No. 13-317

In the Supreme Court of the United States

HALLIBURTON CO. AND DAVID J. LESAR,
Petitioners,

v.

ERICA P. JOHN FUND, INC.,
F/K/A ARCHDIOCESE OF MILWAUKEE
SUPPORTING FUND,
Respondent.

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

BRIEF OF THE WASHINGTON LEGAL FOUNDATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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INTEREST OF *AMICUS CURIAE*

The Washington Legal Foundation (WLF) is a non-profit public interest law and policy center with supporters in all fifty states.[1] WLF devotes a substantial portion of its resources to defending free enterprise, individual rights, and a limited and accountable government. To that end, WLF has appeared before this and other federal courts in numerous cases raising issues related to the proper scope of the federal securities laws. *See, e.g.*, *Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309 (2011); *Morrison v. Nat'l Austl. Bank Ltd.*, 561 U.S. 247 (2010); *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148 (2008). WLF has also participated extensively in litigation in support of its view that federal courts should not certify cases as class actions unless the plaintiffs can demonstrate that they have satisfied each of the requirements of Rule 23 of the Federal Rules of Civil Procedure. *See, e.g., Amgen, Inc. v. Conn. Ret. Plans and Trust Funds*, 133 S. Ct. 1184 (2013); *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541 (2011). WLF also filed an amicus brief when this case was previously before the Court. *Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179 (2011).

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[1] Pursuant to Rule 37.6 of the Rules of this Court, the undersigned hereby state that no counsel for Petitioners or Respondents authored any part of this brief, and no person other than *amicus curiae* or its counsel made any monetary contribution to the preparation or submission of this brief. Pursuant to Rule 37.3(a) of the Rules of this Court, letters of consent from all parties to the filing of this brief are on file or have been submitted to the Clerk of the Court.

WLF agrees with Petitioners that the fraud-on-the-market presumption adopted by the Court in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), is based on flawed economic premises, has proven to be unworkable in practice, and ought to be abandoned or at least substantially modified. WLF writes separately to focus on why, in the alternative, defendants should be allowed to rebut the fraud-on-the-market presumption of reliance at the class certification stage with "price impact" evidence. Not only is there no legal barrier to allowing this type of rebuttal, but it will both harmonize how the element of reliance is addressed by the lower courts in misstatement claims (as in the instant case) and omission claims (as contemplated by *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128 (1972)) and protect the rights of investors who may have viable individual claims even if a case cannot proceed on a class basis.

SUMMARY OF THE ARGUMENT

Price impact is a fundamental prerequisite for the application of the fraud-on-the-market presumption of reliance created by the Court in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988) ("*Basic*"). Indeed, *Basic* expressly permits defendants to rebut the presumption by showing that the alleged misrepresentations did not have any impact on the market price of the security. *Id.* at 248. A key question for defendants in securities class actions, however, is *when* this rebuttal can be presented. As the Court has recognized, once a securities class is certified, the defendants face such "increase[d] * * * potential damages liability and litigation costs that [they] may find it economically prudent to settle and to *abandon a meritorious defense*." *Coopers &*

Lybrand v. Livesay, 437 U.S. 463, 476 (1978) (emphasis added). Accordingly, the inability to present a price impact rebuttal to the fraud-on-the-market presumption at the class certification stage has a significant practical effect.

In two recent decisions – *Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179, 2187 (2011) ("*EPJ Fund*") and *Amgen, Inc. v. Connecticut Ret. Plans and Tr. Funds*, 133 S. Ct. 1184 (2013) ("*Amgen*") – the Court has addressed issues related to class certification in securities fraud cases, but it has not resolved whether class certification is an appropriate stage in the proceedings for a price impact rebuttal to be presented. Indeed, in *EPJ Fund*, the Court expressly reserved this question. 131 S. Ct. at 2187. Nevertheless, based on its reading of *Amgen*, the Fifth Circuit incorrectly concluded in this case that price impact rebuttal "should not be considered at class certification." *Erica P. John Fund, Inc. v. Halliburton Co.*, 718 F.3d 423, 435 (5th Cir. 2013).

