RESTORING THE BALANCE OF CLASS CERTIFICATION POWER IN THE FIFTH CIRCUIT: THE UNITED STATES SUPREME COURT'S OPINION IN *ERICA P. JOHN FUND, INC. V. HALLIBURTON, CO.*

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The Fifth Circuit, like other circuits, occasionally finds itself in conflict with the other circuit courts. *Oscar Private Equity Investments v. Allegiance Telecom, Inc.*[1] and *Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co*.[2] created one of these conflicts in the context of class certification under Federal Rule of Civil Procedure 23. On June 6, 2011, the United States Supreme Court resolved this conflict with its unanimous decision in *Erica P. John Fund, Inc. v. Halliburton Co.*[3]

In *Oscar* and *Halliburton*, the Fifth Circuit held that in addition to proving all of the Federal Rule of Civil Procedure ("FRCP") 23 requirements, a putative securities class must prove loss causation by a preponderance of all admissible evidence before class certification may be granted.[4] This was an exceedingly high burden and was noted as such by district courts within the Fifth Circuit, including twice by District Judge Barbara M.G. Lynn in the District Court's *Halliburton* opinion.[5] The Supreme Court apparently agreed with Judge Lynn that the burden was "exceedingly high" and overruled the Fifth Circuit's decisions in *Oscar* and *Halliburton*: "[t]he question presented in this case is whether securities fraud plaintiffs must also prove loss causation in order to obtain class certification…. [w]e hold that they need not."[6]

The plaintiff filed *Halliburton* on June 3, 2002 in the Northern District of Texas. After proceeding for nearly six years, a hearing on class certification was held on March 21, 2008. The District Court found all elements of Rule 23 agreed to by the parties and satisfied, but denied class certification because the Plaintiffs had not demonstrated the Fifth Circuit's additional requirement of loss causation by a preponderance of all admissible evidence.[7] On February 12, 2010, the Fifth Circuit agreed and affirmed the District Court's conclusion that the class certification motion failed for want of establishing loss causation.[8]

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[1] 487 F.3d 261 (5th Cir. 2007).

[2] 597 F.3d 330 (5th Cir. 2010).

[3] 131 S. Ct. 2179 (2011).

[4] *See Oscar*, 487 F.3d at 269; *Archdiocese of Milwaukee*, 597 F.3d at 335.

[5] *See* Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co., No. 3:02CV1152M, 2008 WL 4791492, *2, *20 (N.D. Tex. Nov. 4, 2008).

[6] *See Erica P. John Fund*, 131 S. Ct. at 2183.

[7] *See Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*, 2008 WL 4791492, at *1.

[8] *See Archdiocese of Milwaukee*, 597 F.3d at 344.

Erica P. John Fund, Inc. v. Halliburton Co.[9]

Chief Justice Roberts, writing for a unanimous Supreme Court, began with a concise holding, narrowly focusing and limiting the opinion:

> To prevail on the merits in a private securities fraud action, investors must demonstrate that the defendant's deceptive conduct caused their claimed economic loss. This requirement is commonly referred to as "loss causation." The question presented in this case is whether securities fraud plaintiffs must also prove loss causation in order to obtain class certification. We hold that they need not.[10]

The Supreme Court's decision overruled the Fifth Circuit's *Oscar* and *Halliburton* decisions and brought the Fifth Circuit in line with the remainder of the federal circuits where loss causation proof was not required to obtain class certification. However, the Supreme Court clarified that it was not addressing any other question about the fraud-on-the-market presumption or how and when it may be rebutted.[11]

In this case, plaintiffs alleged that Halliburton violated section 10(b) of the Securities Exchange Act of 1934 and Securities and Exchange Commission Rule 10b-5 when it deliberately made false statements about "(1) the scope of its potential liability in asbestos litigation, (2) its expected revenue from certain construction contracts, and (3) the benefits of its merger with another company."[12] After defeating a motion to dismiss, the lead plaintiff sought class certification under Rule 23.[13] As stated above, the Supreme Court noted that the District Court found all elements of Rule 23(a) were satisfied and that the action could proceed as a class action under Rule 23(b)(3), but for the problem that Fifth Circuit "precedent required securities fraud plaintiffs to prove 'loss causation' in order to obtain class certification."[14]

