DOES *HALLIBURTON II* ALLOW DEFENDANTS TO PROVE A LACK OF "CORRECTIVENESS" TO DEFEAT CLASS CERTIFICATION?

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In *Halliburton Co. v. Erica P. John Fund, Inc.* ("*Halliburton II*"), the U.S. Supreme Court held that defendants in federal securities fraud cases may defeat class certification by proving a lack of "price impact" at the class certification stage.[3] This holding gave defendants in such cases a significant new opportunity to defeat class certification. But lower courts so far have not given *Halliburton II* the robust application that Halliburton and other corporate defendants may have hoped for.[4]

The Halliburton case itself shows the limited impact *Halliburton II* has had to date. On remand from *Halliburton II*, the district court held that Halliburton proved a lack of price impact for all alleged misrepresentations and corrective disclosures except one: an announcement of an adverse jury verdict in an asbestos case.[5] Therefore, the district court granted class certification, but only as to that single misrepresentation.[6] The Fifth Circuit granted Halliburton leave to appeal this decision, and the Fifth Circuit heard oral argument on August 31, 2016.[7]

The issue in the pending appeal before the Fifth Circuit is narrow but important: When a defendant in a securities fraud class action attempts to rebut the *Basic* presumption by proving a lack of price impact, is the "correctiveness" of the alleged corrective disclosure an issue the district court should consider?[8] The plaintiffs in *Halliburton* argue that correctiveness is a class-wide merits issue like materiality, loss causation, and falsity of the alleged misrepresentation. At the class certification stage, plaintiffs argue, the court should assume the correctiveness of the alleged corrective disclosure, focusing only on whether the corrective disclosure caused a price impact.

Halliburton, on the other hand, argues that correctiveness is necessarily part of the price impact issue. Correctiveness may be a class-wide issue, Halliburton argues, but so is price impact, and the whole point of *Halliburton II* was to allow defendants to attempt to rebut price impact at the class certification stage. If the Fifth Circuit agrees, it will be one step towards the more expansive application of *Halliburton II* that corporate defendants hoped for.

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[3] Halliburton Co. v. Erica P. John Fund, Inc., 134 S. Ct. 2398, 2417 (2014) [*Halliburton II*]; Basic Inc. v. Levinson, 485 U.S. 224 (1988).

[4] For the background to *Halliburton II* and a detailed discussion of the opinion, see our previous article in this journal at Vol. 46, No. 1.

[5] Erica P. John Fund, Inc. v. Halliburton Co., 309 F.R.D. 251, 256, 279–80 (N.D. Tex. 2015) [*EPJF II*].

[6] *Id.* at 280.

[7] Erica P. John Fund, Inc. v. Halliburton Co., No. 15-90038, 2015 WL 10714013, at *1 (5th Cir. Nov. 4, 2015).

[8] Merriam-Webster tells us "correctiveness" is not a word, but it communicates the concept at issue here so conveniently that we will give ourselves permission to use it.

I. BACKGROUND: "MERITS" VS. "PREDOMINANCE" ISSUES IN SECURITIES FRAUD CLASS ACTIONS

The root of the problem in the pending *Halliburton* appeal is that the issues in a securities fraud class action do not neatly divide into "merits" issues and "class certification" issues. Yet courts must draw lines between the elements defendants can dispute at the class certification stage and the elements that must be assumed to be true.

While drawing these lines is difficult, this is what we know from U.S. Supreme Court decisions:

Issue	**Case**	**Defendants Can Challenge at Class Certification?**
Efficient Market	*Halliburton I*[9]	Yes
Loss Causation	*Halliburton I*	No
Materiality	*Amgen*[10]	No
Price Impact	*Halliburton II*[11]	Yes
Correctiveness	*Halliburton III*	?

Based on these decisions, Halliburton argues that correctiveness is part of price impact and different from loss causation and materiality. Plaintiffs, on the other hand, argue that correctiveness is a merits issue much closer to loss causation and materiality.

