American Bar Association
www.supremecourtpreview.org

No. 09-1403

In the Supreme Court of the United States

ERICA P. JOHN FUND, INC., PETITIONER.

V.

HALLIBURTON CO.; DAVID J. LESAR, RESPONDENTS.

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

BRIEF OF PETITIONER

Lewis Kahn
Neil Rothstein
Special Counsel to Lead Plaintiff
KAHN SWICK & FOTI, LLC
206 Covington Street
Madisonville, LA 70447
Tel.: (504) 455-1400

E. Lawrence Vincent
3948 Legacy Drive
#106-324
Plano, TX 75023
Tel.: (214) 680-1668

David Boies
dboies@bsfllp.com
Counsel of Record
BOIES, SCHILLER & FLEXNER LLP
333 Main Street
Armonk, NY 10504
Tel.: (914) 749-8200

Carl E. Goldfarb
Justin D. Fitzdam
BOIES, SCHILLER & FLEXNER LLP
401 E. Las Olas Blvd.
Suite 1200
Ft. Lauderdale, FL 33301
Tel.: (954) 356-0011

QUESTIONS PRESENTED

1. Whether the Fifth Circuit correctly held that plaintiffs in private securities fraud actions must at class certification not only satisfy the requirements set forth in *Basic v. Levinson*, 485 U.S. 224 (1988), to trigger a rebuttable presumption of fraud on the market, but must also establish loss causation by a preponderance of admissible evidence.

2. Whether the Fifth Circuit improperly considered the merits of the underlying litigation, in violation of both *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156 (1974), and Federal Rule of Civil Procedure 23, when it held that plaintiffs must establish loss causation at class certification to invoke the fraud-on-the-market presumption.

RULES 14.1(B) AND 29.6 STATEMENTS

Pursuant to Rule 14.1(b), Petitioner states that the Erica P. John Fund, Inc. was known as Archdiocese of Milwaukee Supporting Fund, Inc., until February 11, 2009 when it changed its name to honor its founder. Petitioner further states that the only parties to the proceeding whose judgment is sought to be reviewed other than the individuals and entities identified in the caption are the following individual Plaintiffs:

John Kimble
Lt. Colonel Ben Alan Murphey

Pursuant to Rule 29.6, Petitioner states that it has no parent corporation and no stock.

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page

Cases

Statutes

Rules

Other Authorities

OPINIONS BELOW

The opinion of the court of appeals affirming the district court's denial of class certification is reported at 597 F.3d 330. The district court's opinion denying class certification is unreported.

JURISDICTION

The judgment of the court of appeals was entered on February 12, 2010. A timely petition for a writ of certiorari was filed on May 13, 2010 and granted on January 7, 2011. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

RULES AND STATUTORY PROVISIONS INVOLVED

Federal Rule of Civil Procedure 23 is set out in the Petitioner's Appendix (Pet. App.) at 141a-49a.

INTRODUCTION

In a federal securities action, a private plaintiff must allege and ultimately prove: (1) the defendant made a material misrepresentation or omission; (2) the defendant acted with scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) the plaintiff's reliance on the misrepresentation or omission; (5) economic loss; and (6) loss causation, *i.e.*, that defendant's misconduct proximately caused plaintiff's loss. *See Dura Pharms., Inc. v. Broudo* (*Dura*), 544 U.S. 336, 341-42 (2005).

While a plaintiff must prove those six elements to prevail at trial, in order to certify a class under Federal Rule of Civil Procedure 23, a plaintiff must only meet the requirements of Rule 23, including the requirement that common issues predominate over individual ones. Under common law understandings of fraud, reliance posed an obstacle to certification because reliance was an individual-level phenomenon: some plaintiffs would have read or heard of the misrepresentation, others would not; some would have placed weight on the misrepresentation, others might have disregarded it.

In *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), this Court adopted the fraud-on-the-market theory. Under that theory, the price of a stock incorporates "publicly available information," including "any public material misrepresentations," and an "investor who buys or sells stock at the price set by the market does so in reliance on the integrity of the market price." *Id.* at 247. That theory allows plaintiffs, upon the requisite showing, to establish a rebuttable presumption of class-wide reliance, thereby overcoming the individual issues that would otherwise prevent certification under a common law view of reliance.

In *Oscar Private Equity Invs. v. Allegiance Telecom, Inc.* (*Oscar*), 487 F.3d 261 (5th Cir. 2007), the Fifth Circuit held that private litigants had to establish loss causation at class certification by a preponderance of the evidence to invoke the fraud-on-the-market presumption, even though reliance and loss causation are separate and distinct elements of a securities claim and even though loss causation will typically turn on common evidence. The Fifth Circuit's holding conflicts with *Basic*, and, because it demands a merits inquiry not required by Rule 23, also conflicts with Rule 23 and *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156 (1974).

No other court agrees with the Fifth Circuit. As Chief Judge Easterbrook wrote for a unanimous panel of the Seventh Circuit, *Oscar* "represents a go-it-alone strategy." *Schleicher v. Wendt*, 618 F.3d 679, 687 (7th Cir. 2010). The judgment of the court of appeals below should be reversed.

STATEMENT OF THE CASE

A. Basic And Oscar

In *Basic*, 485 U.S. at 245-48, this Court held that courts adjudicating private securities fraud cases under Rule 10b-5, 17 C.F.R. 240.10b-5, may presume that members of a proposed class relied on the defendant's allegedly fraudulent, public misrepresentations, provided that the stock in question trades on an efficient market and plaintiffs bought or sold the stock during the relevant time period. That doctrine, establishing a rebuttable presumption of reliance, is known as the "fraud-on-the-market" theory. At the time the Court adopted the theory, all eight courts of appeal that had considered the matter had already reached the same result. *See* Brief for the Securities and Exchange Commission as Amicus Curiae, *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), 1987 U.S. S. Ct. Briefs LEXIS 1151, at *15, *21 n.24.

The Court noted that modern securities markets "differ from the face-to-face transactions contemplated by early fraud cases," and said the market serves as an intermediary between the seller and buyer. *Basic*, 485 U.S. at 243-244. The Court explained:

> 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 misrepresentation, therefore, may be presumed for purposes of a Rule 10b-5 action.

Id. at 247. The Court has since affirmed its holding in *Basic* on several occasions. *See*, *e.g.*, *Stoneridge Inv. Partners LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 159 (2008); *Dura*, 544 U.S. at 342.

In *Oscar*, the Fifth Circuit announced a new and unprecedented requirement for plaintiffs seeking class certification in Rule 10b-5 actions. The Fifth Circuit held that a named plaintiff must establish loss causation, *i.e.,* that a defendant's wrongful conduct caused the plaintiff's injury, by "a preponderance of all admissible evidence" in order to benefit from the fraud-on-the-market presumption of reliance: "Essentially, we require plaintiffs to establish loss causation in order to trigger the fraud-on-the-market presumption." *Oscar*, 487 F.3d at 265, 269. Judge Dennis dissented, declaring: "The majority's decision is, in effect, a breathtaking revision of securities class action procedure that eviscerates *Basic*'s fraud-on-the-market presumption, creates a split from other circuits by requiring mini-trials on the merits of cases at the class certification stage, and effectively overrules legitimately binding circuit precedents." *Id.* at 272 (Dennis, J., dissenting).

The Fifth Circuit justified placing this burden on plaintiffs at class certification partly on perceived policy considerations, noting its concern regarding the "power of the fraud-on-the-market doctrine," which, according to the court, facilitates an "extraordinary aggregation of claims," *id.* at 266-67, as well as what it characterized as the "lethal force of certifying a class of purchasers of securities enabled by the fraud-on-the-market doctrine." *Id.* at 262. The court said it could not "ignore the *in terrorem* power of certification, continuing to abide the practice of withholding until 'trial' a merit inquiry central to the certification decision, and failing to insist upon a greater showing of loss causation to sustain certification." *Id.* at 267.

Oscar relies heavily on *Greenberg v. Crossroads Systems, Inc.*, 364 F.3d 657 (5th Cir. 2004), a summary judgment opinion. There, the Fifth Circuit stated "plaintiffs cannot trigger the presumption of reliance by simply offering evidence of any decrease in price following the release of negative information." *Id.* at 665. Rather, the court held that "[t]o raise an inference through a decline in stock price that an earlier false, positive statement actually affected a stock's price, the plaintiffs must show that the false statement causing the increase was related to the statement causing the decrease." *Id.* While *Greenberg* seemingly requires proof of loss causation to establish the presumption of reliance, the conflation of loss causation and reliance at summary judgment is harmless because plaintiffs in any event have to make a *prima facie* case as to both elements to raise a triable issue of fact.

To achieve class certification in the Fifth Circuit, the *Oscar* court held that plaintiffs must prove a corrective disclosure is "related" to the prior misstatement and that when "multiple items of negative information were released together with the corrective disclosure," plaintiffs must prove by a preponderance of the evidence "that it is more probable than not that it was this negative statement, and not other unrelated negative statements, that caused a significant amount of the decline in the stock price." *Oscar*, 487 F.3d at 266 (quoting *Greenberg*, 364 F.3d at 666).

The Fifth Circuit decided that loss causation must be demonstrated at class certification even though that determination precedes merits discovery. The Court claimed "[l]ittle discovery from defendants is demanded by the fraud-on-the-market regimen. Its 'proof' is drawn from public data and public filings . . . ." *Id.* at 267.

B. The Complaint

This case is a securities class action brought by the Archdiocese of Milwaukee Supporting Fund, Inc., now known for its founder as the Erica P. John Fund, Inc. ("EPJ Fund"), against the Halliburton Company and David J. Lesar ("Lesar"), its former president and chief operating officer during part of the class period (collectively, "Halliburton" or "Defendants"). This action was brought on June 3, 2002 on behalf of all purchasers of Halliburton's common stock. The fourth amended complaint, filed on April 4, 2006, alleges that during the class period—June 3, 1999, to December 7, 2001—Defendants violated §§ 10(b) and 20(a) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 by deliberately falsifying Halliburton's financial results and deliberately misleading the public about: (1) its liability for asbestos claims; (2) its probability of collecting revenue on unapproved claims on fixed-price construction contracts; and (3) the benefits of its merger with Dresser Industries ("Dresser"). These allegations were challenged in defendants' motions to dismiss under FED. R. CIV. P. 12(b)(6) and upheld as sufficient to state a claim for relief.