First, nothing in the *EPJ Fund* and *Amgen* decisions supports the Fifth Circuit's holding here at issue. The touchstone of the relevant analysis is whether a defendant's successful rebuttal as to price impact will necessarily cause a "failure of proof" on an element of the securities fraud claim that "would end the case for one and for all; no claim would remain in which individual reliance issues could potentially predominate." *Amgen*, 133 S. Ct. at 1196. Price impact does not meet these requirements. It is not an element of a securities fraud claim. Moreover, while a lack of price impact may be probative evidence as to materiality and loss causation, it is not dispositive as

to those elements for all class members. *See infra* Part II, at pp. 6-13.

Second, allowing defendants to rebut price impact at the class certification stage would harmonize how courts address rebuttals of the fraud-on-the-market presumption of reliance (in affirmative misstatement cases) and the *Ute* presumption of reliance (in omission cases). Under *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 152-53 (1972) ("*Ute*") and its progeny, there exists a presumption of reliance on alleged omissions, which defendants may rebut at the class certification stage by showing that they did not have a class-wide duty of disclosure. *See infra* Part II.B, at pp. 14-18.

Finally, allowing price impact rebuttal at the class certification stage would better protect the interests of class members who may be able to make an individualized showing of actual reliance. If the court certifies a class, only to determine later that plaintiffs may not rely on the fraud-on-the-market presumption due to the absence of price impact, individual class members' ability to then pursue their claims may be severely compromised due to *res judicata* or statute of repose issues. *See infra* Part II.C, at pp. 18-23.

For the foregoing reasons, and the reasons contained in the briefs of the Petitioners and their other supporting *amici*, WLF urges this Court to reverse the Fifth Circuit's decision.

ARGUMENT

I. The Court Should Overrule or Substantially Modify *Basic*.

The Court should overrule *Basic* and require plaintiffs to show actual reliance on affirmative misstatements to maintain a Rule 10b-5 implied cause of action. Alternatively, the Court should substantially modify *Basic* by requiring class plaintiffs to prove that the alleged affirmative misstatements actually distorted the security's market price. WLF agrees with the extensive arguments supporting these positions that have been presented by the Petitioners and the other amici.

II. Alternatively, Defendants Should Be Allowed To Rebut the Fraud-on-the-Market Presumption at the Class Certification Stage with Price Impact Evidence.

Even if the Court declines to overrule or substantially modify *Basic*, there are significant jurisprudential reasons to allow defendants to rebut the fraud-on-the-market presumption at class certification by showing the absence of price impact. First, price impact is a fundamental prerequisite to the fraud-on-the-market presumption and nothing in the Court's *Basic*, *Amgen*, or *EPJ Fund* decisions prevents a court's consideration of a price impact rebuttal at class certification. Second, the courts have consistently held that defendants may rebut the related *Ute* presumption of reliance for Rule 10b-5 claims based on a fraudulent omission at class certification with evidence showing the absence of a fundamental prerequisite of that presumption—a class-wide duty of

disclosure. Given that private actions under Rule 10b-5 are judicially created, the Court has a vested interest in harmonizing how lower courts address these two related reliance presumptions. Finally, failing to allow defendants to rebut price impact at class certification may prejudice investors with meritorious individual claims whose ability to bring those individual claims would be compromised.

A. Price impact is a fundamental prerequisite to *Basic*'s fraud-on-the-market presumption of reliance and should be rebuttable at class certification.

In *EPJ Fund*, the Court recognized that "[u]nder *Basic*'s fraud-on-the-market doctrine, an investor presumptively relies on a defendant's misrepresentation ***if that 'information is reflected in [the] market price' of the stock at the time of the relevant transaction***." 131 S. Ct. at 2186 (quoting *Basic*, 485 U.S. at 247) (emphasis added). Therefore, if a misrepresentation is not reflected in the market price (*i.e.*, the absence of price impact), the *Basic* presumption of reliance fails. *Amgen*, 133 S. Ct. at 1195 (reaffirming that a misrepresentation that "does not affect market price . . . cannot be relied upon indirectly by investors who, as the fraud-on-the-market theory presumes, rely on the market price's integrity"). This is pure common sense, *cf. Basic*, 485 U.S. at 246 (recognizing that the fraud-on-the-market presumption is "supported by common sense and probability"), and neither the Fifth Circuit nor Respondent have disputed this fundamental point in this case. *See generally* 718 F.3d 423; Brief in Opposition, *Halliburton Co. v. Erica P. John Fund, Inc.*, No. 13-317 (U.S. Oct. 11, 2013).