There is, of course, a simple argument for not allowing defendants to challenge correctiveness at the class certification stage: A lack of correctiveness is an issue common to the entire class, such that a finding of no correctiveness would defeat the claims of the entire class. Therefore, the argument goes, correctiveness is a merits issue that cannot be addressed at class certification.

The problem for plaintiffs is that this argument is *too* simple. The same argument can be made for price impact, yet *Halliburton II* made it clear that defendants *can* challenge price impact. So it is not enough merely to ask whether the issue is common to the entire class. The challenge for the plaintiffs in the pending appeal is to persuade the Fifth Circuit that the inquiry permitted by *Halliburton II* should be quite narrow: assuming the alleged corrective disclosure was in fact corrective, did it impact the stock price?

II. THE DISTRICT COURT'S OPINION APPLYING *HALLIBURTON II*

After the Supreme Court decided *Halliburton II* and the case was remanded to the district court, District Court Judge Lynn ordered the Fund and Halliburton to provide additional

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[9] Erica P. John Fund v. Halliburton Co., 131 S. Ct. 2179 (2011) [*Halliburton I*].

[10] 133 S. Ct. 1184 (2013) [*Amgen*].

[11] 134 S. Ct. 2398 (2014).

briefing on price impact as it relates to class certification. Each side filed an expert report, additional briefing, and a *Daubert* motion to exclude the other side's expert (naturally). After holding an evidentiary hearing and considering the conflicting expert testimony, Judge Lynn wrote a detailed opinion concluding that Halliburton proved a lack of price impact for all alleged misrepresentations and corrective disclosures except one, involving an announcement of an adverse jury verdict in an asbestos case. Therefore, the district court granted class certification, but only as to that single misrepresentation.[12]

The district court opinion contains the most detailed analysis yet of the issues that arise from litigating price impact at the class certification stage under *Halliburton II*, including the following:

How will expert event studies be used at the class certification stage? As expected, the events after remand suggest that dueling expert "event studies" will become the norm at the class certification stage after *Halliburton II*. Both sides submitted event studies, i.e., regression analyses, to show that Halliburton's stock price was, or was not, affected on days when an alleged misrepresentation or corrective disclosure reached the market.[13]

Halliburton's expert, Lucy Allen, found no price impact after any of the alleged misrepresentations or corrective disclosures, with the exception of one date (December 7, 2001), when her analysis indicated that the price reaction was caused by factors other than Halliburton's disclosure of an adverse asbestos verdict.[14]

The Fund's expert, Chad Coffman, found that there were six relevant dates to evaluate price impact, ending with the December 7, 2001 asbestos verdict announcement. Presuming that the Fund's allegations were true—that Halliburton made material misrepresentations or omissions, "with scienter, regarding its asbestos liability and its accounting on fixed-price contracts"—Coffman found that the market price changed significantly in response to each of these six events.[15]

What is the role of Daubert motions in the price impact battle? The experts who did the event studies, Allen and Coffman, disagreed on methodology on several grounds. Both sides filed *Daubert* motions, arguing that the other side's expert's methodology was unreliable. The district court denied both *Daubert* motions, finding that the arguments about reliability of methods were "inextricably intertwined" with the merits arguments about price impact.[16]

Who has the burden of production and persuasion? While the Supreme Court in *Halliburton II* was clear that a defendant can defeat class certification by proving a lack of price impact, the Court did not address the burden of proof. Citing Federal Rule of Evidence 301, Halliburton argued that it is sufficient for the defendant to offer some evidence challenging price impact, in which case the presumption of reliance disappears and the plaintiff then has the burden of persuasion on price impact. The district court rejected this argument,

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[12] *EPJF II*, 309 F.R.D. 251, 256, 280 (N.D. Tex. 2015).

[13] *Id*. at 257.

[14] *Id*. at 263.

[15] *Id*. at 263.