1. Asbestos Allegations

The complaint alleges that Halliburton falsely represented that it had limited asbestos liability and sufficient capital reserves and insurance coverage for its asbestos liability. While Halliburton slowly increased its asbestos reserves during the class period from $25 million on May 15, 2000 to $125 million on November 8, 2001, USCA5 4246, 4596,[1]

[1] References to "J.A." are to the Joint Appendix. References to "S.A." are to the Supplemental Appendix. References to "Pet. App." are to the Appendix submitted with the Petition for a Writ of Certiorari. References to "USCA5" are to the Record.

those reserves paled in comparison to Halliburton's asbestos liabilities. By the end of the class period, the complaint alleges that Halliburton's liability for asbestos claims exceeded $1 billion. *Id.* at 4624. In July 2002, about six months after the end of the class period, Halliburton's asbestos liabilities were at least $2.2 billion, less some "hoped for but uncertain insurance recoveries," and the company took hundreds of millions of dollars of charge-offs/losses. *Id.* at 4603. A few months later, Halliburton revealed it would pay $4 billion to settle asbestos suits/claims, resulting in a $781 million charge to earnings. *Id.*

Most of Halliburton's asbestos liability derived from claims against Harbison-Walker Refractories Company ("Harbison-Walker"), a former subsidiary of Dresser, which Halliburton acquired in 1998 for $7 billion. *Id.* at 4558. On June 28, 2001, Halliburton announced in a press release that Harbison-Walker needed financial assistance with more than 165,000 open claims pending against it, and that the net exposure to Halliburton would be $50-60 million. *Id.* at 4270. Halliburton's stock declined 4.6%. J.A. 250.[2]

On July 25, 2001, Lesar and another Halliburton executive announced during an analyst

[2] All changes in stock price are company-specific changes after accounting for market and industry-wide changes.

call regarding Halliburton's potential liability for asbestos claims against Harbison-Walker that Halliburton "potential exposure" for "this asbestos litigation" was $60 million after taxes. USCA5 4274. That figure accounted for liability for "discontinued operations," and so included both pending and potential claims against Harbison-Walker. *Id.*

In a September 4, 2001 publication, Lesar stated that the asbestos claims against Halliburton were "manageable" and that Halliburton had a "substantial amount of coverage." *Id.* at 4276. On October 23, 2001, Lesar stated "that there have been no adverse developments at all with respect to the Harbison-Walker situation." *Id.* at 4277-78. On November 8, 2001, Halliburton stated that "open asbestos claims [would] be resolved without a material adverse effect on [Halliburton's] financial position or the results of operations." *Id.* at 4596.

On December 4, 2001, Halliburton released news of several adverse verdicts against Dresser. J.A. 256a. Following a December 7, 2001 announcement of another verdict against Dresser arising out of the operations of its former subsidiary, this time for $30 million, Halliburton's stock plummeted a company-specific 42.7%. *Id.* at 259a-60a.

2. Accounting Allegations

During the class period, Halliburton also booked unapproved claim orders stemming from overages on fixed price contracts as revenue, even though it knew its customers were not likely to pay for these claims. USCA5 4562-63. Prior to mid-1997, Halliburton's customers were generally obligated to pay for cost overruns. In late 1997 Halliburton began entering into large fixed price contracts, with the risk of cost overruns largely falling on Halliburton. *Id.* at 4211. Halliburton told analysts that it would not accept or perform change orders unless the customer agreed up front to pay for the extra work, *i.e.*, it would not incur expenses on unapproved claims. *Id.* at 4222. Ultimately, these fixed price contracts resulted in significant cost overruns and delays, with customers refusing to pay millions of dollars in unapproved claims. *Id.* at 4561.

In response, Halliburton changed its accounting practices, *id.* at 4560, and began counting as revenue the amounts of unapproved claims that were supposedly "probable" of collection. *Id.* at 4562-63, 4604-05. This change in revenue recognition policy was disclosed in Halliburton's 1999 Annual Report, released on March 14, 2000. S.A. 471. There, Halliburton said: "Claims and change orders which are in the process of being negotiated with customers, for extra work or changes in the scope of work are included in revenue when collection is deemed probable." *Id.* At the same time, Halliburton also announced that its 1998 revenues included $89 million in unapproved claims it contended were probable of collection and that its 1999 revenues included $98 million in unapproved claims. *Id.* Halliburton knew those sums were not probable of collection. USCA5 4608-09. On April 26, 2000, Halliburton released its first quarter results for 2000, which were also falsely inflated by unapproved claims that Halliburton knew were not probable of collection. *Id.* at 4246, 4611.

On October 24, 2000, Lesar announced that Halliburton would undertake a massive restructuring in light of serious operational problems, including cost overruns in its construction operations. *Id.* at 4256-57. The next day, Halliburton's stock dropped 6.6%. J.A. 229a. In a December 21, 2000 press release, Halliburton disclosed its restructuring plan would cost $120 million and released its fourth quarter earnings. *Id.* at 240a-41a; S.A. 519. According to the release, the $120 million restructuring charge was due, in part, to the fact that "negotiations with customers regarding cost increases on seven … projects have not resulted in resolution of certain claims as originally anticipated." J.A. 242a; S.A. 520. The next day, Halliburton's stock price declined from $37.00 to $36.00, a drop of 3.9%. J.A. 245a.

3. Allegations Regarding Dresser Merger

The complaint further alleges that Halliburton knowingly misrepresented the financial impact of the Dresser acquisition, touting efficiencies it knew would not be realized. For example, on September 13, 1999, a year after the acquisition was complete, an analyst reported that Lesar said regarding the merger, that "following further headcount reductions and significant consolidations, the company is now projecting annual benefits of $500 million." USCA5 4236. However, on October 4, 1999, Halliburton announced that its third-quarter earnings would be less than previously estimated, and that the "Dresser Equipment Group business segment is now significantly underperforming Halliburton's expectations." S.A. 512-13. This news disclosed that Halliburton's previous glowing statements regarding the merger were false, and the stock declined that day by 9%. J.A. 218a.

Halliburton's 1999 Annual Report, released on March 14, 2000, said "[t]he merger with Dresser Industries is now behind us." USCA5 4241. However, on October 24, 2000, Lesar announced Halliburton would undertake a significant restructuring to address several issues, including losses stemming from the Dresser integration and cost overruns on long-term fixed price construction projects. *Id.* at 4256-57. On December 21, 2000, the company disclosed it was taking a $120 million charge, with $25 million due to losses stemming from the Dresser acquisition and merger, and the stock fell 6.6%. S.A. 519; J.A. 229a.

C. District Court Proceedings

On May 9, 2006, Halliburton moved to dismiss the fourth amended complaint. USCA5 4907. The district court denied that motion on March 28, 2007, *id.* at 6467, and discovery began. On July 9, 2007, Lesar moved for reconsideration following this Court's ruling in *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007), regarding the heightened standard required for pleading scienter in private security cases. USCA5 6728. The district court found the complaint satisfied this heightened standard on March 18, 2008. *Id.* at 8469.

On September 17, 2007, the EPJ Fund moved to certify a class of all persons and entities who purchased or acquired common stock of Halliburton during the class period. J.A. 126a-61a. The EPJ Fund provided evidence that the proposed class met the requirements for numerosity, typicality, commonality, and adequacy, as set forth in FED. R. CIV. P. 23(a), and also satisfied the predominance requirement of FED. R. CIV. P. 23(b)(3). *Id.* at 140a-59a. The EPJ Fund invoked the fraud-on-the-market theory to show reliance, *id.* at 147a, and filed the expert report of Jane Nettesheim in support of its class certification motion, *id.* at 163a. In her report, Nettesheim concluded that the market for

Halliburton's stock was efficient, *id.* at 174a, based on her analysis of eleven different factors, the *Cammer*[3]/*Unger*[4]/*Bell*[5] factors, derived from the case law. J.A. 174a-208a. With respect to whether there was a cause and effect relationship between unexpected corporate events or financial releases and the stock price, Nettesheim concluded that the stock price reacted promptly to unexpected news, based on an event study that corrected for market and industry-wide influences through a regression analysis. *Id.* at 184a-198a. In light of *Oscar*, the EPJ Fund also provided evidence, including Nettesheim's report, that the corrective disclosures caused plaintiffs' losses. *See, e.g., id.* at 163a-329a; S.A. 581-83.

Defendants did not challenge the contention that Halliburton's stock trades on an efficient market. J.A. 330a-87a, 549a n.8. Rather, Halliburton argued that the EPJ Fund did not establish loss causation. *See*, *e.g.*, *id.* at 345a, 375a. Halliburton criticized the EPJ Fund's evidence of loss causation, but did not provide contrary evidence. *See id.* at 446a-537a, 668a-777a. Halliburton never contended that proof of the class members' claims,

---

[3] *Cammer v. Bloom*, 711 F. Supp. 1264 (D.N.J. 1989)

[4] *Unger v. Amedisys, Inc.*, 401 F.3d 316, 321 (5th Cir. 2005)

[5] *Bell v. Ascendent Solutions, Inc.*, 422 F.3d 307, 311 (5th Cir. 2005)

including proof of the element of loss causation, would require individualized evidence.

The district court approved the EPJ Fund as the sole class representative, and found "that the Proposed Class satisfied Federal Rule of Civil Procedure 23 as to numerosity, commonality, typicality, and adequacy of [EPJ Fund] as a class representative." Pet. App. 3a. The court denied the motion solely because it found that the EPJ Fund had failed to prove loss causation by a preponderance of the evidence, *id.* at 4a, as required by *Oscar*, 487 F.3d at 265.[6]

D. The District Court's Loss Causation Analysis

The district court admitted that the Fifth Circuit's unique requirement places an "exceedingly high burden on Plaintiffs at an early stage in the litigation," explaining that "the bar is now extremely high for all plaintiffs seeking class certification in securities litigation," but concluded that it was "bound to follow the Fifth Circuit's precedent." Pet App. 7a. Crucially, the requirement that the EPJ Fund prove loss causation was the only barrier to

---

[6] Defendants also contended that the proposed class representatives, the EPJ Fund and Ben Alan Murphey, were not adequate or typical, J.A. 376a-87a, and filed a motion to strike Nettesheim's expert reports. USCA5 7461. The court denied the motion to strike and did not approve Mr. Murphey as a class representative.

class certification in this case. The court acknowledged that "[a]bsent this requirement," it "would [have] certif[ied] the class." *Id.* at 4a; *see also id.* at 54a.