Nor can this point be disputed, for "***[a]ny showing*** that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff, or his decision to trade at a fair market price, will be sufficient to rebut the presumption of reliance." *Basic*, 485 U.S. at 248 (emphasis added). This rebuttal can include a "show[ing] that the misrepresentation in fact did not lead to a distortion of price." *Id.* Indeed, in this case, the Fifth Circuit expressly conceded that "in the absence of price impact, 'the basis for finding that fraud has been transmitted through market price would be gone.' " 718 F.3d at 433 (quoting *Basic*, 485 U.S. at 248). Nonetheless, the Fifth Circuit erroneously affirmed the district court's grant of class certification, reasoning incorrectly that the "*Amgen* Court's analysis leads to the conclusion that price impact fraud-on-the-market rebuttal evidence should not be considered at class certification." *Id.* at 435.

1. Neither *Amgen* nor its rationale precludes price impact rebuttal evidence at class certification.

In this case, the Fifth Circuit held that *Amgen* prohibits a defendant from proffering price impact evidence at class certification to rebut the fraud-on-the-market presumption. 718 F.3d at 435. Not so. *Amgen*'s reasoning suggests that price impact rebuttal evidence is not only appropriate, but also necessary, at class certification.

First, *Amgen* did not address whether a defendant may proffer price impact evidence at class certification to rebut the fraud-on-the-market presumption of reliance. Instead, in *Amgen*, the defendant presented

a truth-on-the-market defense to show that misrepresentations would not have been material to the reasonable investor. 133 S. Ct. at 1203. As the Fifth Circuit noted in this case, the "*Amgen* Court did not discuss whether [price impact] evidence offered for this purpose [*i.e.*, to rebut the presumption of reliance] could be considered at class certification." 718 F.3d at 433.

Second, price impact is not an essential element of a Rule 10b-5 claim. In *Amgen*, the Court held that materiality, although "indisputably" an "essential predicate of the fraud-on-the-market theory," need not be proved by a plaintiff at the class certification stage to ensure predominance. 133 S. Ct. at 1195-96, 1198-99. In *Amgen*, the Court distinguished materiality from market efficiency and publicity, reasoning that even though all three are "essential predicates" of the fraud-on-the-market theory, and each "can be proved on a classwide basis," market efficiency and publicity are not "indispensable elements of a Rule 10b-5 claim," unlike materiality. *Id.* at 1199, 1212. The Court reasoned: "While the failure of common, classwide proof on the issues of market efficiency and publicity leaves open the prospect of individualized proof of reliance, the failure of common proof on the issue of materiality ends the case for the class and for all individuals alleged to compose the class." *Id.* at 1199.

Price impact is analogous to market efficiency and publicity. It is not an "indispensable" element of a Rule 10b-5 claim. And if a defendant at class certification successfully rebuts the existence of price impact and thus, the fraud-on-the-market presumption of reliance, this does not "end the case for one and for all." *Amgen*,

133 S. Ct. at 1196. A plaintiff can still "attempt to establish reliance through the 'traditional' mode of demonstrating that she was personally 'aware of [the defendant's] statement and engaged in a relevant transaction . . . based on that specific misrepresentation.' " *Id*. at 1199 (quoting *EPJ Fund*, 131 S. Ct. at 2185). Although individual issues of reliance would predominate, the "plaintiff's claim would remain live; it would not be 'dead on arrival.' " *Id.* (citation omitted); *see also* 718 F.3d at 431 (Fifth Circuit notes in this case that a "plaintiff can fail to establish publicity, market efficiency, or trade timing, and therefore lose the class-wide presumption of reliance, but still establish individual reliance and prove fraud") (citing *Amgen*, 133 S. Ct. at 1198-99).

