.

An argument based on the fact that effects on market price are susceptible to class wide proof might have some force if price effects were entirely irrelevant to the applicability of a fraud-on-the-market based reliance presumption. Some would undoubtedly prefer to view things in this manner, with reliance entirely eliminated as an element of a Rule 10b-5 claim. *See, e.g., Schleicher v. Wendt*, 618 F.3d 679, 682 (7th Cir. 2010) (asserting that the fraud-on-the-market doctrine “supplants ‘reliance’ as an independent element by establishing a more direct method of causation.”) But this is not what the Court held.



The reasoning of a case like *Schleicher* is fundamentally at odds with *Basic*. This can be readily seen with the example of an alleged misrepresentation to which professional investors in an efficient market assign trivial, or no, importance. Such a misrepresentation would unlikely have any significant effect on market price, making it difficult to conceptualize how it could be said that, but for the alleged misrepresentation, the investor would not have entered into the transaction or that the statement caused the loss. Nonetheless, an advocate of the efficient market hypothesis would likely assert that the information has been absorbed into the market price; the information has merely been given a value of close to (or equal to) zero. Under this view, because the information is “in” the price, a class should be certified; the class would simply lose on the merits. *See Schleicher*, 618 F.3d at 685 (“It is possible to certify a class under Rule 23(b)(3) even though all statements turn out to have only trivial effects on stock prices. Certification is appropriate, but the class will lose on the merits.”).

The Seventh Circuit’s approach makes the reliance presumption irrebutable: any evidence regarding the absence of a price effect would go to the merits, not to rebutting the presumption. Therefore, a defendant would have no opportunity to “burst the bubble” of the presumption. It is no accident that *Schleicher*’s list of “contestable” elements in a Rule 10b-5 case involving a defendant whose shares are traded in an efficient market does not include reliance. 618 F.3d at 682 (“When a company’s stock trades in a large and efficient market, the contestable elements of the Rule 10b-5 claim reduce to false-hood, scienter, materiality, and loss.”).

Under the Seventh Circuit’s approach, a class should be certified solely on a showing of an efficient market. Even requiring a showing of materiality to gain the benefit of the presumption is – despite *Basic*’s express reference to the Sixth Circuit’s use of that prerequisite – a “misreading of *Basic*.” 618 F.3d at 687. And thus evidence demonstrating that the alleged misrepresentations had no effect on market price may only be submitted at trial because that evidence goes solely to the merits of the plaintiff’s claims (*e.g.*, either materiality or loss). The patient defendant who is subject to this regime goes through the entire litigation process before he gains a judgment that is adverse to every member of the class. The implications of the fact that it will be clear at that point that the class should never have been certified are not considered.

Of course, not every defendant is willing to accept the risks associated with taking a case to its conclusion and most cannot afford to do so from an economic or reputational perspective. Thus, many (perhaps most) are sufficiently risk-adverse that they settle to avoid it. As the Fifth Circuit has noted:

[C]lass certification creates insurmountable pressure on defendants to settle, whereas individual trials would not. . . . The risk of facing an all-or-nothing verdict presents too high a risk, even when the probability of an adverse judgment is low.

*Castano*, 84 F.3d at 746 (citation omitted); *see also* Janet Cooper Alexander, *Re-thinking Damages in Securities Class Actions*, 48 STAN. L. REV. 1487, 1511 (1996) (“The

class-based compensatory damages regime in theory imposes remedies that are so catastrophically large that defendants are unwilling to go to trial even if they believe the chance of being found liable is small.”). In this respect, class certification grants plaintiffs with weak cases a bargaining chip to extract from defendants (and current shareholders) more than the plaintiffs’ claims are truly worth. Professionals, whose reputations are affected, are particularly vulnerable.

The *in terrorem* effect of the class certification decision is widely recognized. *See, e.g., Coopers & Lybrand v. Livesay*, 437 U.S. 463, 476, 98 S. Ct. 2454, 57 L. Ed. 2d 351 (1978); *West*, 282 F.3d at 937; *Castano*, 84 F.3d at 746; *In re Rhone-Poulenc Rorer, Inc.*, 51 F.3d 1293, 1299 (7th Cir. 1995). It is one reason for permitting such decisions to be reviewed on appeal prior to issuance of a final judgment in the case. Advisory Comm. Notes on Fed. R. Civ. P. 23 (1998 amends.), 28 U.S.C. App., p. 143; *see Szabo*, 249 F.3d at 675 (noting that the class certification decision at issue turned a \$ 200,000 dispute into a \$ 200 million dispute, making it “a prime occasion for the use of Rule 23(f), . . . .”); *Newton v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 259 F.3d 154, 162 (3d Cir. 2001).

Moreover, the certification of a class action makes the evaluation of the litigation contingency in financial accounting particularly difficult, because of the possible range of results. An erroneous determination based solely on the presumption could very well adversely affect the quality of financial reporting.

Nothing supports such results. *Cf. Basic*, 485 U.S. at 252 (White, J., joined by O’Connor, J., concurring in part

and dissenting in part) (“[A]llowing recovery in the face of affirmative evidence of nonreliance--would effectively convert Rule 10b-5 into a scheme of investor’s insurance. There is no support in the Securities Exchange Act, the Rule, or our cases for such a result.” (internal quotation marks and citations omitted)). The AICPA urges the Court to reject arguments seeking such an outcome.

A better approach would be to allow defendants to attempt to rebut the presumption at the class action certification hearing by considering any evidence that severs the connection between the alleged misrepresentation and the stock price. A successful rebuttal would destroy the reliance commonality embedded in the presumption, and it would then be incumbent on the plaintiffs to prove, by a preponderance of the evidence, that the necessary connection between the alleged misrepresentation and the stock price exists. Failure to do so would necessarily mean that individual issues predominate and that a class should not be certified.

### **III. The Judgment In This Case**

Because *Basic* did not identify a set of requirements for a fraud-on-the-market based reliance presumption to apply, it is not inconsistent with *Basic* for the Fifth Circuit to include in a set of prerequisites a preliminary showing of an effect of an alleged misrepresentation on the market price of the security at issue. The Fifth Circuit’s approach also does not conflict with Rule 23 or with *Eisen*, as neither precludes consideration of merits-related issues relevant to the class certification decision. Whether an alleged misrepresentation moved the market is relevant to that decision because the Fund invoked the fraud-on-the-market theory.

Even if *Basic* required that Halliburton be first in putting forth evidence regarding whether an alleged misrepresentation moved the market price, this does not require that the Fifth Circuit's decision in this case be vacated and the case remanded. Petitioners do not assert that Halliburton's evidence could not burst the bubble of the reliance presumption, and the panel in this case affirmed the denial of class certification on the basis of a finding that the Fund's evidence did not show that the alleged misrepresentations affected the market price of Halliburton's stock.

### CONCLUSION

For the above reasons, the AICPA asks that the Court affirm the judgment below.

Respectfully submitted,

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