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

BRIEF OF PHARMACEUTICAL RESEARCH AND MANUFACTURERS OF AMERICA (PhRMA) AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

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INTEREST OF *AMICUS CURIAE* [1]

The Pharmaceutical Research and Manufacturers of America (PhRMA) is a voluntary, nonprofit association that represents the country's leading research-based pharmaceutical and biotechnology

[1] As required by Supreme Court Rule 37.6, counsel certifies that no party's counsel authored this brief in whole or in part, and that no person or entity other than the *amicus curiae*, its members or undersigned counsel made a monetary contribution to the preparation or submission of this brief. Additionally, the parties have filed blank consents to the filing of all amicus briefs.

companies. PhRMA's members are dedicated to developing medicines and therapeutics that enable patients to lead longer, healthier, and more productive lives.[2] In 2010, PhRMA members invested approximately $49.4 billion (of an industry total of approximately $67.4 billion) in discovering and developing new medicines.[3] New medicines account for 40 percent of the increase in human lifespan between 1986 and 2000. *See* Frank R. Lichtenberg, *The Impact of New Drug Launches on Longevity: Evidence From Longitudinal, Disease-Level Data From 52 Countries*, *1982-2001* 21 (Nat'l Bureau of Econ. Research, Working Paper No. 9754, 2003). PhRMA's mission is to advocate in support of public policies that encourage the discovery of life-saving and life-enhancing medications and products for patients.

PhRMA closely monitors legal issues that impact the pharmaceutical industry and has regularly participated as *amicus curiae* in cases before this Court. *See, e.g.*, *Schindler Elevator Corp. v. U.S. ex rel. Kirk*, No. 10-188 (U.S. argued Mar. 1, 2011); *Astra USA, Inc. v. Santa Clara County*, No. 09-1273 (U.S. Mar. 29, 2011); *Matrixx Initiatives, Inc. v. Siracusano*, No. 09-1156 (U.S. Mar. 22, 2011); *Merck & Co., Inc. v. Reynolds*, 130 S.Ct. 1784 (2010).

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[2] A list of PhRMA's members is *available at* http://www.phrma.org/about/member-companies.

[3] *See* Burrill & Co., *Analysis for PhRMA* (2011) (industry total includes PhRMA research associates and non-members); PhRMA, *Annual Member Survey* (Washington, DC: PhRMA, 2010-2011).

The issues this case presents are especially significant to PhRMA because a number of its members have borne the expense and burden of defending against securities fraud class actions in recent years. In 2008 and 2009, for example, over 40 such actions were filed against pharmaceutical and biotechnology companies.[4] These suits, which this Court has recognized are particularly susceptible to abuse, raise the already substantial costs and risks associated with the development of new medicines. Because a class certification order significantly raises the stakes and the costs of litigating, any later-stage opportunity to require proof of class-wide investor reliance or rebuttal thereof comes only after the dynamics of a case have dramatically changed.

Indeed, many courts and commentators have noted that because of the pivotal status of class certification in large scale litigation, certification decisions often have a decisive effect on the outcome of a case. An order granting certification may force a defendant to settle, regardless of a case's merits, rather than incur the costs of defending a class action. Accordingly, the outcome of this case and its impact on resources being expended in meritless or excessive class action litigation threaten the ability of pharmaceutical and biotechnology companies to research and develop new medical advances.

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[4] *See* Dechert LLP, *Dechert Survey of Securities Fraud Class Actions Brought Against Life Sciences Companies*, at 2 (Mar. 2010), at http://www.dechert.com/library/3-10_WCSL_Kotler_Survey_of_Securities_Fraud_CA.pdf.

SUMMARY OF ARGUMENT

In deciding this appeal, the proper focus should be on the district court's obligation to ensure the class certification requirements of Federal Rule of Civil Procedure 23 are met. At the class certification stage, a district court must assess whether the fraud-on-the-market presumption of reliance presents a viable method of class-wide proof sufficient to meet Rule 23(b)(3)'s predominance requirement. That requirement warrants a "close look" before a case is accepted as a class action, and any evidence bearing on the viability of the presumption properly falls within the scope of the district court's review. Here, the court of appeals held that petitioner had to show price impact to satisfy the predominance requirement, but failed. That holding is consistent with Rule 23(b)(3) and this Court's application of that Rule in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988).

Contrary to the position of petitioner and its *amici*, and a recent decision from the Seventh Circuit, the following principles apply to all securities fraud actions in which, as here, a plaintiff invokes the fraud-on-the-market presumption to satisfy Rule 23(b)(3) predominance.

The fraud-on-the-market presumption is only a potential—not certain—method of proof in each case. Thus, considerations relevant to the presumption's viability set the scope of the district court's Rule 23(b)(3) examination.