Finally, a successful price impact rebuttal would not defeat materiality. To be sure, courts treat price impact evidence as probative of materiality. But this does not render such evidence "essential" to a plaintiff's Rule 10b-5 claim. As the Court in *Basic* noted, "[a]ny 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." 485 U.S. at 236; *see also Matrixx*, 131 S. Ct. at 1318-19 (reiterating the Court's rejection of "bright-line" rules for materiality).

With *Basic*'s admonition in mind, commentators have recognized that price impact alone is not dispositive on the issue of materiality. *See, e.g.*, Thomas L. Hazen, *The Law of Securities Regulation* § 12.9[11][B] (6th ed. 2009 & 2010 Supp.) ("While the impact of information on the market price may be evidence of materiality, courts should be reluctant to

view the absence of an effect on the stock price to negate a finding of materiality."). Many lower courts have agreed. *No. 84 Emp'r-Teamster Joint Council Pension Trust Fund v. Am. W. Holding Corp.*, 320 F.3d 920, 934 (9th Cir. 2003) (holding that lack of immediate market reaction does not preclude a finding that misrepresentations are material); *United States v. Bilzerian,* 926 F.2d 1285, 1298 (2d Cir. 1991) (observing that "whether a public company's stock price moves up or down or stays the same after [filing] . . . does not establish the materiality of the statements made, though stock movement is a factor the jury may consider relevant"); *Geiger v. Solomon-Page Group, Ltd.*, 933 F. Supp. 1180, 1188 (S.D.N.Y. 1996) (holding that evidence of stock price movement may be relevant to materiality, but is not determinative). Accordingly, evidence of a lack of price impact would not dispose of materiality "for one and for all." *Amgen*, 133 S. Ct. at 1196.

2. Price impact is not dispositive as to loss causation and, as a result, the *Amgen* analysis is inapplicable.

In this case, the Fifth Circuit apparently agreed that *Amgen* does not directly prevent a defendant's presentation of rebuttal price impact evidence at class certification. Instead, it found, based on the *Amgen* "analysis," that because "a showing of negative price impact is required to establish loss causation, plaintiffs who cannot establish price impact cannot establish loss causation." 718 F.3d at 434. As a result, if a defendant "were to successfully rebut the fraud-on-the-market presumption by proving no price impact, the claims of all individual plaintiffs would fail because they could

not establish an essential element of the fraud action." *Id.* However, the Fifth Circuit's conclusion that price impact and loss causation are indistinguishable has been expressly rejected by this Court and is incorrect as a matter of law.

The Court in *EPJ Fund* held that the Fifth Circuit "erred by requiring [plaintiff] to show loss causation as a condition of obtaining class certification." 131 S. Ct. at 2186. The Court was not persuaded by Halliburton's attempt to characterize the Fifth Circuit's inquiry as "whether EPJ Fund had demonstrated 'price impact'" (instead of loss causation). *Id.* at 2187. In particular, the Court found that it did not "accept Halliburton's wishful interpretation of the Court of Appeals' opinion. As we have explained, loss causation is a familiar and distinct concept in securities law; ***it is not price impact***." *Id.* (emphasis added).

In *EPJ Fund*, the Court did not hold that price impact evidence is prohibited, if introduced to rebut the fraud-on-the-market presumption at class certification. To the contrary, it specifically reserved any such issue, explaining in no uncertain terms: "Because we conclude the Court of Appeals erred by requiring EPJ Fund to prove loss causation at the certification stage, we need not, and do not, address any other question about *Basic*, its presumption, or how and when it may be rebutted." *Id.*

Those "other question[s]" are now before the Court, which has an opportunity to confirm its correct conclusion that loss causation "is not price impact." *Id.* Contrary to the Fifth Circuit's decision, if a defendant demonstrated the absence of price impact, this would *not* mean that individual plaintiffs necessarily were

unable to establish loss causation. Unlike materiality, which is subject to an "objective test" that applies to every Rule 10b-5 claim based on the alleged misrepresentations (whether or not the claim relies on the fraud-on-the-market theory), loss causation can be subject to individual proof. If an individual plaintiff were able to establish "reliance through the 'traditional' mode of demonstrating that she was personally 'aware of [the defendant's] statements and engaged in a relevant transaction,' " *Amgen*, 133 S. Ct. at 1199 (citation omitted), she also may be able to establish loss causation through some means *other* than the statements' effect on the market price of the securities.