The bulk of the court's 37-page opinion is devoted to its loss causation analysis. The court held that the EPJ Fund could "not establish loss causation without *proof* of a revelation of fraud by Halliburton or an indirect revelation of fraud to the market." *Id.* at 41a.[7] In addition, if non-culpable negative news was released contemporaneously with the corrective disclosure, the court held that EPJ Fund "must show that it was 'more probable than not' that the decline in stock price was caused by the corrective portion of the disclosure, rather than the new information." *Id.* at 31a. This is so, the court explained, because "[w]ith respect to mixed disclosures, the plaintiff's burden is heightened—Plaintiffs must separate actual corrective effects from effects of new negative events." *Id.* at 32a.

The court's analysis of the drop in Halliburton's stock on December 7, 2001 is illustrative. On December 4, 2001, Halliburton disclosed that a district court had entered judgment against Dresser on a $65 million Texas jury verdict and also announced three additional judgments

---

[7] Unless otherwise noted, all emphasis is added, and in quotations, all internal quotations and citations are omitted.

against Dresser in the aggregate amount of $35.7 million. S.A. 509. On December 4, Halliburton's stock dropped 3.7%, and on December 5, 3.8%. J.A. 322a. Then, on December 7, 2001, Halliburton issued a press release detailing another judgment—this one a December 5, 2001, verdict against Dresser for $30 million. S.A. 531. Halliburton's stock price immediately plummeted 42.7%, dropping to $12.00 at the close of trading on December 7, 2001, from $20.85 at the close of trading on December 6. J.A. 259a-60a.

Following the December 7 press release, analysts widely reported that it was the adverse news about Halliburton's asbestos liability that drove down its stock price. The verdict announced on December 7 was the proverbial straw that broke the camel's back. One analyst wrote of "the specter of lawsuits spiraling out of control." *Id.* at 257a-58a. Another wrote: "[I]f only 1% of cases resulted in jury verdicts of a similar magnitude and the awards were upheld at the appellate level, the future liability would be significantly greater than our previous expectations." *Id.* at 259a. TheStreet.com reported: "Halliburton Buried as Investors Stopped Believing": "Halliburton's share dove to nine-year lows … as investors lost faith in the company's claims." USCA5 4577.

However, the district court found that the EPJ Fund had not demonstrated loss causation as to Halliburton's stunning 42.7% stock price drop on

December 7 because it had not disaggregated "the corrective effect resulting from the alleged prior minimization of asbestos liabilities" from "the negative [but non-culpable] effect following the announcement of a new asbestos verdict." Pet. App. 31a.

E. The Fifth Circuit's Opinion

In its FED. R. CIV. P. 23(f) petition,[8] the EPJ Fund stated that the decision denying class certification was likely "dispositive of the litigation, as it is prohibitively expensive for [EPJ Fund] to proceed to final judgment on its individual claims." *Id.* at 77a-78a. Halliburton agreed. *Id.* at 93a, 106a. On December 18, 2008, the Fifth Circuit Court of Appeals accepted the appeal. *Id.* at 108a.

The Fifth Circuit subsequently affirmed the district court's denial of class certification, noting that the EPJ Fund had argued that *Oscar* was contrary to Supreme Court precedent and responding, "Plaintiff may not assail *Oscar* as wrongly decided, as we are bound by the panel decision." *Id.* at 122a, 113a n.2.

Citing *Oscar*, the Fifth Circuit held that to invoke the fraud-on-the-market presumption at the class certification stage, the EPJ Fund had to prove

---

[8] This case has been stayed since the district court denied class certification. Pet. App. 109a, 139a.

loss causation by a preponderance of the evidence: "In order to obtain class certification on its claims, Plaintiff was required to prove loss causation, i.e., that the corrected truth of the former falsehoods actually caused the stock price to fall and resulted in the losses." *Id.* at 113a; *see also id.* at 115a ("Plaintiff must show that an alleged misstatement 'actually moved the market.'"). The court explained that "[t]his showing of loss causation is a 'rigorous process' and requires both expert testimony and analytical research or an event study that demonstrates a linkage between the culpable disclosure and the stock-price movement." *Id.* at 130a.

The Fifth Circuit also held that the plaintiff must show that the "corrective disclosure causing the decrease in price is *related* to the false, non-confirmatory positive statement made earlier, and . . . that it is *more probable than not* that it was this related corrective disclosure, and not any other unrelated negative statement, that caused the stock price decline." *Id.* at 119a-120a (emphasis in original). In addition, the "plaintiffs must prove the corrective disclosure shows the *misleading or deceptive nature* of the prior positive statements." *Id.* at 121a. The corrective disclosure must show the prior misrepresentations or omissions "were *designed to defraud*." *Id.* at 122a.

The court further held that "if a company releases multiple items of negative information on the same day, the plaintiff must establish a reasonable likelihood that a subsequent decline in stock price is due to the revelation of the truth of the earlier misstatement rather than the release of the unrelated negative information." *Id.* at 117a-118a. The court explained that the plaintiff had to rule out possible, non-culpable explanations for the stock drop, stating it was the plaintiff's burden to show "the subsequent loss could not otherwise be explained by some additional factors revealed then to the market." *Id.* at 118a.

In its analysis, the Fifth Circuit held that EPJ Fund failed to establish loss causation as to Halliburton's statement regarding asbestos liability, *id.* at 124a-29a, its accounting for revenue on unapproved claims, *id.* at 132a-36a, or its projections regarding the benefits of its merger with Dresser, *id.* at 129a-32a. The court found either that the corrective disclosures did not reveal the fraud or that EPJ Fund failed to disaggregate the effect of simultaneously released culpable, negative news and non-culpable, negative news. *See*, *e.g.*, *id.* at 15a, 19a, 23a, 26a, 29a, 31a, 36a, 41a, 48a, 52a-53a, 125a-135a.

For instance, the court held that Halliburton's June 28, 2001 announcement that Harbison-Walker, Dresser's former subsidiary, needed financial assistance because of its asbestos liability did not constitute a corrective disclosure even though Halliburton announced the news as unexpected, S.A.

523, and the complaint alleged Halliburton knew throughout the class period that Harbison-Walker would need financial assistance. USCA5 4575. The court said: "we can discern no indication from the June 28, 2001 press release that Halliburton's prior asbestos reserve estimates were misleading or deceptive." Pet. App. 126a-127a.

Similarly, the court found that the EPJ Fund had not established loss causation as to Halliburton's December 21, 2000 announcement that it was taking a charge due to restructuring because the EPJ Fund had failed to separate the effects of culpable and non-culpable news. *Id.* at 134a. On that day, Halliburton announced that it was taking a $95 million write off on primarily "project specific matters," and stated that the charge was due in part to the fact that "negotiations with customers regarding cost increases on seven . . . projects have not resulted in resolution of certain claims as originally anticipated." S.A. 520. That announcement suggested that contrary to its prior assertion, *id.* at 471, Halliburton had booked as revenue cost overruns and charges that were not probable of collection. Halliburton also attributed the charge to "the poor near term market outlook for downstream engineering and construction business," *id.* at 519, and the court found the EPJ Fund had failed to parse out the effect of that downturn, Pet. App. 134a-35a, even though EPJ Fund's expert adjusted for industry wide factors in her event study.

The court specifically noted that the "parties do not dispute . . . the efficiency of the market." *Id.* at 115a. The sole basis for the court's ruling was its holding that the EPJ Fund failed to establish loss causation. *Id.* at 136a.

F. The Petition For A Writ Of Certiorari

EPJ Fund filed a timely petition for a writ of certiorari on May 13, 2010. On October 4, 2010, this Court invited the Acting Solicitor General to express the view of the United States. On December 3, 2010, the Acting Solicitor General filed a petition recommending that the Court grant certiorari and also stating that Fifth Circuit opinion erred, *inter alia*, by considering loss causation at the class-certification stage without relating that inquiry to the Rule 23 requirements. This court granted the petition on January 7, 2011.

SUMMARY OF ARGUMENT

In *Oscar*, the Fifth Circuit held that securities fraud plaintiffs must prove loss causation, *i.e.*, that a defendant's alleged misrepresentations are the proximate cause of their economic loss, at class certification in order to invoke the fraud-on-the-market presumption. The issue in this case is not *whether* plaintiffs must establish loss causation but rather *when* they must do so, and whether it is proper to require proof of loss causation at class certification, even when loss causation turns on common evidence. The Fifth Circuit's unique holding that plaintiffs must to do so at class certification conflicts with *Basic, Eisen v. Carlisle Jacqueline*, 417 U.S. 156 (1974), and Federal Rule of Civil Procedure 23.

The Fifth Circuit's requirement nullifies the fraud-on-the-market presumption this Court established in *Basic* by imposing an additional and substantial prerequisite for invoking the presumption. As the Second Circuit held, such a requirement is "a misreading of *Basic*," because "plaintiffs do not bear the burden of showing an impact on price." *In re Salomon Analyst Metromedia Litig.* (*Salomon*), 544 F.3d 474, 481-83 (2d Cir. 2008). The Fifth Circuit ruling also conflicts with *Basic* by holding that the presumption is rebuttable at class certification, when this Court found it was rebuttable at trial. *See Basic,* 485 U.S. at 249 n.29.

The fraud-on-the-market presumption affords plaintiffs a rebuttable presumption of reliance on a class-wide basis, thereby helping establish that common issues—not individualized ones—predominate. Plaintiffs need not establish loss causation, a separate and distinct element of their cause of action, to invoke the fraud-on-the-market presumption. As Chief Judge Easterbrook, writing for the Seventh Circuit in *Schleicher v. Wendt*, 618 F.3d at 679, 687 (7th Cir. 2010), and the Acting Solicitor General's invitation brief both correctly conclude, loss causation is relevant at class certification only for the predominance inquiry—not for establishing reliance—and then, the only issue is whether proof of loss causation turns on common or individual evidence. Because loss causation focuses on the market's reaction to information and on defendants' conduct, it generally turns on common evidence, as Respondents themselves admit in their supplemental brief at the petition stage. Accordingly, there is no justification for requiring plaintiffs to prove loss causation at class certification.

The Fifth Circuit's holding also violates both *Eisen* and Rule 23, as *Schleicher* and the Acting Solicitor General's brief state, because *Oscar* requires a premature merits inquiry. The proper analysis under Rule 23(b)(3) is how the putative class members will attempt to prove their case—not whether they will ultimately succeed. *See Eisen*, 417 U.S. at 178. Defendants are afforded three opportunities to test the merits of loss causation: a motion to dismiss, summary judgment and trial. The Fifth Circuit cannot unilaterally re-write Rule 23 to provide a fourth opportunity at class certification. The text of Rule 23 and this Court's precedent foreclose that approach.