[16] *Id*. at 256.

reasoning that in effect, this would require the plaintiff to prove price impact directly, a proposition the Supreme Court refused to adopt. The court held that the defendant has the burden of persuasion on the price impact issue.[17]

What is the proper control period for measuring price impact? An event study should take into account how the company's stock price moves relative to industry indices during a specified "control period." Halliburton's expert made adjustments to the Fund's expert's control period, which the district court found were appropriate to achieve internal consistency.[18]

What is the appropriate stock price index to use as a control? To determine whether a corrective disclosure had a price impact, an event study must use a control to adjust for general movement in the company's industry. Based on Halliburton's two main lines of business, Halliburton's expert used an S&P Energy Index and a Fortune Engineering & Construction Index as a control. The Fund's expert argued that these indices were not specific enough. He constructed a peer index composed of companies including Baker Hughes and Schlumberger that analysts considered to be Halliburton's peers. The district court found that the specific peer index better explained Halliburton's stock price movement and was the more appropriate control to use to measure the statistical significance of the price reaction on the six dates at issue.[19]

Is the use of a two-day window appropriate? On some of the dates at issue, the Fund's expert used a two-day window to measure price impact, citing widespread use of a two-day window in financial literature and in Halliburton's own expert's analysis. But the district court found that use of a two-day window was inappropriate in an efficient market.[20]

III. THE DISTRICT COURT'S VIEW OF CORRECTIVENESS UNDER *HALLIBURTON II*

All of the issues discussed above can be important, but perhaps the most significant issue raised by the district court's application of *Halliburton II* was whether the ***defendant can refute price impact by arguing that the alleged corrective disclosures were not in fact corrective***. Halliburton argued that a defendant can rebut the *Basic* presumption of reliance by showing that there was no correction that affected the market price, while the Fund argued that for the purpose of the price impact question the court assumes that the alleged corrective disclosure was in fact corrective of an earlier fraud.

Citing the Supreme Court's reasoning in *Halliburton I*[21] (loss causation), *Amgen*[22] (materiality), and *Halliburton II*[23] (price impact), the district court agreed with the Fund "that class certification is not the proper stage for the court to determine, as a matter of law, whether

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[17] *Id*. at 259–60.

[18] *Id*. at 264–65.

[19] *Id*. at 267–68.

[20] *Id*. at 268–69.

[21] 131 S. Ct. 2179 (2011).

[22] 133 S. Ct. 1184 (2013).

[23] 134 S. Ct. 2398 (2014).

the relevant disclosures were corrective." The district court also found that this argument was "a veiled attempt to assert the "truth on the market" defense, which pertains to materiality and is not at issue at the class certification stage."[24]

IV. THE FIFTH CIRCUIT'S INTERVENING OPINION IN *LUDLOW*

After the district court certified the class in *Halliburton*, the Fifth Circuit issued its opinion in *Ludlow v. BP P.L.C.*[25] *Ludlow* was a securities fraud class action against BP arising from the Deepwater Horizon blowout. The district court denied certification of a pre-spill class, but granted certification of a post-spill class. Both sides appealed, and the Fifth Circuit affirmed.[26]

With respect to the post-spill class, the *Ludlow* plaintiffs alleged that BP misrepresented the magnitude of the crisis, inflating the stock price, and that the stock price fell when certain "corrective events" revealed the truth.[27] To establish a damage model, the plaintiffs relied on an event study performed by an expert, Chad Coffman (the same expert used by the plaintiffs in *Halliburton*).[28]

The question in *Ludlow* was whether the plaintiffs put forward a proper class-wide damage theory as required by *Comcast Corp. v. Behrend.*[29] The district court judge expressed some concerns about the merits of the expert's damage theory, but he found it sufficient for plaintiffs to put forward a coherent class-wide *approach* to damages, regardless of the merits of the approach. BP argued that the district court erred by failing to determine whether the corrective events Coffman relied on were tied to the specific misrepresentations he says they were.[30] In other words, BP challenged the "correctiveness" of the alleged corrective events put forward by the plaintiffs' damage expert.