Indeed, lower courts have made it clear that price impact is merely *one* of the ways that an individual plaintiff can demonstrate loss causation, even as to publicly traded securities. *See*, *e.g.*, *McCabe v. Ernst & Young, LLP*, 494 F.3d 418, 425-426 (3d Cir. 2007) (in case involving private purchase of public company's stock, "non-typical" loss causation allegations may still support viable claim); *Livid Holdings Ltd. v. Salomon Smith Barney, Inc.*, 416 F.3d 940, 949 & n.2 (9th Cir. 2005) (purchaser in "private sale" adequately pleaded loss causation without reference to exchange-listed price); *EP Medsystems, Inc. v. EchoCath, Inc.*, 235 F.3d 865, 871 (3d Cir. 2000) (plaintiff sufficiently alleged a Rule 10b-5 claim against a publicly traded company even though the plaintiff "d[id] not base its claim on public misrepresentations or omissions that affected the price of the stock").

Because loss causation and price impact are distinct issues, a denial of class certification based on the

absence of price impact would not mean that "no claim would remain in which individual reliance issues could potentially predominate." *Amgen*, 133 S. Ct. at 1196. Instead, it would simply mean that individual questions of reliance *and* loss causation were predominant over common ones.

B. The Court should harmonize its Rule 10b-5 affirmative misstatement and omission jurisprudence by permitting defendants to present price impact evidence to rebut the judicially created fraud-on-the-market presumption at class certification.

1. Under *Ute*, defendants may rebut the judicially created reliance presumption at class certification in cases alleging a fraudulent omission.

"Reliance . . . is an essential element of the § 10(b) private cause of action" because it ensures "a proper connection between a defendant's misrepresentation and a plaintiff's injury." *EPJ Fund*, 131 S. Ct. at 2184 (citations and internal quotations omitted). However, the Court has recognized that plaintiffs who allege a fraudulent omission face unique difficulties in proving actual reliance, as "reliance on the *nondisclosure* of a fact is a particularly difficult matter to define or prove[.]" *Mills v. Elec. Auto-Lite Co.*, 396 U.S. 375, 382 n.5 (1970) (emphasis in original); *see also Binder v. Gillespie*, 184 F.3d 1059, 1064 (9th Cir. 1999); *Blackie v. Barrack*, 524 F.2d 891, 908 (9th Cir. 1975) (same). Accordingly, the Court has created a *rebuttable* reliance presumption (the "*Ute* presumption"), which plaintiffs can use upon showing (1) the existence of a material omission; and (2) that the defendant had a duty to

disclose. *Ute*, 406 U.S. at 152-53; *Stoneridge*, 552 U.S. at 159.

Importantly, the *Ute* presumption is rebuttable at class certification. In particular, the lower courts permit class action defendants to rebut the *Ute* presumption by showing that they had no class-wide duty to disclose. *Levitt v. J.P. Morgan Sec., Inc.*, 710 F.3d 454, 468-70 (2d Cir. 2013) (upholding denial of class certification and holding *Ute* presumption inapplicable where defendant clearing firm owed no fiduciary duty to disclose a broker-dealer's scheme to manipulate an initial public offering to plaintiffs-customers of the introducing broker-dealer); *Regents of the Univ. of Cal. v. Credit Suisse First Boston*, 482 F.3d 372, 384-85 (5th Cir. 2007) ("*Credit Suisse First Boston*") (reversing order certifying class and holding *Ute* presumption inapplicable where defendant banks owed no fiduciary duty to plaintiffs who purchased securities); *cf. Stoneridge*, 552 U.S. at 159 (affirming lower court's dismissal of action because, *inter alia*, the *Ute* presumption was inapplicable where defendants merely transacted business with the issuer of plaintiffs' securities, as defendants owed plaintiffs no duty to disclose the issuer's allegedly fraudulent business practices).[2]

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[2] Post-*Amgen*, it remains proper for defendants to rebut the *Ute* reliance presumption by showing that a defendant had no class-wide duty to disclose. Unlike materiality, the existence of a duty to disclose can involve individualized facts that render the issue unsuitable for class treatment. *See, e.g.*, *Credit Suisse First Boston*, 482 F.3d at 383 (denying class certification because the *Ute* presumption was inapplicable where defendant banks owed no class-wide duty of disclosure, but specifying that plaintiffs could still prove individual reliance on defendants' conduct).