The presumption rests on *multiple* factors, including whether the alleged misstatement was material and capable of distorting the security's market price. Further, as this Court observed in *Basic*, relevant evidence includes any that severs the

link between the alleged misrepresentation and the price. 485 U.S. at 248. Proof showing the absence of price impact, including the market's failure to react to disclosures correcting the allegedly misstated or concealed information, *i.e.*, the absence of "loss causation," can sever the link. When it does, the district court must consider such evidence as part of its rigorous Rule 23 analysis.

As a proposed class-wide method of proving reliance and overcoming individualized issues, the fraud-on-the-market presumption is subject to Rule 23(b)(3)'s close scrutiny. It is not enough that the presumption's elements or rebuttal proof are susceptible to common proof. Rule 23(b)(3)'s convenience and judicial economy objectives are at risk if the presumption ultimately fails to provide a common method of proving reliance at trial. Thus, district courts must predict how the presumption will play out.

Consistent with Rule 23(b)(3) and *Basic*, the Second Circuit sensibly allows the defendant an opportunity to rebut the presumption before certifying the class. *In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474 (2d Cir. 2008). This opportunity ensures that any information bearing on the presumption's viability comes to the district court's attention and assists it in discharging its Rule 23 obligation. A rebuttal opportunity is particularly helpful to district courts in securities fraud actions based on alleged misstatements concerning the development and testing of medicines and therapeutics—a process made effectively transparent by the FDA's regulatory framework and one that often puts the alleged materiality of the purportedly concealed or misstated information in question.

In the end, the Second Circuit in *In re Salomon* and the Fifth Circuit in this case each enable a district court to evaluate information needed to assess the viability of the presumption before certifying a class. When the materiality of the alleged misstatements and their actual impact on price are called into question at the class certification stage, evidence bearing on these issues will come before the district court, whether in plaintiff's initial showing or the defendant's rebuttal. Either way, with the evidence before the district court, the result is the same, and the district court can decide whether Rule 23(b)(3) predominance is met.

In seeking reversal, petitioner and its *amici* rely heavily on the Seventh Circuit's recent decision in *Schleicher v. Wendt*, which holds that a plaintiff does not need to show the misstatement affected the market price before obtaining class certification. 618 F.3d 679 (7th Cir. 2010). That opinion, however, loses sight of the principles governing the use of the presumption as a class-wide method of proof, as well as the district court's role in testing whether such method is viable and satisfies Rule 23(b)(3).

According to *Schleicher*, at the class certification stage, the only relevant fraud-on-the-market element is whether the issuer's stock trades in an efficient market. The other underlying fraud-on-the-market elements, such as materiality, or evidence showing the absence of economic loss arising from the alleged misstatement, present no obstacle to class certification and should not be considered because they all concern questions of law or fact common to the class. This flawed reasoning, however, is not in accord with Rule 23(b)(3) class certification objectives and transforms a district court's rigorous Rule 23(b)(3)

scrutiny into little more than a pro forma exercise. The reasoning in *Schleicher* would, among other things, prevent a district court from considering class-wide evidence rebutting the fraud-on-the-market presumption before certifying a class. As a result, *Schleicher* does not present a correct path to resolving the issues on this appeal.

ARGUMENT

I. The Fraud-On-The-Market Presumption Is Subject To Rule 23(b)(3) Scrutiny

Petitioner bases this securities fraud action on Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Securities and Exchange Commission Rule 10b-5, 17 C.F.R. § 240.10b-5. [5] *See Superintendent of Ins. of N. Y. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 13 n.9 (1971) ("It is now established that a private right of action is implied under § 10(b).").

"Reliance by the plaintiff upon the defendant's deceptive acts is an essential element of the § 10(b) private cause of action." *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 159 (2008). Ordinarily, when a plaintiff alleges misstatements, the issue of reliance concerns whether the individual investor read or heard them, and, if so,

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[5] Section 10(b) of the Securities Exchange Act of 1934 prohibits (1) the "use or employ[ment] . . . [of] any . . . deceptive device," (2) "in connection with the purchase or sale of any security," and (3) "in contravention of" Securities and Exchange Commission "rules and regulations." 15 U.S.C. § 78j(b). Rule 10b-5 prohibits, among other things, the making of any "untrue statement of a material fact" or the omission of any material fact "necessary in order to make the statements made . . . not misleading." 17 C.F.R. § 240.10b-5 (2004).

whether they had any effect on the investor's decision to buy or sell the security. By its nature, this inquiry is too individualized to permit the action to proceed as a class action. Thus, absent a class-wide method of proof, the reliance element invariably defeats Rule 23(b)(3)'s requirement that "questions of law or fact common to class members predominate over any questions affecting only individual members . . . ." FED. R. CIV. P. 23(b)(3); *see Basic,* 485 U.S. at 242 (acknowledging that proof of each proposed class member's reliance forecloses class treatment "since individual issues then would . . . overwhelm[ ] the common ones").