The Fifth Circuit's rule further compounds the prejudice to plaintiffs by requiring a merits determination without merits discovery. The Fifth Circuit held that "plaintiffs must prove the corrective disclosure shows *the misleading or* *deceptive nature* of the prior positive statements" and that "the corrective disclosure more probably than not shows that the original estimates or predictions were *designed to defraud*." Pet. App. 121a-122a. That test effectively requires plaintiffs to establish scienter, and to do so through defendants' corrective disclosures alone. Even at trial, when plaintiffs must prove scienter, they are not limited to doing so through defendants' corrective disclosures alone.

The Fifth Circuit ruling also deprives plaintiffs of their Seventh Amendment right to a jury trial by directing courts to deny certification if plaintiffs fail to establish loss causation by a preponderance of the evidence. In so doing, the Fifth Circuit imposes a higher standard at class certification than pertains at summary judgment, and requires courts to make a merits determination that is not part of their proper role as a gatekeeper to class certification under Rule 23.

Not surprisingly, other courts have uniformly rejected *Oscar*, which, as the Seventh Circuit noted, represents a "go-it-alone strategy," *Schleicher*, 618 F.3d at 687, which this Court should foreclose.

ARGUMENT

A. The Fifth Circuit's Rule Requiring Proof Of Loss Causation At Class Certification Conflicts With This Court's Ruling In *Basic*

There can be no dispute that the Fifth Circuit "require[s] plaintiffs to establish loss causation in order to trigger the fraud-on-the-market presumption." Pet. App. 115a (quoting *Oscar*, 487 F.3d at 265).[9] While the Fifth Circuit claimed its new requirement stemmed from this Court's opinion in *Basic,* that assertion is simply wrong. Nowhere does this Court's decision in *Basic* require proof of loss causation at the class certification stage. Rather, in *Basic*, this Court held a plaintiff may invoke the fraud-on-the-market presumption provided defendants made public misrepresentations, the company's stock traded in an efficient market, and plaintiffs traded shares after the misrepresentation and before the truth was revealed. *See Basic*, 485 U.S. at 241-42, 247-48. This Court has repeatedly reaffirmed its holding. In *Stoneridge Inv. Partners LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148 (2008), the Court described and reaffirmed its holding in *Basic*: "[U]nder the fraud-

[9] *See also Alaska Elec. Pension Fund v. Flowserve Corp.*, 572 F.3d 221, 227-28 (5th Cir. 2009); *Fener v. Operating Eng'rs Constr. Indus. & Misc. Pension Fund (Local 66)*, 579 F.3d 401, 408 (5th Cir. 2009); *Oscar*, 487 F.3d at 269.

on-the-market doctrine, reliance is presumed when the statements at issue become public. The public information is reflected in the market price of the security. Then it can be assumed that an investor who buys or sells stock at the market price relies upon the statement." 552 U.S. at 159; *see also Musick, Peeler & Garrett v. Emp'rs Ins. of Wausau*, 508 U.S. 286, 295 (1993) (citing *Basic* for proposition that 10b-5 action has a "reliance requirement").

In *Dura*, 544 U.S. at 341-42, this Court reaffirmed *Basic* and confirmed that reliance and loss causation are separate and distinct elements of a 10b-5 cause of action. Reliance, often referred to as transaction causation, addresses why a plaintiff bought or sold a stock, while loss causation analyzes the proximate cause of plaintiff's injury. The Court also held that plaintiffs must establish loss causation in order to prevail on the merits of a 10b-5 action, stating:[10]

> In cases involving publicly traded securities and purchases or sales in public securities markets, the action's basic elements include ... (4) reliance,

[10] Section 78u-4(b)(4) of the Private Securities Litigation Reform Act of 1995 (PSLRA), 15 U.S.C. § 78u-4 *et seq.*, states: "In any private action . . . the plaintiff shall have the burden of proving that the act or omission of the defendant alleged to violate this chapter caused the loss for which the plaintiff seeks to recover damages."

> often referred to in cases involving public securities markets (fraud-on-the-market cases) as 'transaction causation,' *see Basic, supra*, at 248-49, 485 U.S. 224, 108 S. Ct. 978, 99 L.Ed.2d 194 (nonconclusively presuming that the price of a publicly traded share reflects a material misrepresentation and that plaintiffs have relied upon that misrepresentation as long as they would not have bought the share in its absence); ... and (6) 'loss causation,' i.e., a causal connection between the misrepresentation and the loss.

Neither in *Dura* nor any other case has this Court held that loss causation constitutes a prerequisite for invoking the fraud-on-the-market presumption.

The lower courts have repeatedly recognized the conflict between *Basic* and *Oscar*. The Seventh Circuit, in a unanimous opinion written by Chief Judge Easterbrook, held that *Oscar*, in conflict with *Basic,* requires plaintiffs to "prove everything (except falsity) required to win on the merits" before a class could be certified. *Schleicher*, 681 F.3d at 683. Imposing such a standard, the court noted, "would make certification impossible in many securities cases." *Id.* at 686.[11]

[11] Accordingly, the issue in this case is not, as Respondents contend, "whether certain meritless class actions should be

In *Salomon*, defendants argued that "the district court erred by not placing the burden on plaintiffs to prove that the alleged misrepresentations [by analysts] 'moved the market,' i.e., had a measurable effect on the stock price." 544 F.3d at 482. The Second Circuit rejected that argument because "plaintiffs do not bear the burden of showing an impact on price." *Id.* at 483. The court ruled that defendants' argument was "a misreading of *Basic*," *id.* at 482, and held that the requirements outlined in *Basic* are "all that is needed to warrant the presumption," *id.* at 481. According to the court, "[t]he point of *Basic* is that an effect on market price is *presumed* based on the materiality of the information and a well-developed market's ability to readily incorporate that information into the price of securities." *Id.* (emphasis in original).

Every district court outside of the Fifth Circuit that has addressed the holding in *Oscar* has declined to adopt it. *Oscar* has been rejected, disagreed with, distinguished, or simply not followed by district courts in the First, Second, Fourth, Sixth, Ninth, Tenth, and Eleventh circuits. *See* Pet. at 15-17.

---

certified." Respondents' Supplemental Brief at 5, *Erica P. John Fund, Inc., fka Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.,* No. 09-1403 (Dec. 14, 2010) (Respondents' Supplemental Brief).

1. *Basic* Did Not Grant The Fifth Circuit Discretion To Develop Its Own Fraud-On-The-Market Jurisprudence

In *Oscar*, the Fifth Circuit claimed *Basic* "'allows each of the circuits room to develop its own fraud-on-the-market rules.'" *Oscar*, 487 F.3d at 264. That approach is at odds with the principal that federal statutes should be uniformly interpreted and applied—a standard this Court has long striven to uphold. *See Williams v. Taylor*, 529 U.S. 362, 389-90 (2000) ("well-recognized interest in ensuring that federal courts interpret federal law in a uniform way"); *Mississippi Band of Choctaw Indians v. Holyfield*, 490 U.S. 30, 43 (1989) ("federal statutes are generally intended to have uniform nationwide application").

Neither *Basic* nor any other opinion of this Court grants the Fifth Circuit *carte blanche* to "tighten" the requirements for invoking the fraud-on-the-market presumption, which Congress has never seen fit to do in the more than twenty years since *Basic* was decided. *See Schleicher*, 618 F.3d at 686 ("Unlike the fifth circuit, we do not understand *Basic* to license each court of appeals to set up its own criteria for certification of securities class actions or to 'tighten' Rule 23's requirements.").

2. Placing The Burden On Plaintiffs To Establish Loss Causation Negates The Presumption Of Reliance Established in *Basic*

Basic established a rebuttable presumption of class-wide reliance on defendants' public, allegedly fraudulent misrepresentations (or omissions), provided that the stock trades in an efficient market and plaintiffs bought or sold the stock between the time of the statement and corrective disclosure. *Basic*, 486 U.S. at 241-42, 246-47. The *Oscar* court adds an additional and substantial prerequisite: proof of loss causation. The *Oscar* court declared that it was not "improperly shift[ing] the burden, from a defendant's right of rebuttal to a plaintiff's burden of proof" 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." 487 F.3d at 265 (emphasis in original). That contention is wrong for several reasons.

First, the Fifth Circuit's ruling negates the presumption established by this Court in *Basic* without requiring any contrary showing by defendants. Instead of putting defendants to the task of rebutting the fraud-on-the-market presumption, the Fifth Circuit's rule immediately places the burden on plaintiffs to prove loss causation, thereby eviscerating the holding in *Basic* and rendering the fraud-on-the-market presumption dead on arrival. *See id.* at 276 (Dennis, J., dissenting) ("Under the majority's approach, *Basic*'s fraud on the market presumption is essentially a dead letter, little more than a quaint reminder of earlier times. . . .").

Requiring proof of loss causation to establish reliance "subverts the fraud-on-the-market presumption by requiring the plaintiffs to prove, as a precondition to the application of the presumption, the very facts that are to be presumed under *Basic* (*i.e.*, that the defendant's material misrepresentation was reflected in the stock price)." *Id.* at 274 (Dennis J., dissenting). Thus, the Fifth Circuit rule essentially eliminates the presumption in contravention of *Basic*, where this Court said: "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; *see id.* ("[W]here materially misleading statements have been disseminated into an impersonal, well-developed market for securities, the reliance of individual plaintiffs on the integrity of the market price may be *presumed*.").