2. To harmonize the affirmative misrepresentation and omission strands of its Rule 10b-5 jurisprudence, the Court should permit price impact evidence to rebut the reliance presumption at class certification in affirmative misrepresentation cases.

As set forth immediately above, a defendant may rebut *Ute*'s judicially created reliance presumption at class certification with evidence of no class-wide duty of disclosure. The Court should harmonize its two strands of Rule 10b-5 jurisprudence by ensuring that affirmative misstatement defendants also have an equivalent opportunity to rebut the judicially created fraud-on-the-market presumption at class certification with price impact evidence.

As a threshold matter, the issues of the defendant's duty of disclosure and price impact are analogous, warranting their equivalent treatment at class certification. First, a failure to prove price impact, like a failure to prove a class-wide duty to disclose, will not "end the case for one and for all," unlike a failure to prove materiality. *Amgen*, 133 S. Ct. at 1196; *Credit Suisse First Boston*, 482 F.3d at 383. Second, the duty to disclose is an essential prerequisite of the *Ute* presumption, 406 U.S. at 154, and similarly, price impact is an essential prerequisite of the fraud-on-the-market presumption, *Basic*, 485 U.S. at 248. Put differently, just as a class cannot be presumed to rely on disclosures that it was not required to receive, so too a class cannot presumptively rely in common when it purchases at a market price unaffected by affirmative misstatements. Finally, a plaintiff in an omission case

could potentially show individual reliance on a defendant's statements that omitted material information, even where the defendant lacked a class-wide duty to disclose. *See Credit Suisse First Boston*, 482 F.3d at 383. Likewise, a plaintiff in an affirmative misstatement case could potentially show individual reliance without price impact. *See Amgen*, 133 S. Ct. at 1199 (describing a plaintiff's ability to "establish reliance through the 'traditional' mode of demonstrating that she was personally 'aware of [the defendant's] statement and engaged in a relevant transaction . . . based on that specific misrepresentation.' ") (citation omitted).

Moreover, harmonization will discourage plaintiffs from engaging in "artful pleading" in an attempt to lower their class certification hurdle. As numerous lower courts have recognized: "The distinction between misstatements and omissions is often illusory. A statement is misleading when it omits the truth. Thus, in most securities fraud cases, an affirmative misstatement can be cast as an omission and vice versa." *In re Smith Barney Transfer Agent Litig.*, 290 F.R.D. 42, 47 (S.D.N.Y. 2013); *see also In re Salomon Analyst Metromedia Litig.*, 236 F.R.D. 208, 219 (S.D.N.Y. 2006) ("[A]ffirmative misleading statements always omit *something*; namely, they omit the information that would correct or mitigate their misleading nature and thereby render the statements true." (emphasis in original)). In light of this "illusory" distinction, plaintiffs often seek to characterize their claims so as to follow the path of least resistance to obtaining class certification. *See, e.g., Joseph v. Wiles*, 223 F.3d 1155, 1163 (10th Cir. 2000) (finding that despite the plaintiff's "valiant[]" struggle to plead ". . .

in such a manner as to intertwine affirmative acts with omissions in a strained attempt to recharacterize the . . . alleged conduct within the definition of 'omission,' " plaintiff's claims were based on affirmative acts). Harmonization will significantly reduce, if not eliminate, the incentive to engage in such manipulative conduct.

C. Establishing the absence of price impact at the class certification stage comports with the purposes of Federal Rule of Civil Procedure 23 and ensures that individual class members will not suffer undue prejudice.

It might appear to confer an unqualified advantage upon a proposed class if a defendant is barred from using price impact evidence to rebut the fraud-on-the-market presumption at the class certification stage. In truth, however, delaying the use of such evidence until later in the litigation potentially imperils the rights of class members and undermines the basic purposes of Federal Rule of Civil Procedure 23 ("Rule 23").