The fraud-on-the-market presumption adopted in *Basic* allows a private securities fraud plaintiff to overcome Rule 23(b)(3)'s otherwise insurmountable predominance hurdle. *See Basic*, 485 U.S. at 242. It rests on the theory that investors rely upon the integrity of a stock's trading price and, when the stock trades in an impersonal, efficient market (an open and developed market), its price reflects all public, material information, including any alleged material misrepresentations or omissions. *See id*. at 244-47. When invoked at the class certification stage, a district court's Rule 23(b)(3) predominance inquiry largely concerns an assessment of the presumption's likely availability at trial. And information relevant to that assessment bears directly on whether Rule 23(b)(3)'s predominance requirement is in fact met.

II. A Rule 23(b)(3) Fraud-On-The-Market Inquiry Must Consider Materiality, Not Just Whether The Security In Question Traded In An Efficient Market

In *Basic*, this Court acknowledged at least four distinct elements "giving rise to the presumption" identified by the court of appeals in that case:

> (1) that the defendant made public misrepresentations; (2) that the misrepresentations were material; (3) that the shares were traded on an efficient market; (4) that the misrepresentations would induce a reasonable, relying investor to misjudge the value of the shares; and (5) that the plaintiff traded the shares between the time the misrepresentations were made and the time the truth was revealed.

Id. at 248, 248 n.27 (citing *Levinson v. Basic Inc*., 786 F.2d 741, 750 (6th Cir. 1986), and noting that "elements (2) and (4) may collapse into one").

Consistent with *Basic*'s listing of several different fraud-on-the-market elements, the economic logic of the presumption requires several underlying factual premises, only one of which is an efficient market. For example, an efficient market can only impound in the price an alleged misstatement that is public. *See Gariety v. Grant Thornton, LLP*, 368 F.3d 356, 369 (4th Cir. 2004) (instructing the district court on remand to address "whether [defendant] made a public misrepresentation" as part of its "finding of whether common issues predominate over individual issues in the context of reliance and the application of fraud-on-the-market theory"). Even in an efficient market, however, not every public misstatement affects a security's share price—only those that are

material are likely to mislead the market and affect market prices in a manner sufficient to warrant a presumption they actually did so. *See In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1425 (3d Cir. 1997) (Alito, J.) ("In the context of an 'efficient' market, the concept of materiality translates into information that alters the price of the firm's stock."); *Blackie v. Barrack*, 524 F.2d 891, 906 (9th Cir. 1975) ("Materiality circumstantially establishes the reliance of some market traders and hence the inflation in the stock price . . . .").

Moreover, the role of materiality as a necessary element of the presumption is at least as significant as the efficiency of the market. Reliance may be presumed only as to those misstatements a reasonable investor likely would have viewed as significantly altering the total mix of information in the market. *See Basic*, 485 U.S. at 231-32. "[T]o the extent that information is not important to reasonable investors, it follows that its release will have a negligible effect on the stock price." *Burlington*, 114 F.3d at 1425.[6] Almost by definition, alleged misstatements that are not material cannot move the market price and thus cannot satisfy Rule 23(b)(3)'s fraud-on-the-market assessment.

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[6] This Court in *Basic* recognized the relationship between materiality and the presumed price distortion: "[I]n an open and developed securities market, the price of a company's stock is determined by the available material information regarding the company and its business . . . . " *Basic*, 485 U.S. at 241; *id.* at 246 n.24 (stating, "we need only believe that market professionals generally consider most publicly announced material statements about companies, thereby affecting stock market prices.").

Evidence bearing on the Rule 23(b)(3) predominance determination includes proof showing the likely absence of any of the fraud-on-the-market elements or "that the misrepresentation in fact did not lead to a distortion of price . . . ." *Basic*, 485 U.S. at 248. For example, a seemingly material misstatement may nevertheless fail to distort the trading price if, through coverage by market analysts, the market is already aware of the truth, and so never misled. *Id*. (noting that where the market is privy to the truth, "the basis for finding that the fraud had been transmitted through market price would be gone."). Similarly, the extent, if any, to which the market price of the security reacts to a disclosure correcting the misstatement is probative of whether the alleged misstatement distorted the market price in the first instance. *See Berks County Employees' Ret. Fund v. First Am. Corp.*, 734 F. Supp. 2d 533, 541 n.52 (S.D.N.Y. 2010) (finding no Rule 23(b)(3) predominance where "'no evidence' that any of the alleged misrepresentations resulted in an 'immediate increase' in First American's stock price and 'no evidence' that any corrective disclosure 'caused an immediate decrease' in stock price").