Second, by nullifying the presumption, the Fifth Circuit also undermines the reasons the Court gave in *Basic* for adopting the presumption. This Court held that presumptions are useful when "direct proof" is "difficult", adding that "[r]equiring a plaintiff to show a speculative state of facts, *i.e.*, how he would have acted if omitted material information had been disclosed, or if the misrepresentation had not been made, would place an unnecessarily unrealistic evidentiary burden on the Rule 10b-5 plaintiff who has traded on an impersonal market." *Id.* at 245. But, contrary to this Court's decision, the Fifth Circuit used the presumption to impose an additional and "exceedingly high burden" on plaintiffs seeking class certification. Pet. App. 71. In *Basic*, this Court explained that the presumption furthered Congress' intent in enacting the 1934 Act: "In drafting that Act, Congress expressly relied on the premise that securities markets are affected by information, and enacted legislation to facilitate an investor's reliance on the integrity of those markets." *Basic*, 485 U.S. at 245-46. The Fifth Circuit's rule, however undermines investor reliance on the integrity of the market because it established an additional and unnecessary hurdle before an investor may bring an action in reliance on the integrity of the market. In *Basic*, this Court said that the presumption is "supported by common sense and *probability*," noting that "[r]ecent empirical studies have tended to confirm Congress' premise that the market price of shares traded on well-developed markets reflects all publicly available information, and, hence, any material misrepresentations." *Id.* at 246. By contrast, in substituting its judgment for that of this Court, the Fifth Circuit required near economic certainty before the presumption applies: proof established by a preponderance of the evidence that any drop in the stock price in a specific case was due to a corrective disclosure.

Third, while defendants can challenge at class certification plaintiffs' evidence of market efficiency, *Basic* establishes that the proper time to rebut the presumption of reliance itself—a quintessential merits issue—is at *trial*, *not* class certification: "Proof of that sort is a matter for trial, throughout which the District Court retains the authority to amend the certification order as may be appropriate." *Id.* at 249 n.29; *see also In re PolyMedica Corp. Sec. Litig.*, 432 F.3d 1, 7 n.10 (1st Cir. 2005) ("defendant may still rebut this presumption at trial"); *Kaplan v. Rose*, 49 F.3d 1363, 1378 n.3 (9th Cir. 1994) ("the ultimate resolution of this question is an issue for trial").

Fourth, even assuming the presumption could be rebutted at class certification, which is contrary to *Basic*, the presumption does not dissolve in the face of any contrary evidence, as the Fifth Circuit suggests. Rather, any contrary showing must be sufficient to undermine the presumption or, in the words of this Court, to "sever[]" it. *Basic*, 485 U.S. at 248. As this Court said: "Any showing that *severs* the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff, or his decision to trade at a fair market price, will be sufficient to rebut the presumption of reliance." *Id.*

This Court placed the burden of both production and persuasion on defendants, stating that the presumption could be rebutted if defendants "could show . . . the market price *would not have been affected* by their misrepresentations." *Id.* at 248. This Court reinforced this point by its reference to the commentary to Rule 301 of the Federal Rules of Evidence, which states in pertinent part: "Presumptions governed by this rule are given the effect of placing upon the opposing party the burden of establishing the nonexistence of the presumed fact, once the party invoking the presumption establishes the basic facts giving rise to it." FED. R. EVID. 301 advisory committee's note.[12]

Under FED. R. EVID. 301, if the defendant meets its "burden of going forward with evidence to rebut or meet the presumption," then the trier of fact must determine whether the plaintiff has met its burden of persuasion. That determination is a classic merits inquiry and has no bearing on class certification.[13]

---

[12] *See also ITC Ltd. v. Punchgini, Inc.*, 482 F.3d 135, 149 (2d Cir. 2007); 21B CHARLES ALAN WRIGHT & KENNETH W. GRAHAM, JR., FEDERAL PRACTICE AND PROCEDURE § 5126 (2d ed. 2010); JACK B. WEINSTEIN & MARGARET A. BERGER, WEINSTEIN'S FEDERAL EVIDENCE § 301.02[3][c] (2d ed. 2006).

[13] The Fifth Circuit also justified its requirement by reference to a theoretical possibility that the market for a given security might be inefficient or strong-form efficient with respect to a particular type of information. *Oscar*, 487 F.3d at 269-70.

Because it will be a rare case in which defendants cannot present some contrary evidence, a presumption that dissolves in the face of any contrary evidence would be essentially the same as no presumption at all. *See Oscar*, 487 F.3d at 274 (Dennis, J. dissenting) ("[I]n the majority's view, the *Basic* presumption evaporates as soon as a defendant simply introduces a mere possibility the defendant's material misrepresentation might not have affected the market price."). Thus, under the Fifth Circuit's interpretation, the presumption established by *Basic* becomes virtually pointless, contrary to this Court's reasoning in *Basic*. *See Basic*, 485 U.S. at 245 ("Presumptions typically serve to assist courts in managing circumstances in which direct proof, for one reason or another, is rendered difficult."); *id.* ("[P]resumptions are also useful devices for allocating the burdens of proof between parties."); *see also U.S. Dep't of Justice v. Landano*, 508 U.S. 165, 175 (1993).

That theoretical possibility does not justify negating the presumption, which is grounded in "probability," *see Basic*, 485 U.S. at 246, not certainty.

3. There Is No Justification For Requiring Proof Of Loss Causation To Trigger The Fraud-On-The-Market Presumption

The Fifth Circuit fails to explain why proof of loss causation is necessary to trigger the fraud-on-the-market presumption or is otherwise necessary at class certification.

The presumption of class-wide reliance on the market price is relevant at class certification only for determining whether plaintiffs can establish reliance through common evidence and so whether common issues predominate for purposes of FED. R. CIV. P. 23(b)(3). *See Basic*, 485 U.S. at 228. The existence of an efficient market establishes a presumption of class-wide reliance based on common facts and avoids the need for a class member by class member analysis of reliance on particular mis-representations.

Loss causation is distinct from reliance and is not a prerequisite for establishing the fraud-on-the-market presumption. In *Basic*, this Court affirmed the trial court's class certification order, which was based on the-fraud-on-the-market presumption, even though the plaintiff in that case did not establish loss causation at class certification. *See Basic*, 485 U.S. at 228, 250. Unlike reliance, loss causation is normally a matter determined by common facts and should not be an issue at class certification. When loss causation rests on common evidence, as is usually the case and as is the case here, loss causation is purely a merits inquiry that should be addressed at summary judgment or at trial:

> After a class has been certified, and other elements of the claim have been established, the court will need to pin down when the stock's price was affected by any fraud. That decision, like the other issues, can be made on a class-wide basis, because it affects investors in common. It gets the cart before the horse to insist that it be made before any class can be certified.

Schleicher, 618 F.3d at 687 (emphasis in original); *see also In re Initial Pub. Offering Sec. Litig.*, 260 F.R.D. 81, 106 n.214 (S.D.N.Y. 2009.) ("It is sufficient [at class certification] for plaintiffs to prove only that loss causation can be shown on a class-wide basis."); Brief for the United States as Amicus Curiae [U.S. Invitation Br.] at 9, *Erica P. John Fund, Inc., fka Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*, No. 09-1403 (Dec. 3, 2010) ("[T]he only relevant question at the class-certification stage is whether resolution of the loss-causation issue can be expected to turn on proof that is common to class members generally."); John C. Coffee Jr., *Securities Litigation: The Year Ahead*, 245 N.Y.L.J. 5 (Jan. 20, 2011) ("loss causation relates to the efficient market's reaction to the corrective disclosure; this is really a common issue, rather than an individual issue"); Donald C. Langevoort, *Basic at Twenty: Rethinking Fraud On The Market*, 2009 WIS. L. REV. 151, 162 (2009) ("Plainly, showing market impact is the plaintiff's burden on the merits, but it is unclear why this should be a class-certification issue: marketplace impact is an issue common to the class rather than anything having to do with individualized reliance or nonreliance.").

4. Loss Causation Is Not A Test Of The Applicability Of The Fraud-On-The-Market Presumption Or Of Price Distortion At The Time Of A Misrepresentation Or Omission

The Fifth Circuit erroneously concluded that plaintiffs who cannot establish loss causation at class certification are not entitled to invoke the fraud-on-the-market presumption. Not only does that conclusion conflict with this Court's ruling in *Basic*, it also rests on a misunderstanding of the relationship between reliance and loss causation.

To begin with, applicability of the fraud-on-the-market-presumption turns on whether the market is efficient, not on whether plaintiffs can establish loss causation. "[N]early every court that has considered the proposition has concluded that where materially misleading statements have been disseminated into an impersonal, well-developed market for securities, the reliance of individual plaintiffs on the integrity of the market price may be *presumed*." *Basic*, 485 U.S. at 247; *see also Salomon*, 544 F.3d at 481 ("The point of *Basic* is that an effect on market price is *presumed* based on the materiality of the information and a well-developed market's ability to readily incorporate that information into the price of securities.") (emphasis in original). And while plaintiffs cannot recover for misrepresentations that did not affect the market price, whether or not a misrepresentation affected the stock price—either by inflating the price or keeping the price from falling—is a merits analysis not relevant to the Rule 23 analysis. As the Seventh Circuit said, "[i]t is possible to certify a class under Rule 23(b)(3) even though all statements turn out to have only trivial effect on prices. Certification is appropriate but the class will lose on the merits." *Schleicher*, 618 F.3d at 685.[14]

[14] In a unanimous ruling, this Court defined materiality as information that would be important, in the total mix of information, to a reasonable investor. *Basic*, 485 U.S. at 231-32 ("[T]o fulfill the materiality requirement 'there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available.'"); *id.* at 250 (White, J., concurring in part and dissenting in part) ("I agree that the standard of materiality we set forth in *TISC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449, 96 S. Ct. 2126, 2132, 48 L.Ed. 2d 757 (1976), should be applied to actions under §10(b) and Rule 10b-5."). The Court

Moreover, because reliance and loss causation are distinct concepts, whether plaintiffs can establish reliance does not depend on whether they can establish loss causation. For instance, plaintiffs cannot necessarily establish loss causation even as to a misrepresentation (or omission) that unquestionably inflated the price of the stock (or kept the price from falling). This is because an intervening cause could have removed the price inflation before the corrective disclosure was made, thereby breaking the causal link between misrepresentation and corrective disclosure. Under the fraud-on-the-market theory of reliance endorsed by this Court in *Basic*, plaintiffs are entitled to a rebuttable presumption that they relied on the

---

eschewed any bright line rule and instead selected a fact-based test. *See id.* at 236 ("Any approach that designates a single fact or occurrence as always determinative of an inherently fact specific finding such as materiality, must necessarily be overinclusive or underinclusive."); *see also Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1097 (1991) (materiality depends on what is "significant enough to be important to a reasonable investor"); *see also TISC Indus.,* 426 U.S. at 450 ("The determination [of materiality] requires delicate assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts and the significance of those inferences to him, and these assessments are peculiarly ones for the trier of fact.").

integrity of the market price and indirectly on the misrepresentations (or omissions) that were incorporated into the market price *when those misrepresentations were made*. Loss causation, by contrast, largely depends on what happens to the stock price at the time of the corrective disclosure.