As the Court has recognized, even where a plaintiff cannot establish reliance on a class-wide basis, there may be members of the class who can make an individualized showing of actual reliance. *Amgen*, 133 S. Ct. at 1199. If a defendant who possesses rebuttal price impact evidence is allowed to present such evidence only at trial, this could create barriers to these class members proceeding upon their individualized proof.

Because reliance is an essential element of a Rule 10b-5 claim, a defendant who successfully rebuts the

fraud-on-the-market-presumption at trial is entitled to judgment as a matter of law as to the entire class. Under elementary principles of *res judicata*, this entry of judgment ordinarily extinguishes the underlying fraud claim against the defendant and bars any subsequent action on that same claim—including, potentially, any actions by individual class members. As has been observed: "Preclusion by representation lies at the heart of the modern class action developed by such procedural rules as Civil Rule 23. The central purpose of each of the various forms of class action is to establish a judgment that will bind not only the representative parties but also all nonparticipating members of the class certified by the court." 18A Charles Alan Wright, et al., Fed. Prac. & Proc. § 4455 (2d ed. 2013).[3]

Indeed, it is precisely because of the principle of "preclusion by representation" that the need exists for close scrutiny at class certification of the "predominance" and other certification prerequisites. 7 William B. Rubenstein, Newberg on Class Actions § 22.1 (4th ed. 2013) ("A 'rigorous analysis' of the propriety of certification is necessary because, among other things, a class action judgment has *res judicata* effect with respect to absent class members.")

Of note, Rule 23 itself does not compel a district court in a securities class action to permit class

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[3] *See also id*. ("A host of motives underlie the intention to achieve preclusion. These motives cover a range as broad as the divergent desires to avoid the burden of multiple individual actions that would occur without a class action and to avoid the nonenforcement of claims that would not be pursued in individual actions. …")

members to pursue fraud claims individually, after the court has entered judgment in defendant's favor due to the lead plaintiff's inability following class certification to prove an essential element of the claim, such as reliance. Nor does *Basic*, or any subsequent decision of the Court, mandate in these circumstances that a district court adopt some mechanism to preserve the ability of class members who did not previously intervene in the case or file their own complaints, to resurrect and litigate the dismissed fraud claim based on evidence of individualized reliance. Circuit courts likewise have not provided explicit guidance on this issue.

Rather, whether in these circumstances there is some mechanism by which individual class members may litigate their own claims (*e.g.*, based on an individualized showing of actual reliance)—and what the specific contours of this protective mechanism should be—has effectively been left as a matter of judicial administration to district courts' discretion. As such, upon receiving notice of a proposed securities fraud class action, members of the proposed class generally cannot predict with any degree of certainty how the district court may eventually exercise its discretion with regard to their individual claims.

Even where a lead plaintiff has failed on behalf of the class to prove the element of reliance and the district court wishes to permit individual claims to be litigated, ***the five-year statute of repose governing Rule 10b-5 securities fraud claims (28 U.S.C. § 1658(b)(2) ("Section 1658")) may as a matter of law bar such claims***. If a defendant's ability to rebut the fraud-on-the-market presumption is delayed until

trial, there is a distinct risk that more than five years will have elapsed from when the earliest misrepresentation alleged in the Complaint was made and the issue of reliance is fully and finally litigated in the class action.

This risk is not merely hypothetical, given that in securities class actions: (i) complaints often allege misrepresentations that occurred many months (and sometimes a year or more) prior to the filing of the complaint (under Section 1658, it is the date of the misrepresentation that triggers the running of the period of repose); (ii) complaints often are amended, further delaying the litigation; (iii) district courts often take many months (and sometimes a year or more) to issue a ruling on a defendant's motion to dismiss; (iv) if the motion to dismiss is denied, fact and expert discovery is often highly protracted; (v) discovery disputes between the parties frequently arise and spawn satellite motion practice that can require months or a year or more to resolve; (vi) the briefing of Rule 56 motions is notoriously time-consuming, and district courts can take months or a year or more to decide such motions; and (vii) the pre-trial phase of the case (motions *in limine*, etc.) obviously can take many additional months. In some instances, final resolution of the securities class action is further delayed by appeals.