The Supreme Court thus focused on the sole dispute, whether the lead plaintiff had satisfied the prerequisites of Rule 23(b)(3).[15] Rule 23(b)(3) requires that courts find that "questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy."[16] These requirements are sometimes referred to as predominance and superiority. When courts are considering the predominance requirement, *i.e.* whether common questions of law or fact predominate, the starting block is the elements of the underlying cause of action. Here, plaintiffs had alleged violations of section 10(b) and Rule 10b-5, which require proof of: "(1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation."[17] Chief Justice Roberts correctly noted that whether

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[9] 131 S. Ct. 2179 (2011).

[10] *Id*. at 2183.

[11] *See id.* at 2187.

[12] *See id.* at 2183.

[13] *See id*.

[14] *See id.*

[15] *Id*. at 2184.

[16] *Id*. (citing FED. R. CIV. P. 23(b)(3)).

[17] *Id*. at 2184.

common questions of law or fact predominate in a securities fraud action often turns on the element of reliance.[18]

The Supreme Court then focused on its creation in *Basic Inc. v. Levinson*[19] of the fraud-on-the-market presumption of reliance.[20] According to the high court, the traditional, single plaintiff manner of proving reliance is a showing that a plaintiff was aware of a company's statement and purchased stock based on that specific misrepresentation.[21] However, in *Basic*, the Supreme Court realized that this traditional method of proving reliance "effectively would prevent such plaintiffs from proceeding with a class action, since individual issues would overwhelm the common ones."[22] Therefore, the *Basic* court created a rebuttable presumption of reliance, *i.e.* the fraud-on-the-market theory, which stated that the market price of shares traded on an efficient market reflects all publicly available information, including any material misrepresentations, and because the market transmits information to investors in the processed form of a market price, courts can presume that an investor relied on the public misstatements whenever he bought or sold stock at the market price.[23] In order for plaintiffs to invoke this rebuttable presumption of reliance, plaintiffs must demonstrate that the alleged misstatements were publicly known, "that the stock traded in an efficient market, and that the relevant transaction took place 'between the time the misrepresentations were made and the time the truth was revealed.'"[24] Thus, once proved, plaintiffs are entitled to a rebuttable presumption of reliance, referred to as transaction causation by the Supreme Court, and common issues of reliance will predominate over individual ones.[25]

In *Halliburton*, the Fifth Circuit's error was requiring additional proof of loss causation.[26] Chief Justice Roberts noted that the Supreme Court had "never before mentioned loss causation as a precondition for invoking *Basic*'s rebuttable presumption of reliance … [and that t]he term loss causation does not even appear in [the] *Basic* opinion."[27] Reliance (or transaction causation) focuses on "facts surrounding the investor's decision to engage in the transaction," while loss causation, according to the Supreme Court, "requires a plaintiff to show that a misrepresentation…affected the…market price [and] caused a subsequent economic loss."[28] These are two distinct concepts of securities law and the Supreme Court delineated the two stating that "[l]oss causation has no logical connection to the facts necessary to establish the efficient market predicate to the fraud-on-the-market theory."[29]

Realizing that proof of loss causation at the class certification stage was to be short lived, Halliburton conceded that "securities fraud plaintiffs should not be required to prove loss causation in order to invoke *Basic*'s presumption of reliance."[30] Halliburton contended that the

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[18] *Id*.

[19] 485 U.S. 224 (1988).

[20] Erica P. John Fund, Inc. v. Halliburton, Co., 131 S. Ct. 2179, 2185 (2011).

[21] *Id*.

[22] *Id*. (quotations omitted).

[23] *Id.*

[24] *Id*. at 2185 (citing *Basic*, 485 U.S. at 248 n.27).

[25] *See e.g., Erica P. John Fund*, 131 S. Ct. at 2185–86.

[26] *Id*. at 2185–86.

[27] *Id*. at 2186.

[28] *Id*.

[29] *Id*.

[30] *Id*.