This Court made that very point in *Dura* when it struck down the Ninth Circuit's rule that loss causation was demonstrated by showing that "the price *on the date of purchase* was inflated because of the misrepresentation." 544 U.S. at 342 (emphasis in original). The Court held that the Ninth Circuit's "statement of the law is wrong" since "[n]ormally, in cases such as this one (*i.e.,* fraud-on-the-market cases), an inflated purchase price will not itself constitute or proximately cause the relevant economic loss." *Id.* As the Court explained, price distortion at the time of the misrepresentation or omission is not the determining factor in establishing loss causation. *See id.* at 342-43. "[A]s a matter of pure logic, at the moment the transaction takes place, the plaintiff has suffered no loss; the inflated purchase payment is offset by ownership of a share that *at that instant* possesses equivalent value." *Id.* at 342. The Court explained that assuming the plaintiff later sells its stock for a loss, the key for loss causation is determining the cause of that loss. "[T]hat lower price may reflect, not the earlier misrepresentation, but changed economic circumstances, changed investor expectations, new industry-specific or firm-specific facts, conditions, or other events, which taken separately or together account for some or all of that lower price." *Id.* at 343.

In *Schleicher*, the Seventh Circuit also demonstrated that a plaintiff's inability to prove loss causation at class certification does not mean that the price of the stock was not inflated by a misrepresentation or that some class members were not injured. 618 F.3d at 686-87. In the court's example, a lie on September 1 boosted the stock's price by $1, and by October 1 professional investors had discounted the issuer's statement as false, and the stock quickly lost the $1 gained because of the fraud. *Id.* at 687. The court noted that if the issuer made a corrective disclosure on November 1, the stock price would not move. *Id.* In the Seventh Circuit's example, depriving plaintiffs of the fraud-on-the-market presumption because they could not prove at class certification that the truth leaked out prior to the defendant's known corrective disclosure would lead to the denial of certification and an unjust result. Rather, the court said that "[a]fter a class has been certified, and other elements of the claim have been established, the court will need to pin down *when* the stock's price was affected by any fraud." *Id.*.(emphasis in original); *see also* U.S. Invitation Br. at 20 n.3 (discussing footnote 29 in *Basic* and stating: "That analysis suggests that, if the evidence ultimately demonstrates that the distortive effect of a defendant's misstatements was cured as of a particular date, a class certification order may be amended to exclude class members who purchased or sold shares after that date.").

As a result, even if *Basic* were read to permit an analysis of initial price distortion as part of the class certification inquiry, affirmative proof of loss causation should not be required at that stage. The Second Circuit's ruling in *Salomon*, which permits a defendant to rebut the presumption of reliance by showing there was no price distortion in the first place, is not to the contrary. *See Salomon*, 544 F.3d at 483 ("[T]he burden of showing that there was no price impact is properly placed on defendants at the rebuttal stage."). Any such "price impact" would have occurred at the time of the misstatement or omission. Loss causation, by contrast, concerns whether a subsequent corrective disclosure caused plaintiffs' loss. Thus, the Second Circuit does not permit a defendant to rebut the fraud-on-the-market presumption by showing a lack of loss causation, as Halliburton contends, Respondents' Supplemental Brief at 2-3, let alone require affirmative proof of loss causation from the plaintiff.

Moreover, the Second Circuit ruling is misguided. *Basic* held that plaintiffs may establish reliance on a class-wide basis and satisfy the predominance requirement of Rule 23 by establishing that the stock traded on an efficient market, provided the defendants made public misrepresentations and plaintiffs bought or sold the stock during the relevant interval. *Basic* did not hold that plaintiffs must prove at class certification that reliance in fact took place—that question is for trial. Therefore, there is no reason to give the defendant an opportunity at class certification to rebut an element—actual reliance—which plaintiffs do not have to prove until trial. Any contention to the contrary rests on a confusion and conflation of the requirements for class certification and for ultimately prevailing on the merits.

B. The Fifth Circuit's Rule Imposes An Improper And Premature Merits Inquiry In Violation Of *Eisen* And Federal Rule Of Civil Procedure 23

To certify a class, plaintiffs must demonstrate that they satisfy the prerequisites of FED. R. CIV. P. 23(a): numerosity, commonality, typicality and adequacy. In damage actions, plaintiffs must also demonstrate that "questions of law or fact common to class members predominate over any questions affecting only individual members." Pet. App. 142a. Provided these requirements are met, the class should be certified. *See Shady Grove Orthopedic Assocs., P.A. v. Allstate Ins. Co.*, 130 S. Ct. 1431, 1437 (2010) (Rule 23 "[b]y its terms . . . creates a categorical rule entitling a plaintiff whose suit meets the specified criteria to pursue his claim as a class action").

In the Fifth Circuit alone, for a damages case brought under federal securities laws, plaintiffs must also demonstrate loss causation. By imposing that added requirement, which the Fifth Circuit admits entails a "merit inquiry," *Oscar*, 487 F.3d at 267, the Fifth Circuit ruling conflicts with Rule 23 and *Eisen*, where this Court held that "nothing in either the language or history of Rule 23 . . . gives a court any authority to conduct a preliminary inquiry into the merits of a suit in order to determine whether it may be maintained as a class action." 417 U.S. at 177. While *Eisen* was initially construed as a blanket prohibition against consideration of the merits of the underlying claims at class certification, courts have since interpreted *Eisen* to prohibit examination of the merits except insofar as necessary to determine whether the Rule 23 prerequisites have been met. *See*, *e.g.*, *In re Initial Pub. Sec. Offerings Litig.*, 471 F.3d 24, 41 (2d Cir. 2006) ("[A] district judge should not assess any aspect of the merits unrelated to a Rule 23 requirement. . . .").

The issue here is not whether plaintiffs must establish loss causation by a preponderance of the evidence. They must—at trial. The issue is whether they must also do so, without merits discovery, at class certification, even though the Fifth Circuit has not tied that requirement to Rule 23. *See Eisen*, 417 U.S. at 178 ("In determining the propriety of a class action, the question is not whether the plaintiff or plaintiffs have stated a cause of action or will prevail on the merits, but rather whether the requirements of Rule 23 are met.").

Trial courts must make a rigorous determination of whether the FED. R. CIV. P. 23 prerequisites are satisfied. In cases involving the fraud-on-the-market presumption, that means determining whether plaintiffs have met the requirements for invoking the presumption, in particular by showing that the market in question is efficient, because that is crucial to showing common issues predominate.[15] Plaintiffs, however, do not have to demonstrate at class certification that they are likely to prevail on the merits as to any element of their cause of action, including reliance and loss causation. Just as antitrust plaintiffs must establish at class certification that their claim of class-wide injury depends on common evidence, but not that they will prevail on the merits in showing injury, federal securities plaintiffs must establish for certification that their claim of class-wide reliance rests on common evidence, not that their reliance claim will ultimately prove successful. *See In re Hydrogen Peroxide Antitrust Litig.*, 552 F.3d 305, 311-12 (3d Cir. 2008) ("Plaintiffs' burden at the class certification stage is not to prove the element of antitrust impact," but only "to demonstrate that the element of antitrust impact is capable of proof at

---

[15] Following *Basic*, courts find individual issues predominate when plaintiffs cannot demonstrate market efficiency. *See*, *e.g.*, *In re Initial Pub. Offering Sec. Litig.*, 471 F.3d 24 (shares of initial public offerings cannot trade on an efficient market); *Binder v. Gellepsie*, 184 F.3d 1059 (9th Cir. 1999) (securities traded over the counter or on "pink sheets").

trial through evidence that is common to the class rather than individual to its members").

Under Rule 23, certification of a class is proper—provided the other prerequisites are met, as they were in this case—when common issues predominate. A plaintiff proves loss causation by showing that the corrective disclosure, and not some other event, caused the decline in the stock price. Facts necessary for such proof are usually general; they do not depend on how particular investors behave or what they believe. Neither court below stated that establishing loss causation (or its absence) required an individualized inquiry and could not be established through common evidence. Even assuming that whether a particular misstatement or omission moved the stock price were relevant to the application of the fraud-on-the-market presumption—which it is not—the Fifth Circuit's approach is flawed because that question will turn on evidence common to all members of the proposed class. In such instances, loss causation will either exist for the whole class, or for no one, as Respondents admit. *See* Respondents' Supplemental Brief at 9 (acknowledging "loss causation stands or falls on a classwide basis"). Accordingly, there is no justification for examining the merits of loss causation at class certification.

1. The Fifth Circuit Imposes At Class Certification A Merits Inquiry Not Required By Rule 23

By requiring proof of loss causation at class certification, the Fifth Circuit has done precisely what *Eisen* and Rule 23 prohibit: "requir[ed] mini-trials on the merits of cases at the class certification stage." *Oscar*, 487 F.3d at 272 (Dennis, J., dissenting). The Fifth Circuit does not limit merits determinations at class certification to those related to the Rule 23 prerequisites; rather, it requires plaintiffs to prove almost their entire case. *See Schleicher*, 618 F.3d at 683 ("before a class can be certified [under *Oscar*] plaintiffs must prove everything (except falsity) required to win on the merits"); U.S. Invitation Br. at 11 ("[T]he court of appeals erred at the outset by going beyond Rule 23 criteria and assessing the putative class members' ability to prove their case on the merits."). The extended analysis of loss causation in both the district court and Fifth Circuit—an analysis that encompasses virtually the entire substance of both opinions—demonstrates that this is a quintessential merits examination, one reserved for a jury provided plaintiff establishes a prima facie case. "[L]oss causation has been compared to 'the tort concept of proximate cause, *Emergent Capital Inv. Mgmt., LLC v. Stonepath Group*, Inc., 195 F. Supp.2d 551, 559 (S.D.N.Y. 2002), and [p]oximate cause is a classic jury question." *Smith v. New York Enter. America, Inc., SW*, No. 06 Civ. 3082(PKL), 2008 WL 2810182, at *6 (S.D.N.Y. July 21, 2008) (quoting *Southard v. Eight Ball, Inc.*, No. 96 Civ. 5542, 1997 WL 391123, at *14 (S.D.N.Y. July 11, 1997)); *see also Lentell v. Merrill Lynch & Co., Inc.*, 396 F.3d 161, 174 (2d Cir. 2005) ("[l]oss causation is a fact-based inquiry").