In addition, a district court's Rule 23 consideration of fraud-on-the-market evidence, including identifying likely corrective disclosures by proof of resulting economic loss, serves the important purpose of identifying the period of trading during which investors could have presumptively relied, thereby defining the class period start and end dates. *See Basic*, at 229 n.5; *In re Fannie Mae Sec. Litig.*, 247 F.R.D. 32, 38 (D.D.C. 2008) ("In determining the duration of a securities fraud class based on a fraud-on-the-market theory, the Court must determine whether 'a curative disclosure had been made so as to

render it unreasonable for an investor, or the market, to continue to be misled by the defendants' alleged misrepresentations.'"). For example, even when an initial price distortion is shown, or presumed, the absence of an economic loss following the alleged corrective disclosure on which the proposed class end date is based suggests a curative event removed any such inflationary effects beforehand. Investors who purchase the security after removal of the inflation do not have access to the presumption of reliance, and, as to them, individualized reliance issues predominate.

Notwithstanding the various fraud-on-the-market issues that can arise at the class certification stage, the Seventh Circuit, in *Schleicher,* treats the efficient market element as the only relevant factor.[7] 618 F.3d at 688 ("The district court assured itself that the market for Conseco's stock was thick enough to transmit defendants' statements to investors by way of the price. That finding supports use of the fraud-on-the-market doctrine as a replacement for individual reading and reliance on defendants' statements."). Petitioner advances the Seventh Circuit's position on the primacy of the efficient market element. *See* Pet. Br. 38 ("The existence of an efficient market establishes a presumption of class-wide reliance . . . ."); *id*. at 40 ("the fraud-on-the-

[7] *Schleicher* also concedes the efficient market element usually presents no obstacle to class certification when the issuer is a "large, public company." *See id*. at 681 ("When a large, public company makes statements that are said to be false, securities-fraud litigation regularly proceeds as a class action."). In the district court, respondent Halliburton "d[id] not dispute the efficiency of the market . . . ." *Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton*, *Co*., 597 F.3d 330, 335 (5th Cir. 2010).

market presumption turns on whether the market is efficient"); *see also* U.S. Br. 10-11.

But *Schleicher*, and the position of the petitioner, are not supported by *Basic* and effectively eviscerate Rule 23(b)(3)'s predominance inquiry in private Rule 10b-5 actions. No serious examination of the fraud-on-the-market presumption as a possible method of showing reliance can overlook the pivotal element of materiality. But that is precisely what *Schleicher* does.

III. Rule 23 Requires A Rigorous Analysis Of The Fraud-On-The-Market Presumption

It is impossible for a district court to ignore evidence calling into question the fraud-on-the-market presumption's viability and still conclude that Rule 23(b)(3)'s predominance requirement is met. *See Gen. Tel. Co. of the Sw. v. Falcon*, 457 U.S. 147, 161 (1982) (reiterating that a class action "may only be certified if the trial court is satisfied, after a rigorous analysis, that the prerequisites of Rule 23(a) have been satisfied"); *see also* FED. R. CIV. P. 23(c)(1)(C) Adv. Comm. Notes 2003 ("A court that is not satisfied that the requirements of Rule 23 have been met should refuse certification until they have been met.").

Because Rule 23 is designed to make sure only cases properly subject to class treatment proceed as class actions, a district court should be afforded discretion to consider any relevant evidence for or against class certification. As the Fourth Circuit reminds us, "[w]e must not lose sight of the fact that when a district court considers whether to certify a class action, it performs the public function of determining whether the representative parties should

be allowed to prosecute the claims of absent class members." *Gariety,* 368 F.3d at 366-67; *id*. at 365-67 (instructing that a district court cannot accept at face value plaintiff's fraud-on-the-market allegations, but, instead, must look beyond the pleadings to conduct the "rigorous analysis").

A district court should also have the power to require the parties to provide whatever information it needs for a "definitive assessment." *In re Initial Public Offering Sec. Litig.*, 471 F.3d 24, 41 (2d Cir. 2006) ("*IPO*"). As the Ninth Circuit has explained, a district court must have "sufficient information to form a reasonable judgment" regarding whether the elements of Rule 23 are met. *Blackie*, 524 F.2d at 901 n.17. "Lacking that, the court may request the parties to supplement the pleadings with sufficient material to allow an informed judgment on each of the Rule's requirements." *Id.*; *see also Teamsters Local 445 Freight Div. Pension Fund v. Bombardier Inc.*, 546 F.3d 196, 204 (2d Cir. 2008) ("We require only that a court 'receive enough evidence, by affidavits, documents, or testimony, to be satisfied that each Rule 23 requirement has been met.'") (citing *IPO*, 471 F.3d at 41).