The facts of this case illustrate the point. The operative complaint in this case is the plaintiffs' Fourth Consolidated Amended Complaint, N.D. Tex. Docket No. 02-1152 (April 4, 2006), which alleges claims based on misrepresentations that allegedly were made prior

to December 7, 2001. With regard to these alleged misrepresentations, the statute of repose lapsed long ago.[4]

Thus, if a defendant has conclusive evidence of a lack of price impact, but is not permitted to present that evidence until trial, then this opens the door to the possibility that by the time the plaintiff's fraud-on-the-market presumption is adjudicated, the period of repose provided for by Section 1658 will have run—and a district court might determine (absent controlling precedent to the contrary[5]) that Section 1658 precludes

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[4] Effective July 30, 2002, the period of repose under 28 U.S.C. § 1658(b) was amended from three years to five years. *See Margolies v. Deason*, 464 F.3d 547, 550 (5th Cir. 2006). Because the complaint in this case was filed prior to July 30, 2002, the applicable repose period is three years.

[5] Under the Court's decision in *Am. Pipe & Constr. Co. v. Utah*, 414 U.S. 538, 554 (1974), "the commencement of a class action suspends the applicable statute of limitations as to all asserted members of the class who would have been parties had the suit been permitted to continue as a class action." In a later case, however, the Court found that federal statutes of repose (such as the statutes of repose in the federal securities laws) are not subject to equitable tolling. *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 364 (1991). The Second Circuit recently concluded that because Rule 23 does not expressly create a class action tolling rule, tolling under the Court's decision in *American Pipe* is best understood as a judicially created rule based on equitable considerations and, as a result, cannot extend a statute of repose. *Police and Fire Ret. Sys. of City of Detroit v. IndyMac MBS, Inc.*, 721 F.3d 95, 109 (2d Cir. 2013) ("[p]ermitting a plaintiff to file a complaint or intervene after the repose period . . . has run would therefore necessarily enlarge or modify a substantive right and violate the Rules Enabling Act."). *But see Joseph*, 223 F.3d at 1167-68 (holding that statute of repose for Rule 10b-5 claims is

any class members from pursuing their own claims and using any individualized proof of reliance that they may have in support of their claims.

It also is possible that a district court could conclude (correctly or not) that Section 1658 does ***not*** have the effect of barring class members in a securities fraud class action from proceeding based on individualized proof of actual reliance. But until and unless the issue is decided in the case, members of the proposed class cannot predict whether a Section 1658 issue will arise in the first place, much less how the district court will resolve it.

Thus, delaying a defendant's ability to present rebuttal price impact evidence until the merits stage of a class action is tantamount to requiring every class member who might make an individualized showing of actual reliance to take the drastic prophylactic step of seeking to intervene in the action or filing a separate individual action long before the class claims are decided. But many class members do not have the practical ability to do so (and therefore their potential claims may always remain at risk). Moreover, effectively forcing members of the proposed class to pursue their own claims would result in the kind of duplicative litigation that Rule 23 was designed to avoid. In contrast, permitting the fraud-on-the-market presumption to be tested at the class certification

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subject to *American Pipe* tolling). It is not clear how the Fifth Circuit would resolve the issue in this case—the court has recognized there is a circuit split on the issue but has expressly declined to decide the issue. *See Hall v. Variable Annuity Life Ins. Co.*, 727 F.3d 372, 375 n.5 (5th Cir. 2013).

stage—and thereby avoiding the uncertainty and potential prejudice to class members that might otherwise arise—strikes an appropriate balance between efficiently litigating class-wide common issues and treating individual members of the proposed class fairly.

CONCLUSION

For the reasons stated above, WLF respectfully urges the Court to reverse the Fifth Circuit's decision. Even if the Court declines to overrule or substantially modify the fraud-on-the-market presumption created in *Basic*, it should clarify that price impact evidence can be used to rebut the presumption at the class certification stage of a case.

Respectfully submitted,

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