The Fifth Circuit disagreed with BP. The Fifth Circuit reasoned that BP's challenge to the connection between the alleged misrepresentations and the alleged corrective events raised issues similar to loss causation and materiality. Citing *Halliburton I* (loss causation) and *Amgen* (materiality), the Fifth Circuit held that the district court did not err by refusing to address whether it was proper for the damages expert to include certain corrective events in his damage model. "[W]hether certain corrective disclosures are linked to the alleged misrepresentations in question is undeniably common to the class," the court said, making it inappropriate to determine that issue at the class certification stage.[31]

V. THE OPINION GRANTING HALLIBURTON LEAVE TO APPEAL

After the district court issued its order granting class certification, Halliburton filed a motion for leave to appeal, raising the question of "whether a defendant in a federal securities

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[24] *EPFJ II*, 309 F.R.D. at 260–61.

[25] 800 F.3d 674 (5th Cir. 2015).

[26] *Id*. at 677.

[27] *Id*. at 680.

[28] *Id*. at 683–84.

[29] 133 S. Ct. 1426 (2013).

[30] *Ludlow*, 800 F.3d at 686.

[31] *Id*. at 687–88.

fraud class action may rebut the presumption of reliance at the class certification stage by producing evidence that a disclosure preceding a stock-price decline did not correct any alleged misrepresentation."[32] The Fifth Circuit Court of Appeals, Judges Jolly, Dennis, and Prado, granted leave to appeal.

Judge Dennis wrote an opinion "reluctantly" concurring in the decision to grant Halliburton leave to appeal. In his view, consideration of correctiveness at the class certification stage would be contrary to *Halliburton I*, *Amgen*, and *Ludlow*. "Thus, as I read *Halliburton II*," he wrote, "it did not render the corrective nature of a disclosure a class certification issue because, even though it bears on the issue of price impact, it does not affect the issue of predominance at the class certification stage." Nevertheless, Judge Dennis concurred in allowing the appeal because he thought it appropriate for the court to clarify *Halliburton II* for the benefit of the courts and future litigants.[33]

VI. KEY ISSUES IN THE BRIEFING AND ORAL ARGUMENT TO THE FIFTH CIRCUIT

The briefing and oral argument in Halliburton's latest appeal to the Fifth Circuit shows the difficulty of determining how "correctiveness" fits into the framework established by *Halliburton I*, *Amgen*, *Halliburton II*, and most recently, *Ludlow*. Halliburton argues that when the plaintiff's price impact theory is based on a price drop following a corrective disclosure, then correctiveness is inherently part of price impact under *Halliburton II*. The Fund, on the other hand, seeks to reconcile *Halliburton II* with *Halliburton I* and *Amgen* by arguing that correctiveness—like loss causation and materiality—is a class-wide merits issue that should not be resolved at the class certification stage. These arguments raise many difficult questions, including the following:

1. Is correctiveness evidence price-impact evidence?

Halliburton: "[I]f Halliburton's evidence concerning correctiveness is price-impact evidence, there can be no doubt the district court erred by refusing to consider it at the class-certification stage."[34] Price declines happen for numerous reasons. The fact that the stock price declines following the release of negative information proves nothing if the negative information did not actually *correct* an earlier misrepresentation.[35]

The Fund: *Halliburton II* allows consideration of evidence concerning price impact, but the price impact inquiry authorized by *Halliburton II* is quite narrow. The Supreme Court's concern was that parties were already routinely offering event studies to prove or disprove market efficiency at the class certification stage, and it made no sense to bar defendants from using the same event studies as direct evidence of the absence of price impact. The Court permitted defendants to show that a corrective disclosure had no price impact through an event

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[32] Erica P. John Fund, Inc. v. Halliburton Co., No. 15-90038, 2015 WL 10714013, at *1 (5th Cir. Nov. 4, 2015).

[33] *Id*. at *2–3.

[34] Brief of Halliburton Co. and David J. Lesar at 27, Erica P. John Fund, Inc. v. Halliburton Co., No. 15-11096 (5th Cir. Aug. 31, 2016) [*Halliburton's Brief*].