That the Rule 23(b)(3) analysis may concern liability-related issues (such as materiality) should not diminish a district court's obligation. As this Court has noted, "the class determination generally involves considerations that are enmeshed in the factual and legal issues comprising the plaintiff's cause of action." *Coopers & Lybrand v. Livesay*, 437 U.S. 463, 469 (1978) (superseded on other grounds) (internal quotation marks omitted); *see* FED. R. CIV. P. 23(c)(1)(A) Adv. Comm. Notes 2003 (advising "it is appropriate to conduct controlled discovery into the

merits, limited to those aspects relevant to making the certification decision on an informed basis"). Moreover, an assessment of the presumption's availability is not a merits determination. *See Teamsters Local 445 Freight Div. Pension Fund v. Bombardier, Inc.*, No. 05-1898, 2006 WL 2161887, at *9 (S.D.N.Y. Aug. 1, 2006), *aff'd*, 546 F.3d 196 (2d Cir. 2008). ("[W]hether the plaintiff may take advantage of the presumption of reliance . . . and whether the plaintiff has proven reliance are distinct inquiries.") (emphasis omitted).

Likewise, a district court has considerable flexibility when conducting a Rule 23 analysis to avoid a full-fledged trial. On a class certification motion, the district court makes no formal findings of fact and announces no conclusions on the merits. *Gariety*, 368 F.3d at 365 (Rule 23 findings serve the district court "*only*" in determining whether class certification is appropriate and does not bind a fact finder whose findings on the merits govern the ultimate judgment) (emphasis in original); *Unger v. Amedisys Inc.,* 401 F.3d 316, 323 (5th Cir. 2005) ("the court's determination for class certification purposes may be revised (or wholly rejected) by the ultimate fact-finder"). As the Second Circuit explains: "[A] district judge must be accorded considerable discretion to limit both discovery and the extent of the hearing on Rule 23 requirements. But even with some limits on discovery and the extent of the hearing, the district judge must receive enough evidence, by affidavits, documents, or testimony, to be satisfied that each Rule 23 requirement has been met." *IPO*, 471 F.3d at 41.

Contrary to these fundamental Rule 23 principles, *Schleicher* categorically excludes from the district court's Rule 23 examination evidence bearing on fundamental fraud-on-the-market elements other than the efficient market element. *See Schleicher*, 618 F.3d at 684, 687. *Schleicher* thus undermines the district court's important Rule 23 obligation to ensure that the requirements of Rule 23 are met.

IV. Each Fraud-On-The-Market Element's Susceptibility To Class-Wide Proof Is Not Enough To Justify Rule 23(b)(3) Certification

Whether an alleged misstatement is both material and public is a question common to all class members. So, too, is evidence a defendant may offer to challenge application of the fraud-on-the-market presumption, *e.g.*, proof that severs the link between the alleged misrepresentation and the price. The common nature of the issues and evidence bearing on the viability of the presumption, however, does not itself satisfy the "systemic efficiency" goals of Rule 23(b)(3). *See Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 615 (1997).[8]

Rather, proof of class-wide Rule 10b-5 reliance hinges on whether the presumption presents a viable method of proof, not on whether each of its separate elements is subject to common proof. In other words,

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[8] Class action treatment pursuant to Rule 23(b)(3) is "not as clearly called for" as it is in Rule 23(b)(1) and (b)(2) situations. *See Amchem*, 521 U.S. at 615. For this reason, certification under Rule 23(b)(3) warrants a "close look." *Id.* (quoting Benjamin Kaplan, *Continuing Work of the Civil Committee: 1966 Amendments of the Federal Rules of Civil Procedure (I)*, 81 HARV. L. REV. 356, 390 (1967)).

each element's susceptibility to common proof does not reveal whether the plaintiff likely has access to the presumption and, hence, the ability to prove reliance without individualized proof. *In re New Motor Vehicles Canadian Export Antitrust Litig.,* 522 F.3d 6, 25 (1st Cir. 2008) ("Plaintiffs cannot make their case without common proof of causation, and they can only prove causation through common means if their novel theory is viable . . . .").

To answer that question, a district court needs to "formulate some prediction" about the likely availability of the fraud-on-the-market presumption as a proposed method of proof. *See, e.g., In re Hydrogen Peroxide Antitrust Litig.,* 552 F.3d 305, 311 (3d Cir. 2008) (a "district court must formulate some prediction as to how specific issues will play out in order to determine whether common or individual issues predominate in a given case") (internal quotation marks omitted).