Fifth Circuit's use of "loss causation" was "shorthand for a different analysis," and the actual inquiry was whether the lead plaintiff had demonstrated price impact.[31] According to the Supreme Court, price impact refers to the effect of a misrepresentation on a stock price, and it was Halliburton's theory "that if a misrepresentation does not affect market price, an investor cannot be said to have relied on the misrepresentation merely because he purchased stock at that price."[32] The Supreme Court made short work of this theory explaining that loss causation and price impact, while the legal concepts share some consistent language, are in fact distinct legal concepts, and the Supreme Court could not ignore the Fifth Circuit's "repeated and explicit references to 'loss causation.'"[33]

Following this matter-of-fact pronouncement, the Supreme Court vacated the Fifth Circuit's judgment and limited its holding to the loss causation issue.[34] "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."[35]

The Supreme Court's decision brought the Fifth Circuit back in line with the other circuits that did not require proof of loss causation.[36] However, the Supreme Court oral argument underscores the narrow scope of the holding, which left the door open for Halliburton's argument that it rebutted the presumption of class wide reliance by proving lack of "price impact."

During oral argument, Justice Kagan had an exchange with Halliburton's counsel that clarified Halliburton's position. Justice Kagan asked Halliburton's counsel what argument it was making in its brief:

> One possible argument you could be making is that the plaintiffs have to show a price impact. Another possible argument you could be making is that you have to have the opportunity to rebut the plaintiff's use of the *Basic* presumption by yourself showing that there was no price impact.[37]

Halliburton's counsel clarified that it was not the first argument:

> *Basic* puts the initial burden on the defendant to show the absence of price impact, showing that the presumed fact does not exist. Once that threshold showing is made, the burden remains on the plaintiff under Rule 301 and Rule 23 to show by a preponderance of the evidence that the market price was in fact, distorted.[38]

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[31] *Id*. at 2186–87 (quotations omitted).

[32] *Id*. at 2187.

[33] *Id*. (further stating "[w]hatever Halliburton thinks the Court of Appeals meant to say, what it said was loss causation… [w]e take the Court of Appeals at its word… [b]ased on those words, the decision below cannot stand.").

[34] *Id*. at 2187.

[35] *Id*.

[36] *See id*. at 2184 (citing *In re* Salomon Analyst Metromedia Litig., 544 F.3d 474, 483 (2d Cir. 2008) (not requiring investors to prove loss causation at class certification stage); Schleicher v. Wendt, 618 F.3d 679, 687 (7th Cir. 2010) (same); *In re* DVI, Inc. Sec. Litig., 639 F.3d 623, 636–37 (3d Cir. 2011) (same; decided after certiorari was granted)).

[37] Transcript of Oral Argument at 27–28, Erica P. John Fund, Inc. v. Halliburton Co., 131 S. Ct. 2179 (2011) (No. 09-1403).

[38] *Id.* at 28.

This exchange suggests that Halliburton was not arguing that the Fifth Circuit simply meant price impact when it said loss causation or that the plaintiffs needed to prove price impact as an initial matter to obtain class certification, as the Fifth Circuit's *Halliburton* decision indicated. Instead, Halliburton seemed to be inviting the court to go beyond the question of whether *Oscar* should be overruled and to rule on Halliburton's argument that lack of price impact could be used by defendants to rebut the reliance presumption and only then would plaintiffs be required to affirmatively prove that the market price was in fact distorted, *i.e.* price impact.[39] The Court declined Halliburton's invitation, issuing a narrow decision that did not address how or when the presumption may be rebutted. Thus, the Court left open the possibility that Halliburton could use the "price impact" argument to make an end-run around the holding that loss causation does not have to be proved at the class certification stage.

The Aftermath of *Halliburton*

After the Supreme Court's June 6, 2011 decision, the following sequence of events occurred in relatively short order:

- July 20, 2011 – The Fifth Circuit issued a one page opinion that simply reversed the district court and remanded for further proceedings.[40]
- January 27, 2012 – The District Court issued an order granting class certification.[41]
- February 10, 2012 – Defendants filed a brief requesting permission to appeal the class certification.
- February 22, 2012 – Plaintiff filed its response objecting to another appeal.
- May 22, 2012 – Fifth Circuit Judges Clement and Owen granted Defendants' petition for leave to appeal. Circuit Judge Dennis dissented from the decision to grant leave to appeal.
- June 4, 2012 – District Judge Barbara Lynn stayed the matter pending resolution of this second appeal.
- March 6, 2013 – Setting for oral arguments in the Fifth Circuit.