[35] *Id.* at 28.

study, because such a showing would rebut the presumption of class-wide reliance and show that individual issues of reliance predominate.[36] "Nowhere in *Halliburton II* does the Court indicate that Defendants may rebut the presumption of reliance by showing a disclosure was not corrective."[37]

2. Is correctiveness like loss causation, which cannot be considered at class certification under *Halliburton I*?

The Fund: "Halliburton's attempt to graft an analysis of whether a disclosure is corrective onto the price impact inquiry erroneously seeks to introduce loss causation at class certification in direct violation of *Halliburton I*." Halliburton is erroneously reading *Halliburton II* to eviscerate *Halliburton I*, when nothing in *Halliburton II* supports this interpretation.[38]

Halliburton: Even if the same evidence was relevant to loss causation in *Halliburton I*, Halliburton's correctiveness evidence must be considered because it goes directly to the price impact inquiry authorized by *Halliburton II*.[39]

3. Is correctiveness like materiality, which cannot be considered at class certification under *Amgen*?

The Fund: In *Amgen*, the Supreme Court held that materiality may not be considered at the class certification stage, because it is a merits issue common to the entire class. Correctiveness is similar to materiality in this respect.[40]

Halliburton: Materiality is a discrete issue that can be resolved in isolation from the other prerequisites of the *Basic* presumption and thus can be "wholly confined to the merits stage."[41]

4. Is correctiveness a "truth-on-the-market" defense in disguise?

The Fund: The *Amgen* court found that defendants may not rebut the *Basic* presumption by presenting a truth-on-the-market defense because such a defense is just a way of showing the misrepresentations were not material.[42] The district court correctly found that "Halliburton's arguments regarding whether the disclosures were corrective are, in effect, a veiled attempt to assert the 'truth on the market' defense, which pertains to materiality."[43]

Halliburton: "[W]hether a disclosure is corrective has nothing to do with whether the earlier misrepresentation was material." "A disclosure's correctiveness turns solely on its relationship to the prior misrepresentation." "A truth-on-the-market defense, by contrast, asserts that the truth entered the market before the misrepresentation, thus making it impossible

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[36] Brief of the Lead Plaintiff-Appellee and the certified class at 28–29, Erica P. John Fund, Inc. v. Halliburton Co., No. 15-11096 (5th Cir. Aug. 31, 2016) [*Fund's Brief*].

[37] *Id.* at 30.

[38] *Id.* at 32–33.

[39] *Halliburton's Brief*, *supra* note 34, at 31.

[40] *Fund's Brief*, *supra* note 36, at 33–34.

[41] *Halliburton's Brief*, *supra* note 34, at 37 (citing *Halliburton II*, 134 S. Ct. 2398, 2416 (2014)).

[42] *Fund's Brief*, *supra* note 36, at 34 (citing *Amgen*, 133 S. Ct. 1184, 1197–99 (2013)).

[43] *Id.* at 34–35 (citing *EPFJ II*, 309 F.R.D. 251, 260–61 (N.D. Tex. 2015)).

for the misrepresentation to materially mislead investors."[44] Halliburton's position is not that the market learned the truth before the alleged misrepresentations were made, but that the disclosure of the asbestos verdict did not correct any prior misrepresentation.[45]

5. Does *Ludlow* support the district court's refusal to consider correctiveness?

The Fund: The Fifth Circuit has already rejected Halliburton's correctiveness argument in *Ludlow*. *Ludlow* found that the plaintiffs' argument was "in tension with Halliburton I's holding that no proof of loss causation is required at the class certification stage." In addition, *Ludlow* reasoned that *Amgen* foreclosed the defendant's argument because "whether certain corrective disclosures are linked to the alleged misrepresentations in question is undeniably common to the class." The Fund's position is that the same reasoning applies to Halliburton's correctiveness argument.[46]

Halliburton: "*Ludlow* addressed only the consideration of damages at class certification and has nothing to say about price-impact rebuttal under the reliance element." The case before the Fifth Circuit, in contrast, deals exclusively with price-impact rebuttal.[47]

One problem with Halliburton's attempt to distinguish *Ludlow* is that, as the Fund pointed out in its brief, Judge Dennis already rejected Halliburton's narrow reading of *Ludlow* in his concurring opinion granting leave to appeal.[48] Although Judge Dennis is not on the panel assigned to hear Halliburton's appeal, the Fund argued that he was not alone in this view, citing some district court opinions that adopt a similar interpretation of *Halliburton II*.