In *Oscar*, the Fifth Circuit defends its holding by citing the 2003 amendment to Rule 23, which required determination of class certification "at an early practicable time," instead of "as soon as practicable." *See Oscar*, 487 F.3d at 267. Even after the 2003 revisions, however, it is improper for a court to undertake at class certification a merits inquiry—whether for proof of loss causation, scienter, or materiality—which does not overlap with a determination of one of the prerequisites of Rule 23. *See* FED. R. CIV. P. 23(c)(1)(A) advisory committee's note (2003 amendments) (noting "an evaluation of the probable outcome on the merits is not properly part of the certification decision"). Equally unavailing is the fact that Rule 23 no longer says a class certification ruling "may be conditional." *Id.* "Even after a class certification order is entered, the judge remains free to modify it in light of subsequent developments in the litigation." *See Gen. Tel. Co. of Southwest v. Falcon*, 457 U.S. 147, 160 (1982). While the district court must determine that the prerequisites for class certification have been met, that does not justify grafting a merits inquiry onto a proper Rule 23 analysis.

2. Plaintiffs Are Prejudiced By The Requirement That They Establish Loss Causation Without Merits Discovery

This case was the subject of multiple motions to dismiss and multiple amended complaints before the district court denied defendants' motion to dismiss the fourth amended complaint, more than four and one half years after the initial complaint was filed. In any court other than the Fifth Circuit, the EPJ Fund would not face a new merits hurdle until summary judgment. There is no justification for subjecting private plaintiffs in security actions in the Fifth Circuit to such a unique disadvantage.

The loss causation analysis by the courts below illustrates why plaintiffs need merits discovery to establish loss causation. On December 20, 2000, Halliburton announced in a company press release that it was taking a $95 million charge that was due in part to the fact that "negotiations with customers regarding cost increases on seven . . . projects have not resulted in resolution of certain claims as originally anticipated." S.A. 520. Even though the face of the announcement showed that the $95 million charge was related to contractual claims that had not been resolved as the company "originally anticipated," thereby calling into question the company's prior assertion that it would only book unapproved claims when probable of collection, *id.* at 471, the Fifth Circuit found that the EPJ Fund had not established loss causation. The court said that the announcement included non-culpable negative news and concluded the EPJ Fund failed to parse the effect of the culpable from the non-culpable news, which Halliburton had packaged together. Pet. App. 134a. With merits discovery, the EPJ Fund could have looked behind the announcement, determined how much of the charge was related to cost overruns on long-term fixed price contracts and whether the other restructuring charges were related to problems with such contracts. The district court noted that Halliburton in its announcement attributed these cost overruns to "changes in market conditions, specifically labor disturbances in Venezuela and West Africa." *Id.* at 35a. With merits discovery, the EPJ Fund could test that assertion and determine the degree to which overruns were actually due to labor disturbances. Finally, Halliburton argued to the Fifth Circuit that "[t]here is no indication at all that these additional costs . . . had anything to do with unapproved claims previously recognized as revenue." Appellees' (Respondents') Brief to the Fifth Circuit Court of Appeals at 53. Again, with merits discovery the EPJ Fund could have determined whether there was such a connection.

The prejudice to plaintiffs is exacerbated by the fact that the Fifth Circuit effectively requires proof of scienter in order to establish loss causation at class certification.[16] *See, e.g.,* Pet. App. 121a-22a (holding that "plaintiffs must prove the corrective disclosure shows *the misleading or deceptive nature* of the prior positive statements" and that "the corrective disclosure more probably than not shows that the original estimates or predictions were *designed to defraud*.").[17] As this Court recently explained, evidence of scienter is different from evidence of falsity, and so may require additional discovery. *Merck & Co., Inc. v. Reynolds*, 130 S. Ct. 1784, 1796-97 (2010).

Even at trial, plaintiffs do not have to establish scienter though a corrective disclosure that "shows the misleading or deceptive nature of the prior positive statements." Pet. App. 121a-22a. Rather, plaintiffs may establish scienter through direct or circumstantial evidence that the defendants knew or were reckless in not knowing that their

---

[16] Scienter, of course, turns on defendants' conduct and so is common to the class.

[17] While the Fifth Circuit stated in a footnote that "a plaintiff need not prove at the class certification stage intentional fraud by the defendant," *id.* at 123a n.35, the court effectively required proof of scienter to establish loss causation. *See*, *e.g.*, *id.* at 126a (did not show "prior reserve estimates were intentionally misleading"); *id.* at 126a-27a ("no indication [prior estimates] were misleading or deceptive"; *id.* at 129a ("undermines any conclusion . . . the company acted with deception"); *id* at 132a ("Plaintiff fails to show these announcements . . . revealed deceptive practices in Halliburton's accounting assumptions.").

assertions at issue were false at the time they made them. *See*, *e.g.*, *Herman & MacLean v. Huddleston*, 459 U.S. 375, 390 n.30 (1983); *Alpern v. UtiliCorp United, Inc.*, 84 F.3d 1525, 1536-37 (8th Cir. 1996); *In re Software Toolworks, Inc.*, 50 F.3d 615, 627 (9th Cir. 1994). The Fifth Circuit, however, imposes a more demanding test of scienter at class certification than pertains at trial.

The impact of the Fifth Circuit's loss causation requirement is readily apparent here. Most of Halliburton's asbestos liability derived from claims against Harbison-Walker, a former subsidiary of Dresser, which Halliburton acquired in 1998 for $7 billion. USCA5 4558. On June 28, 2001, the Fifth Circuit held that Halliburton's June 28, 2001 announcement that Harbison-Walker, Dresser's former subsidiary, had sought financial assistance to pay its pending asbestos claims was not a corrective disclosure because the June 28, 2001 announcement did not indicate that Halliburton *knew* of Harbison-Walker's financial difficulties prior to the announcement. Pet. App. 125a-27a. The court disregarded the allegation in the complaint that Halliburton knew throughout the class period that Harbison-Walker would need Halliburton's financial assistance to pay its own asbestos claims. USCA5 4575. Absent an admission by Halliburton, the only way to "prove" that the June 28, 2001 corrective disclosure "shows the misleading or deceptive nature" of Halliburton's prior announcements would be to establish *through merits discovery* that

Halliburton knew but failed to disclose prior to June 28, 2001 that it would ultimately bear financial responsibility for claims against Harbison-Walker.

Similarly, Halliburton claimed that the adverse asbestos verdict disclosed on December 7, 2001, which caused its stock to tumble 42.7%, was an unexpected development, and so cannot constitute a corrective disclosure. The EPJ Fund alleged, and is entitled to merits discovery to prove, that Halliburton knew its asbestos liability was a "ticking 'time bomb[],'" *id.* at 4567, and that given Halliburton's aggressive litigation tactics, the soaring number of asbestos claims against it (including the 165,000 Harbison-Walker claims), and its unwillingness to settle claims except for a minimal amount, Halliburton knew, or was grossly negligent in not knowing, that it was only a matter of time before it would get saddled with significant adverse jury verdicts and that its reserves were neither conservative nor adequate. In sum, the EPJ Fund is entitled to merits discovery to establish what Halliburton knew and when it knew it.

C. The Fifth Circuit's Rule Constitutes Impermissible Judicial Legislation That Impinges On A Plaintiff's Right To A Jury Trial And Unduly Limits Private Securities Actions

1. The Fifth Circuit Rule Was Motivated By Policy Concerns Regarding Class Certification

The Fifth Circuit has repeatedly expressed concern that class certification creates undue settlement pressure on defendants. It did so in *Oscar* where it spoke of the "lethal force of certifying a class of purchasers of securities enabled by the fraud on the market doctrine" and said it could not "ignore the *in terrorem* power of certification." *Oscar*, 487 F.3d at 262, 267.

The Fifth Circuit, of course, does not provide empirical support for its implicit assumption that frivolous cases regularly survive motions to dismiss and are certified, thereby putting undue pressure on defendants to settle. And it ignores altogether the important role class actions play in enabling plaintiffs with claims too small to warrant pursuing individually to combine their claims and seek judicial redress. *See Deposit Guar. Nat'l Bank, Jackson, Miss. v. Roper*, 445 U.S. 326, 339 (1980) ("Where it is not economically feasible to obtain relief within the traditional framework of a multiplicity of small individual suits for damages, aggrieved persons may be without any effective redress unless they may employ the class-action device.").

The concerns expressed by the Fifth Circuit, even if they were justified and not balanced by countervailing concerns, do not permit the Fifth Circuit to import a premature merits inquiry into Rule 23. As the Seventh Circuit stated:

> Rule 23 allows certification of classes that are fated to lose as well as classes that are sure to win. To the extent it holds that class certification is proper only after the representative plaintiffs establish by a preponderance of the evidence everything necessary to prevail, *Oscar Private Equity* contradicts the decision, made in 1966, to separate class certification from the decision on the merits.

Schleicher, 618 F.3d at 686.

The Federal Rules of Civil Procedure, including Rule 23, are binding on all federal courts. It is "of overriding importance" that "courts must be mindful that the Rule [23] as now composed sets the requirements they are bound to enforce." *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 620 (1997); *see also Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 861 (1999) ("[W]e are bound to follow Rule 23 as we understood it upon its adoption, and . . . we are not free to alter it except through the process prescribed by Congress in the Rules Enabling Act.").

This Court has specifically admonished the lower courts not to be swayed by their perceived policy preferences in construing the Federal Rules of Civil Procedure. *See, e.g., Jones v. Bock*, 549 U.S. 199, 212 (2007) ("[C]ourts should generally not depart from the usual practice under the Federal Rules on the basis of perceived policy concerns."). In *Leatherman v. Tarrant County Narcotics Intelligence & Coordination Unit*, 507 U.S. 163 (1993), the Court unanimously reversed the Fifth Circuit for imposing a heightened pleading standard in § 1983 suits against municipalities, even though "if [the] Rules . . . were rewritten today, claims against municipalities under § 1983 might be subjected to the added specificity requirement. . . . But that is a result which must be obtained by the process of amending the Federal Rules, and not by judicial interpretation." 507 U.S. at 168. The Court similarly struck down courts of appeals in *Swierkiewicz v. Sorema N.A.*, 534 U.S. 506, 515 (2002), and *Hill v. McDonough*, 547 U.S. 573 (2006), for imposing heightened pleading requirements not authorized under Rule 23 in certain categories of cases.