Halliburton's direct holding will likely only affect plaintiffs in the Fifth Circuit who no longer have to worry about proving a merits-based loss causation element at the class certification stage. It is what *Halliburton* left unsaid, *i.e.* not addressing any other question about *Basic*, its presumption, or how and when it may be rebutted, that remains an open question for all plaintiffs and defendants alike. This is readily apparent from the arguments Halliburton puts forth in its new briefing to the Fifth Circuit regarding rebutting the presumption of reliance at the class certification stage. These new arguments look similar to the merits-based loss causation inquiry albeit with the burden initially on the defendants.

In its brief, Halliburton makes several arguments, one of which details a circuit split over whether the presumption of reliance may be rebutted "at the class-certification stage with evidence that the alleged misrepresentations did not distort the market price."[42] Halliburton

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[39] *See id.* at 27–28.

[40] *See* Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co., 647 F.3d 533, 534 (5th Cir. 2011).

[41] Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co., No. 3:02CV1152M, 2012 WL 565997, at *1 (N.D. Tex. Jan. 27, 2012).

[42] Defendants' Petition for Permission to Appeal the District Court's January 27, 2012 Order Granting Plaintiff's Motion to Certify Class at 11, Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co., No. 3:02CV1152M, 2012 WL 565997, at *1 (N.D. Tex. Jan. 27, 2012), No. 12-90007 (5th Cir. Feb. 10, 2012), 2012 WL 560072 at *11.

contends that it should be allowed to rebut the reliance presumption in this manner at the class-certification stage and cites to the Fifth Circuit's *Oscar* decision in support, along with the Second Circuit's decision in *In re Salomon Analyst Metromedia Litigation*[43] and the Third Circuit's decision in *In re DVI, Inc. Securities Litigation.*[44] This is the same argument Halliburton proffered during its Supreme Court oral argument.

> *Basic* puts the initial burden on the defendant to show the absence of price impact, showing that the presumed fact does not exist. Once that threshold showing is made, the burden remains on the plaintiff under Rule 301 and Rule 23 to show by a preponderance of the evidence that the market price was in fact, distorted.[45]

In *Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*,[46] the opinion reversed by the Supreme Court, the Fifth Circuit reiterated its position that in order to prove loss causation, a plaintiff had to prove the alleged misstatements "actually moved the market."[47]

> [T]he causal connection between an allegedly false statement and the price of a stock may be proved either by an increase in stock price immediately following the release of positive information, or by showing negative movement in the stock price after release of the alleged "truth" of the earlier falsehood.[48]

Actual movement of the market, proof of a price increase or proof of a price decrease, which is the Fifth Circuit's standard for proof of loss causation, sounds very similar to proof of price distortion or price impact. In *Halliburton*, the Supreme Court stated that price impact "refers to the effect of a misrepresentation on a stock price,"[49] and Halliburton even stated during its Supreme Court oral argument that the Fifth Circuit meant price impact, not loss causation.[50] The difference may be an initial burden on the defendants to prove absence of price impact, but the end result is the same, a plaintiff will have to prove a merits-based inquiry (loss causation or price impact) at the class certification stage. Even Halliburton conceded that at least one circuit has held that "price impact is a 'merits' issue that cannot be considered at the class certification stage."[51]

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[43] 544 F.3d 474 (2d Cir. 2008).

[44] 639 F.3d 623, 638 (3d Cir. 2011); *see* Defendants' Petition for Permission to Appeal the District Court's January 27, 2012 Order Granting Plaintiff's Motion to Certify Class at 11–12, Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co., No. 3:02CV1152M, 2012 WL 565997, at *1 (N.D. Tex. Jan. 27, 2012), No. 12-90007 (5th Cir. Feb. 10, 2012), 2012 WL 560072 at *11–12.

[45] Transcript of Oral Argument at 28, Erica P. John Fund, Inc. v. Halliburton Co., 131 S. Ct. 2179 (2011) (No. 09-1403).

[46] 597 F.3d 330 (5th Cir. 2010).

[47] 597 F.3d at 335.

[48] *Id*.

[49] *See* Erica P. John Fund, Inc. v. Halliburton Co., 131 S. Ct. 2179, 2187 (2011).