Of course, there is always a risk that a plaintiff's proposed method of proof will not pan out. And a district court cannot demand a guaranty from a plaintiff that it will. *See United Steel Workers v. ConocoPhillips*, Co., 593 F.3d 802, 809 (9th Cir. 2010) (holding that a district court cannot insist that it be "assured" that the plaintiff's proposed class-wide method of proof will apply at trial). What is required, however, is at least a reasonable expectation that the presumption will apply based on a sufficient showing of the elements supporting the presumption. Otherwise, if it turns out the presumption fails as a class-wide method of proving reliance at trial, then the "economy and efficiency of class action treatment are lost and the need for judicial supervision and the risk of confusion are magnified." *See Zinser v. Accufix*

Research Inst., Inc., 253 F.3d 1180, 1189 (9th Cir. 2001) (quoting 7A CHARLES ALAN WRIGHT, ARTHUR R. MILLER & MARY K. KANE, FEDERAL PRACTICE AND PROCEDURE § 1778, at 535-39 (2d ed. 1986)); *see also Tardiff v. Knox County*, 365 F.3d 1, 4-5 (1st Cir. 2004) ("[C]lass action machinery is expensive and in our view a court has the power to test disputed premises early on if and when the action would be proper on one premise but not another.").

The Seventh Circuit's opinion in *Schleicher*, however, in effect holds that the fraud-on-the-market elements, including materiality, are always common questions and this alone satisfies Rule 23(b)(3) predominance. *See Schleicher*, 618 F.3d at 685, 687. Petitioner and the United States, as *amici*, adopt this position. *See* Pet. Br. 39-40,49; U.S. Br. 11, 17-19 n.2. This approach is not defensible for the reasons discussed. It transforms a district court's rigorous Rule 23(b)(3) scrutiny into little more than a pro forma exercise and rubber stamp. Under *Schleicher*'s reasoning, a district court in a securities fraud action would not ever need to look behind the pleadings, even to examine an efficient market allegation, because the fraud-on-the-market elements rest entirely on class-wide proof. Not even the petitioner or its *amici*, however, would go that far. *Schleicher*, in effect, endorses at the class certification stage, a motion to dismiss standard that, in violation of Rule 23, accepts the complaint's allegations as true and does not stray beyond its four corners.

V. A Defendant Should Be Afforded An Opportunity To Rebut The Fraud-On-The-Market Presumption Before A Class Is Certified

A defendant can, of course, oppose a class certification motion. To have meaning, however, that opportunity should include showing that the presumption is untenable, for whatever reason, as a class-wide method of proof. In *In re Salomon, supra,* the Second Circuit correctly interprets *Basic* and recognizes that this opportunity to rebut emanates from Rule 23(b)(3) itself. 544 F.3d at 485 ("a successful rebuttal *defeats* certification by defeating the Rule 23(b)(3) predominance requirement . . . . Hence, the court must permit defendants to present their rebuttal arguments before certifying a class . . . .") (emphasis in original) (internal citations and quotation marks omitted).

Consistent with its transcendent duty to ensure Rule 23 requirements are met, a district court should not defer a defendant's opportunity to rebut the factual premises upon which the fraud-on-the-market presumption rests. Nor should it limit the relevant Rule 23(b)(3) evidence a defendant may introduce, except through the exercise of its discretion to control the scope of the class certification proceeding and avoid mini-trials. The "rigorous analysis" a district court must undertake, *Falcon,* 457 U.S. at 161, requires the district court remain receptive to all relevant Rule 23 evidence, regardless of whether a plaintiff or defendant is the proponent.

Basic adopted a rebuttable presumption that allows the defendant to make "[a]ny showing that severs the link between the alleged misrepresentation and either the price received (or paid) . . . ."

Basic, 485 U.S. at 248. The contention that footnote 29 in *Basic* defers any inquiry into rebuttal evidence until after class certification is not well founded. To be sure, in *Basic*, this Court stated that possible rebuttal proof in that case "is a matter for trial," at which time the district court could amend the certification order if needed. *See id*. at 249 n.29.

But footnote 29 does not state that rebuttal proof is *only* a matter for trial. Footnote 29 responds to potential difficulties plaintiffs in *Basic* might have in ultimately prevailing on a fraud-on-the-market theory given the "incongruity" and "oddities" in the case, a concern raised by the dissenting opinion. *See id.* at 249 n.29; *see also id*. at 260-62 (White, J., dissenting). But any rebuttal is speculative; no actual rebuttal proof is cited and so the majority states that it "see[s] no need to engage in the kind of factual analysis the dissent suggests . . . ." *Id*. at 249 n.29. Hence this Court concludes: "The District Court's certification of the class here was appropriate when made but is subject on remand to such adjustment, if any, as developing circumstances demand." *Id*. at 250. Common sense suggests that evidence that can defeat the presumption after a class is certified can also defeat the presumption before certification.

