



To read the decision in *Erica P. John Fund, Inc. v. Halliburton Co.*, please [click here](#).

The Supreme Court Rejects Loss Causation Requirement at Class Certification Stage

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Yesterday, in *Erica P. John Fund, Inc. v. Halliburton Co.*, No. 09-1403, the Supreme Court unanimously held that private securities fraud plaintiffs do not need to prove loss causation in order to obtain class certification. The high court drew a firm line between two separate elements of a private securities fraud claim: (i) reliance on alleged misrepresentations or omissions, and (ii) loss causation. The Supreme Court noted that consensus exists that plaintiffs invoking the fraud on the market presumption of reliance must “prove” that alleged misrepresentations were publicly known, that the relevant security traded on an efficient market, and that the plaintiffs traded in the stock between the time the alleged misrepresentations were made and the time the truth was publicly revealed. For several years, the Fifth Circuit also required securities plaintiffs seeking to trigger the presumption to establish loss causation at the class certification stage. See *Oscar Private Equity Invs. v. Allegiance Telecom, Inc.*, 487 F.3d 261 (5th Cir. 2007). In contrast, the Second, Third, and Seventh Circuits have rejected a loss causation requirement in connection with class certification. See *In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474 (2d Cir. 2008); *In re DVI, Inc., Sec. Litig.*, No. 08-8033, 08-8045, 2011 WL 1125926 (3d Cir. Mar. 29, 2011); *Schleicher v. Wendt*, 618 F.3d 679 (7th Cir. 2010). *Halliburton* overturned the Fifth Circuit line of cases requiring loss causation, but its narrow rationale focused on what is not required, and did not provide guidance on several related issues including the standard for use of expert testimony submitted at the class certification stage in securities and other cases, and how and when the presumption of reliance may be rebutted. Nor did the court signal how it may resolve the broader class action issues set to be decided this term, most prominently the host of issues presented in *Wal-Mart Stores v. Dukes*, No. 10-277.

BACKGROUND

In 2002, plaintiffs brought suit against Halliburton and its Chief Operating Officer, alleging violations of sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5. The complaint alleged that the company made a series of material misrepresentations that inflated its stock price. The complaint then identified eight supposed corrective disclosures by the company, each of which was followed by a stock price decline.

In evaluating the plaintiffs’ motion for class certification, the district court assessed whether the plaintiffs were entitled to a class-wide presumption of reliance based on the “fraud-on-the-market” theory. The district court concluded that plaintiffs failed to establish any connection between the alleged misrepresentations, the alleged corrective disclosures, and the ensuing stock decline, and therefore were not entitled to a class-wide presumption of reliance.

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OPINION OF THE COURT

Applying a body of law developed by the Fifth Circuit, a panel of that Court affirmed, stating: "[W]e are satisfied that the district court here understood the need for the corrective disclosures to reveal the actionable truth about prior misstatements Plaintiff largely failed to identify disclosures that had a *corrective* effect linked to a specific misrepresentation, as opposed to simply a *negative* effect[.]" *Archdiocese of Milwaukee Supporting Fund, Inc., v. Halliburton Co.*, 597 F.3d 330, 338 (5th Cir. 2011).

SUMMARY OF THE DECISION

In a unanimous opinion written by Chief Justice Roberts, the Supreme Court reversed, holding that private securities fraud plaintiffs do not need to prove loss causation in order to obtain class certification.

The Court framed its analysis by reference to the standard for certifying a class asserting a private securities fraud claim under §10(b) and Rule 10b-5. The Court observed: "Whether common questions of law or fact predominate in a securities fraud action often turn on the element of reliance. . . . This is because proof of reliance ensures that there is a proper 'connection between a defendant's misrepresentation and a plaintiff's injury.'" To avoid placing an "unnecessarily unrealistic evidentiary burden" on plaintiffs, the Court explained that it established in *Basic Inc. v. Levinson* a rebuttable presumption of reliance based on the "fraud-on-the-market" theory, which is based on the hypothesis that the market price of a security traded on an efficient market reflects all publicly available information.

The Court then noted that plaintiffs "must prove certain things" to invoke *Basic's* rebuttable presumption of reliance. These include, for example, "that the alleged misrepresentations 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.'" The Court concluded that neither *Basic* nor "its logic" supported adding loss causation "as a precondition for invoking *Basic's* rebuttable presumption of reliance." This is because "[l]oss causation addresses a matter different from whether an investor relied on a misrepresentation, presumptively or otherwise, when buying or selling a stock." What reliance requires is "transaction causation"; the Court's analysis therefore turns "on facts surrounding the investor's decision to engage in the transaction." Plaintiffs may indeed have relied upon a misrepresentation when buying or selling a stock at a distorted price, regardless of whether they subsequently suffered a loss. Accordingly, the Court concluded: "Loss causation has no logical connection to the facts necessary to establish the efficient market predicate to the fraud-on-the-market theory."

The Court rejected Halliburton's argument that, rather than requiring loss causation *per se*, the Fifth Circuit's decision could be upheld by reading its use of "loss causation" as shorthand for the inability of plaintiffs to prove the alleged misrepresentation's "price impact," *i.e.*, showing that the issuer's stock price declined following allegedly corrective disclosures. Under Halliburton's price impact theory, "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." The Court concluded that it "simply cannot ignore the Court of Appeals' repeated and explicit references to 'loss causation.'" The Supreme Court therefore vacated the Court of Appeal's judgment and remanded the case for further proceedings consistent with its opinion without addressing the merits of Halliburton's "price impact" argument.

"Loss causation has no logical connection to the facts necessary to establish the efficient market predicate to the fraud-on-the-market theory."

OPINION OF THE COURT

IMPLICATIONS

In *Halliburton*, the Supreme Court abrogated the line of Fifth Circuit case law holding that private securities fraud plaintiffs need to prove loss causation in order to obtain class certification. Because only the Fifth Circuit had imposed such a loss causation requirement, the Court's decision will have only limited practical effect. The Court also limited its holding to the determination that plaintiffs seeking class certification do not need to show that the alleged misrepresentation caused their subsequent economic loss, and did not amplify its existing teachings on the underpinnings and contours of the fraud-on-the-market presumption. In *Basic*, the Supreme Court stated that the presumption of classwide reliance may be rebutted by "[a]ny showing that severs the link between the alleged misrepresentation and . . . the price received (or paid) by the plaintiff." Among other things, potentially left open for the Court of Appeals on remand is whether plaintiffs are entitled to the fraud-on-the-market presumption even though they cannot demonstrate any effect by alleged misstatements on Halliburton's stock price.

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