6. Does barring the defendant from challenging correctiveness at the class certification stage lead to absurd results?

Halliburton: Refusing to consider whether an alleged corrective disclosure was actually corrective will lead to absurd results, because it allows plaintiffs to rely on a price drop following *any* release of negative information, even if the information has nothing to do with an earlier misrepresentation.[49]

The Fund: The results are not so absurd. Plaintiffs have to clear the initial hurdle of pleading loss causation, which includes pleading a plausible case for price impact and correctiveness. Plus, defendants get another opportunity to challenge correctiveness at the summary judgment stage.

VII. CONCLUSION

The oral argument in the Fifth Circuit on August 31, 2016 touched on all of these

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[44] *Halliburton's Brief*, *supra* note 34, at 38.

[45] *Id.* at 39.

[46] *Fund's Brief*, *supra* note 36, at 35–36.

[47] *Halliburton's Brief*, *supra* note 34, at 41–42.

[48] *Fund's Brief*, *supra* note 36, at 36.

[49] *Halliburton's Brief*, *supra* note 34, at 44.

questions. The panel of Judges Davis, Higginson, and Elrod grappled with where to draw the line between "merits" issues like loss causation and materiality, which defendants cannot challenge at class certification, and price impact, which defendants are now allowed to challenge under *Halliburton II*. Not surprisingly, the panel was interested in the parties' views on whether the Fifth Circuit's decision in *Ludlow* resolves the issue.

If the oral argument presented any surprise, it was the panel questioning the premise that the district court refused to consider Halliburton's correctiveness evidence. The arguments in both sides' briefs assumed that Judge Lynn refused to consider Halliburton's evidence that the disclosure of the asbestos verdict was not really a "corrective" disclosure. But the panel seemed not so sure. Judge Higginson questioned Halliburton's argument that Judge Lynn did not consider whether the asbestos disclosure was simply a revelation of new bad news. "But she did," he said, and pointed out that the judge broke down Halliburton's expert's argument and rejected it.[50] "I don't see that in fact she didn't address it."[51]

This was one question where the parties seemed to agree. Judge Lynn stated 13 times in her opinion that she did *not* consider Halliburton's correctiveness argument, Halliburton's counsel argued, and even the Fund did not take the position that Judge Lynn actually considered that argument.[52] While the Fund's counsel said that Judge Lynn heard all of Halliburton's evidence, he urged the court to reach the correctiveness issue regardless, for the sake of the clarity of the law.[53]

As this line of questioning shows, there are several options open to the Fifth Circuit. The Court of Appeals could sidestep Halliburton's legal argument and affirm on the ground that the district court *did* consider Halliburton's correctiveness evidence and rejected it, resolving the factual issue against Halliburton. On the other hand, the court could address the legal issue raised by Halliburton and affirm on the ground that correctiveness is not properly part of the price impact inquiry under *Halliburton II*.

What if the court decides that *Halliburton II* does authorize defendants to challenge correctiveness at the class certification stage? In that case, the court could either reverse and render judgment for Halliburton or reverse and remand. In oral argument, Judge Elrod specifically asked Halliburton's counsel whether the court should remand to the district court to consider whether the disclosure at issue was corrective.

Of course, whatever the Fifth Circuit does, it could potentially lead to a *third* appeal to the U.S. Supreme Court. The *Halliburton* litigation saga that began 14 years ago seems far from over, and its outcome will continue to shape the future of securities fraud class actions.

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[50] Oral argument at 8:11, http://www.ca5.uscourts.gov/OralArgRecordings/15/15-11096_8-31-2016.mp3 (last visited Dec. 30, 2016).

[51] *Id*. at 16:37.

[52] *Id*. at 8:30, 16:50.

[53] *Id*. at 34:40.