As this Court acknowledged, the court of appeals in *Basic* included in its description of rebuttal proof evidence that "rebut[s] . . . the elements giving rise to the presumption, or show that the misrepresentation in fact did not lead to a distortion of price . . . ." *Id*. at 248. This should include, for example, the opportunity to introduce analyst reports and other public materials showing either that, at the time of the alleged misstatement, the market already was

aware of information allegedly misstated or concealed, or that the market became aware of the truth before the alleged corrective disclosure date. A district court can easily and readily determine from such proof that the fraud-on-the-market presumption will not be available to show reliance for all or part of the class period. Rebuttal proof is particularly useful when plaintiff's proposed class period start and end dates are arbitrary and designed to increase defendant's potential exposure. *See id*. at 229 n.5.

Consistent with this interpretation of *Basic*, the Second Circuit recognizes a defendant's right to offer evidence rebutting the fraud-on-the-market presumption, on grounds other than market efficiency, at the class certification stage. *See In re Salomon*, 544 F.3d at 485. The Second Circuit is correct. *Basic*'s fraud-on-the-market presumption is a judicial response to the class certification barrier presented by individualized proof of reliance in a securities fraud case, "[a]rising out of considerations of fairness, public policy, and probability, as well as judicial economy . . . ." *Basic*, 485 U.S. at 245. Denying a rebuttal opportunity at the class certification stage contravenes the presumption's objective because it is at that stage when the district court must form a reasonable judgment about the presumption's availability as a class-wide method of proof. Indeed, there is no more appropriate time than on a motion for class certification to consider information bearing on such availability. *See In re DVI, Inc. Sec. Litig.*, Nos. 08-8033 & 08-8045, slip op. at 31 (3d Cir. Mar. 29, 2011) ("[W]e believe 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.").[9]

Any other approach would unfairly prejudice defendants in Rule 10b-5 class actions. Because a class certification order significantly raises the stakes and the costs of litigating, any later-stage opportunity to rebut comes only after a dramatic change in the dynamics of the case. *See Hydrogen Peroxide*, 552 F.3d at 310 (noting "pivotal status of class certification in large-scale litigation" and "decisive effect" certification decisions have irrespective of the merits); FED. R. CIV. P. 23(f) Adv. Comm. Notes 1998 ("An order granting certification . . . may force a defendant to settle rather than incur the costs of defending a class action and run the risk of potentially ruinous liability.").

As a matter of policy, deciding potentially dispositive issues in putative class actions as early as practicable is favored. *See Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 558-59 (2007). At the class certification stage, the prohibitive costs of litigating a certified class action still await. One study concludes that "the vast majority of certified class actions settle, most soon after certification." Robert G. Bone

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[9] The class certification stage is a judicially convenient stage to consider rebuttal proof. Plaintiffs, for example, often employ event studies to show the market is efficient. These studies explore whether new information correlates with price movements and include a review of analyst reports, press releases and securities filings, among other public information about the issuer. Hence, potential rebuttal information showing the allegedly misstated or withheld information is not new information and, therefore, not material. It may already be before the district court via public information that plaintiff's own event study relies on at the class certification stage.

& David S. Evans, *Class Certification and the Substantive Merits*, 51 DUKE L.J. 1251, 1291 (2002). To the extent considering rebuttal evidence may result in a case not proceeding as a class action, consideration of such evidence at the class certification stage is consistent with public policy.

The absence of a class-certification-stage rebuttal opportunity would be acutely detrimental to PhRMA's member companies who operate in an environment where success is arduous and expensive, and potentially high securities litigation defense costs only further raise the barrier to entry. Many of the characteristics that make success in the pharmaceutical and biotechnology industries difficult also explain why such companies are particularly susceptible to securities fraud suits. Most new drugs do not produce a profit. *See* PhRMA, *Pharmaceutical Industry Profile 2010*, at 11 (Washington, DC: PhRMA March 2010) ("Industry Profile"), at http://www.phrma.org/sites/default/files/159/profile_2010_final.pdf ("Just 2 in 10 Approved Medicines Recoup R&D Costs.").[10] And, each time a drug fails to reach expectations, an enterprising plaintiff's attorney will scour the record of public statements in search of anything that, in retrospect, may suggest the possibility of a misrepresentation. Companies may be less likely to undertake the risk of developing new

[10] Furthermore, recent estimates place the average costs of developing new drugs between $800 million and $1.3 billion. *See* Congressional Budget Office, *Research and Development in the Pharmaceutical Industry*, at 2 (Oct. 2006) ("CBO Report"), at www.cbo.gov/ftpdocs/76xx/doc7615/10-02-DrugR-D.pdf; Industry Profile at 27. From research and development to regulatory approval, the process takes approximately 12 years to complete. CBO Report at 2.

treatments—like those that PhRMA members are currently developing for cancer, cardiovascular disease, and HIV/AIDS (*id*. at 3-4)—when even approved drugs face continued uncertainty imposed by settlement-driven suits that, once a class is certified, generate potentially ruinous legal expenses.