Here, the Fifth Circuit has effectively amended Rule 23 by imposing a new prerequisite for class certification, usurping the role of this Court and Congress. *See Amchem*, 521 U.S. at 620 ("Courts are not free to amend a rule outside the process Congress ordered . . . .); *Bus. Guides, Inc. v. Chromatic Commc'ns Enters., Inc.*, 498 U.S. 533, 552 (1991).

2. Recalibrating The Require-ments For A Securities Class Action Is the Role Of Congress, Not The Courts

Any policy determination to further "tighten" the requirements for bringing security class actions lies with Congress—which could have altered the requirements established in *Basic* for invoking the fraud-on-the-market presumption at any point over the last two decades and which can always modify the requirements for bringing a federal securities action—or with this Court and Congress, which collectively can amend Rule 23. Congress has repeatedly acted to readjust the balance between plaintiffs' right to pursue meritorious claims and defendants' right to be protected against vexatious litigation. Most recently, Congress addressed concerns regarding securities class actions by enacting the PSLRA, Pub. L. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C.), and the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"), Pub. L. 105-353, 112 Stat. 3227 (codified as amended in scattered sections of 15 U.S.C.). *See Schleicher*, 618 F.3d at 686 ("[T]he means that Congress chose to deal with settlement pressure were to require more at the pleading stage and to ensure that litigation occurs in federal court under these special standards, rather than state court under looser ones."). The PSLRA protects defendants in securities class actions by imposing heightened pleading requirements, 15 U.S.C. § 78u-4(b); deferring discovery until after motions to dismiss are resolved, *id.* § 78u-4(b)(3)(B); and replacing joint and several liability with proportionate liability, *id.* § 78u-4(f)(2)(B)(i), among other measures. *See also Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 313 (2007) (discussing heightened pleadings requirements imposed by the PSLRA). SLUSA addressed concerns that plaintiffs' counsel were circumventing the PSLRA by filing claims in state court. That Act curbs forum selection and promotes national standards for securities traded on national exchanges by preempting certain state law actions for fraud, negligence, or breach of fiduciary duty and by making all "covered class actions" removable to federal court. *See* 112 Stat. 3227; *see also Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 81-82 (2006).

Any further measure to modify the requirements for securities fraud class actions requires participation by Congress. As the Seventh Circuit recognized, "[w]e do not think it appropriate for the judiciary to make its own further adjustments by reinterpreting Rule 23 to make likely success on the merits essential to class certification in securities-fraud suits." *Schleicher*, 618 F.3d at 686.

3. The Fifth Circuit's Rule Deprives Plaintiffs Of The Right To A Jury Trial And Requires Plaintiffs To Meet A Higher Standard Of Proof At Class Certification Than At Summary Judgment

The Fifth Circuit's rule improperly infringes on a plaintiff's Seventh Amendment right to a jury trial because it requires a court to make a merits ruling on an element of plaintiff's claim under a preponderance-of-the-evidence standard even though the court does not need to make such a ruling in performance of its gatekeeping role under Rule 23. While a court must determine if common issues predominate in its role as a gatekeeper to class certification, it does not need to determine whether plaintiff can establish loss causation. In requiring plaintiff to do so by a preponderance of the evidence, the Fifth Circuit has violated plaintiff's Seventh Amendment right to a jury trial by imposing a higher standard of proof for an element of the claim at class certification than at summary judgment under FED. R. CIV. P. 56. *See* U.S. Invitation Br. at 13 ("[T]he Fifth Circuit's approach improperly requires district courts to usurp the role of juries in resolving disputed issues of loss-causation.").

Plaintiffs are entitled to a jury trial on security fraud claims if they make a sufficient initial showing. *See Tellabs,* 551 U.S. at 326-28; *see also In re U. S. Fin. Sec. Litig.*, 609 F.2d 411, 432 (9th Cir. 1979); *Dasho v. Susquehanna Corp.*, 461 F.2d 11, 21 (7th Cir. 1972); *Rachal v. Hill*, 435 F.2d 59, 64-65 (5th Cir. 1970).

Summary judgment under Rule 56 is only warranted "if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." FED. R. CIV. P. 56(a); *see Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986) (summary judgment is appropriate "against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial."). "Summary judgment . . . is inappropriate when the evidence is susceptible of different interpretations or inferences by the trier of fact." *Hunt v. Cromartie*, 526 U.S. 541, 553 (1999). The Fifth Circuit requires plaintiffs to clear a far more onerous standard at class certification than applies at summary judgment, thereby violating plaintiffs' Seventh Amendment right to a jury trial on disputed issues of loss causation.

In *Alaska Elec. Pension Fund v. Flowserve Corp.*, the Fifth Circuit opined that it was not depriving plaintiff of its right to a jury trial because "the court's determination on class certification may be revised (or wholly rejected) by the ultimate fact finder" and because even if the class is not certified, the plaintiff could always pursue his or her own claim. 572 F.3d 221, 229 (5th Cir. 2009). However, in many, if not most, securities actions—as the parties recognized was the case here, *compare* Pet. App. 77a-78a *with* Pet. App. 93a, 106a—an adverse ruling on class certification would likely be a death knell for the case, because pursuing the case on behalf of an individual plaintiff would be prohibitively expensive.

4. The Fifth Circuit's Rule Would Unduly Restrict Private Securities Actions And Preclude Meritorious Actions

Private securities actions play a central role in enforcement of the securities laws and deterring wrongdoing, as Congress has recognized: "[Private securities litigation] promotes public and global confidence in our capital markets and helps to deter wrongdoing and to guarantee that corporate officers, auditors, directors, lawyers and others properly perform their jobs." Joint Explanatory Statement of the Committee of Conference on H.R. 1058 (Joint Explanatory Statement) at 31, reprinted in 2 U.S.C.C.A.N. 730 (104th Cong., 1st Sess. 1995). This Court has also noted on numerous occasions the key role played by private securities actions. *See, e.g., Tellabs*, 551 U.S. at 313 ("This Court has long recognized that meritorious private actions to enforce federal antifraud securities laws are an essential supplement to criminal prosecutions and civil enforcement actions brought, respectively, by the Department of Justice and the Securities and Exchange Commission (SEC)."); *Dura*, 544 U.S. at 345 ("The securities statutes seek to maintain public confidence in the marketplace. They do so by deterring fraud, in part, through the availability of private securities fraud actions."); *Basic*, 485 U.S. at 231 ("[A] private cause of action . . . for a violation of § 10(b) and Rule 10b-5 . . . constitutes an essential tool for enforcement of the 1934 Act's requirements.").

The Securities and Exchange Commission and Solicitor General recognize the importance of private securities litigation as well. *See, e.g.,* Brief of the United States as Amicus Curiae Supporting Respondents at 1, *Merck & Co., Inc. v. Reynolds*, 130 S. Ct. 1784 (2010) (No. 08-905) ("Meritorious private securities-fraud actions are an essential supplement to criminal prosecutions and civil enforcement actions brought by the United States and the Securities and Exchange Commission (SEC)."). Private securities actions are essential because they supplement SEC actions and potentially provide injured shareholders with compensation that they would otherwise not receive. James D. Cox & Randall S. Thomas, *SEC Enforcement Heuristics: An Empirical Inquiry*, 53 DUKE L.J. 737, 779 (2003). In fact, 85% of settled private cases do not have a parallel SEC action. *Id.* at 777.

The SEC has stressed the importance of the fraud-on-the-market presumption, in particular, to the proper enforcement of the securities laws by private litigants:

> While the Commission is not required to show reliance in its own enforcement actions, the Commission believes that the proper interpretation and application of the fraud-on-the-market presumption is important to the effective enforcement of the federal securities laws. It is well recognized that private securities actions "provide 'a most effective weapon in the enforcement' of the securities laws and are 'a necessary supplement to Commission action.'"

Brief of the Securities and Exchange Commission as Amicus Curiae at 3, *In re WorldCom, Inc. Sec. Litig.*, No. 03-9350 (2d Cir. Apr. 19, 2004) (quoting *Bateman Eichler, Hill Richards, Inc. v. Berne*r, 472 U.S. 299, 310 (1985)).

The Fifth Circuit's rule undercuts private enforcement of federal securities laws by nullifying the fraud-on-the-market presumption and imposing an "exceedingly high burden on security plaintiffs at an early stage of the litigation." Pet. App. 7a. The Fifth Circuit's rule also largely immunizes defendants who release culpable negative news on the same day as significant non-culpable negative news and even incents them to do so because of the difficulty of disaggregating the effects of negative culpable and non-culpable news. "An unfortunate consequence of the Fifth Circuit approach is that it encourages strategic decisions to time corrective disclosure to coincide with other negative news likely to affect the company's stock." THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION § 12.10[5] (6th ed. 2009). In short, the Fifth Circuit's rule threatens the viability of many meritorious private securities actions. As Judge Easterbrook explained in *Schleicher*: "The particular step that the fifth circuit took in *Oscar* . . . would make certification impossible in many securities suits, because when true and false statements are made together it is often impossible to disentangle the effects with any confidence." 618 F.3d at 686.

It is not only plaintiffs in private securities actions who stand to lose. The ensuing risk to the financial markets, which depend on private enforcement actions as well as SEC actions to deter fraud, is substantial, as the recent financial crisis illustrates. *See Merrill Lynch, Pierce, Fenner & Smith, Inc*, 547 U.S. at 78 ("The magnitude of the federal interest in protecting the integrity and efficient operation of the market for nationally traded securities cannot be overstated.").

CONCLUSION

For the foregoing reasons, the ruling of the Fifth Circuit should be reversed and this case remanded with directions that the proposed class be certified because the only reason the district court declined to do so, and the only reason the court of appeals affirmed that decision, was the EPJ Funds' failure to prove loss causation at class certification.

Respectfully submitted,

David Boies
dboies@bsfllp.com
Counsel of Record
BOIES, SCHILLER & FLEXNER LLP
333 Main Street
Armonk, NY 10504
Tel.: (914) 749-8200

Carl E. Goldfarb
Justin D. Fitzdam
BOIES, SCHILLER & FLEXNER LLP
401 E. Las Olas Blvd.
Suite 1200
Ft. Lauderdale, FL 33301
Tel.: (954) 356-0011

Lewis Kahn
Neil Rothstein
Special Counsel to Lead Plaintiff
KAHN SWICK & FOTI, LLC
206 Covington Street
Madisonville, LA 70447
Tel.: (504) 455-1400

E. Lawrence Vincent
3948 Legacy Drive
#106-324
Plano, TX 75023
Tel.: (214) 680-1668

February 2011