[50] Transcript of Oral Argument at 27, Erica P. John Fund, Inc. v. Halliburton Co., 131 S. Ct. 2179 (2011) (No. 09-1403).

[51] Defendants' Petition for Permission to Appeal the District Court's January 27, 2012 Order Granting Plaintiff's Motion to Certify Class at 12, Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co., No. 3:02CV1152M, 2012 WL 565997, at *1 (N.D. Tex. Jan. 27, 2012), No. 12-90007 (5th Cir. Feb. 10, 2012), 2012 WL 560072 at *12 (citing Schleicher v. Wendt, 618 F.3d 679, 685 (7th Cir. 2010)).

In the pending *Halliburton* appeal in the Fifth Circuit, the key question is whether the defendant can rebut the presumption of reliance at the class certification stage by showing a lack of price impact. While the Fifth Circuit has yet to weigh in on this issue, the U.S. Supreme Court recently addressed the analogous issue of whether the defendant can defeat class certification based on lack of materiality. In *Amgen Inc. v. Connecticut Retirement Plans and Trust Funds*,[52] decided on February 27, 2013 in a six to three decision, the Supreme Court held that while plaintiffs in a securities fraud class action must prove materiality to prevail on the merits, "such proof is not a prerequisite to class certification."[53] Like Halliburton, Amgen conceded an efficient market and did not dispute that all of the Rule 23(a) requirements for class certification were met.[54] Therefore, like the *Halliburton* case, the sole issue was Rule 23(b)(3) and whether "questions of law or fact common to class members predominate over any questions affecting only individual members."[55] Amgen contended that certification had to be denied unless the plaintiff, Connecticut Retirement, proved "materiality, for immaterial misrepresentations or omissions, by definition, would have no impact on Amgen's stock price in an efficient market."[56] Further, Amgen argued the District Court had erred when it failed to consider its rebuttal evidence offered in opposition to the plaintiff's class certification motion, principally that the alleged misrepresentations and omissions were immaterial.[57] The Supreme Court granted certiorari to resolve conflict on this issue among the Courts of Appeals, the same conflict Halliburton pointed to in its brief to the Fifth Circuit.[58]

The Supreme Court held that proof of this materiality was not appropriate at the class-certification stage. "Amgen's argument, if embraced, would necessitate a mini-trial on the issue of materiality at the class-certification stage."[59] "Proof of that sort is a matter for trial (and presumably also for a summary-judgment motion under Federal Rule of Civil Procedure 56)."[60] The Supreme Court succinctly stated:

> Rule 23(b)(3) requires a showing that *questions* common to the class predominate, not that those questions will be answered, on the merits, in favor of the class. Because materiality is judged according to an objective standard, the materiality of Amgen's alleged misrepresentations and omissions is a question common to all members of the class Connecticut Retirement would represent. The alleged misrepresentations and omissions, whether material or immaterial, would be so equally for all investors composing the class. As vital, the plaintiff class's inability to prove materiality would not result in individual questions predominating. Instead, a failure of proof on the issue of materiality would end the case, given that materiality is an essential element of the class members' securities-fraud claims. As to materiality, therefore, the class is entirely cohesive: It will

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[52] 133 S. Ct. 1184 (2013).

[53] *Amgen,* 133 S. Ct. at 1191.

[54] *Id.* at 1190–91.

[55] *Id.* at 1191.

[56] *Id.*

[57] *Id.* at 1194.

[58] *Id.*

[59] *Id.* at 1201.

[60] *Id.* at 1204 (citations omitted) (quotations omitted).

> prevail or fail in unison. In no event will the individual circumstances of particular class members bear on the inquiry.[61]

The *Amgen* decision seems to weaken the basis for Halliburton's pending appeal. Whether phrased as proof of materiality by the plaintiff or rebuttal evidence by the defense of lack of price impact, it may be difficult for Halliburton to overcome the argument that class members will rise and fall together. Like materiality in *Amgen*, price impact in *Halliburton* is a merits issue that is common to all members of the class. Arguably this makes price impact an inappropriate inquiry for class certification where the class will "prevail or fail in unison."[62]

[61] *Id.* at 1191 (emphasis in original).

[62] *Id.*