Moreover, PhRMA's member companies are unique in that information concerning the development and testing of new medicines and therapeutics is made transparent through FDA regulations and procedures. In effect, there is a constant, ongoing public debate over the success or failure of such products. This debate is further reflected in reports of securities analysts who closely follow these public developments. Where alleged misstatements and omissions concern FDA-regulated drugs, prohibiting an opportunity to show the market's awareness of the allegedly withheld or misstated information (and thus the absence of materiality as a basis for the fraud-on-the-market presumption) is particularly detrimental.

Notably, the Seventh Circuit's position in *Schleicher* effectively bars an opportunity to oppose application of the fraud-on-the-market presumption using facts or arguments common to the class. That result would prevent a district court from considering materiality, rebuttal evidence or even from setting the beginning and end dates of the class period, an exercise that rests on considerations such as when the truth likely entered the market and, thus, the availability of the fraud-on-the-market presumption during all or portions of the class period. *See* Section II., *supra.* *Schleicher* is contrary to Rule 23(b)(3), *Basic*, and *In re Salomon*, and should be rejected.

VI. Evidence Of Price Impact Is Proper At The Class Certification Stage

When sufficient doubt exists about the viability of the fraud-on-the-market presumption for purposes of satisfying Rule 23(b)(3), a district court should have the authority, *sua sponte*, to insist upon a greater showing before certifying a class, including a showing effectively requiring the plaintiff to come forward in the first instance with proof of price impact or economic loss related to the alleged misstatement. At a minimum, a district court should be permitted to consider defendant's rebuttal proof that severs the link between the alleged misstatement and the price. That is the rule in *Basic* and the Second Circuit. *Basic*, 485 U.S. at 248; *In re Salomon*, 544 F.3d at 483-85.

Although petitioner depicts the Fifth Circuit as imposing a loss causation rule at odds with the Second Circuit [Pet. Br. 24, 30], any distinction is procedural. The Fifth Circuit requires that a plaintiff show price impact. *Oscar Private Equity Investments v. Allegiance Telecom, Inc.,* 487 F.3d 261, 269 (5th Cir. 2007); *Alaska Elec. Pension Fund v. Flowserve Corp.,* 572 F.3d 221, 229 (5th Cir. 2009) (per curiam; panel including O'Connor, J.). In the Second Circuit, a plaintiff's Rule 23(b)(3) showing must include a public, material misrepresentation about stock traded in an efficient market, and that the plaintiff traded the shares between the time the misrepresentation was made and the time the truth was revealed. *In re Salomon,* 544 F.3d at 481, 481 n.4. If it does, a defendant in the Second Circuit may, also pursuant to Rule 23(b)(3), rebut the presumption by making any showing that severs the link between the alleged misrepresentation and the price, including

"by showing, for example, the absence of a price impact." *Id*. at 484[11]; *see In re DVI*, *Inc. Sec. Litig*., Nos. 08-8033 & 08-8045, slip op. at 31-32 (3d Cir. Mar. 29, 2011) ("[W]e agree with the Second Circuit that a defendant's successful rebuttal demonstrating that misleading material statements or corrective disclosures did not affect the market price of the security defeats the presumption of reliance for the entire class, thereby defeating the Rule 23(b) predominance requirement.").

Accordingly, whether it is the plaintiff seeking to prove price impact to establish class-wide reliance (as in the Fifth Circuit) *or* the defendant showing the absence of price impact to rebut the fraud-on-the-market presumption (as in the Second Circuit), plaintiffs and defendants will introduce evidence when that issue calls into question plaintiff's proposed use of the fraud-on-the-market presumption at trial. As a practical matter, under either circuit's approach, the district court will then look at the evidence presented to determine whether Rule 23(b)(3) is met.

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[11] *See also In re Salomon*, 544 F.3d at 486 n.9 ("By contrast, we hold that plaintiffs must show that the statement is material (a prima facie showing will not suffice). However, once that is done, the burden shifts to the defense to show that the allegedly false or misleading material statements did *not* measurably impact the market price of the security.")

CONCLUSION

The decision of the court of appeals should be affirmed.

Respectfully submitted,

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