Erica P. John Fund, Inc. v. Halliburton Co.: Supreme Court Eliminates Fifth Circuit Hurdle to Securities Fraud Class Action Certification

On June 6, 2011, the Supreme Court unanimously held that federal private securities fraud plaintiffs need not prove loss causation at the class action certification stage.[1] In rejecting the Fifth Circuit Court of Appeals requirement that loss causation be shown as a prerequisite to class certification, the Court resolved a split among the circuits while at the same time reaffirming that loss causation ultimately must be proved to prevail on the merits.

I. Facts and Procedural History

The Erica P. John Fund is the lead plaintiff in a putative securities fraud class action against Halliburton.[2] The Fund alleged that Halliburton made misrepresentations designed to inflate its stock price in violation of § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5.[3] After surviving a motion to dismiss, the Fund moved for class certification.[4]

Fifth Circuit precedent required proof of loss causation before a class could be certified under Federal Rule of Civil Procedure 23(b)(3) in a private securities fraud action.[5] The Fifth Circuit was the only circuit to require loss causation to be established at the class certification stage; the Second, Third, and Seventh circuits do not require that showing.[6]

The district court, applying Fifth Circuit precedent, rejected the plaintiff's certification request because loss causation had not been demonstrated.[7] In doing so, the district court stated that "absent this stringent loss causation requirement, it would have granted the [plaintiff's] certification request."[8] The Court of Appeals for the Fifth Circuit affirmed the district court's ruling.[9]

II. The Supreme Court's Decision

In reversing the Fifth Circuit's decision, the Supreme Court focused solely on whether the plaintiff had met the prerequisites for class certification under Rule 23(b)(3).[10] Of importance to the Court was whether

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1 *Erica P. John Fund, Inc. v. Halliburton Co.*, No. 09-1403, slip op. at *1, 563 U.S. ____ (June 6, 2011).

2 *Id*. at *1.

3 *Id.* at *1-2.

4 *Id.* at *2.

5 *Id.* (citing *Oscar Private Equity Invs. v. Allegiance Telecom, Inc.* 487 F.3d 261, 269 (5th Cir. 2009)).

6 *Id.* at *3 (citing *In re Salomon Analyst Metromedia Litigation*, 544 F.3d 474, 483 (2d Cir. 2008); *In re DVI, Inc. Securities Litigation*, 2011 WL 1125926, *7 (3d Cir. 2011); *Schleicher v. Wendt*, 618 F.3d 679, 687 (7th Cir. 2010)).

7 *Id.* at *2.

8 *Id.* at *3 (Internal quotation marks omitted).

9 *Id.*

10 FED. R. CIV. P. 23(b)(3). In pertinent part: "A class action may be maintained if Rule 23(a) is satisfied and if: (3) the court finds that the questions of law or fact common to class members predominate over any questions affecting only

common "questions of law and fact predominate." In a securities fraud case, under § 10(b) and Rule 10b-5, reliance is one of the essential elements.[11] The Court found that "[w]hether common questions of law or fact predominate in a securities fraud action often turns on the element of reliance."[12]

The Court then discussed its ruling in *Basic Inc. v. Levinson*,[13] which provides guidelines for showing reliance in a § 10(b) cause of action. *Basic* recognized that proof of actual reliance would normally require individual inquiries, which would overwhelm common issues and therefore make certification impossible given Rule 23(b)(3)'s predominance requirement.[14] *Basic* allows these individual inquiries to be avoided at the class certification stage by presuming reliance upon a showing that the market in the securities at issue is "efficient" because "the market price of shares traded on a well-developed market reflects all publicly available information, and . . . any material misrepresentations."[15] The rebuttable "fraud-on-the-market" presumption under *Basic* allows plaintiffs to proceed as a class, as misstatements are presumed to be incorporated into the share price, so that common issues can be resolved before any remaining individualized questions as to reliance are addressed.[16]

The *Halliburton* Court found the Fifth Circuit's requirement that loss causation be proved in order to invoke the "fraud-on-the-market" presumption of reliance "is not justified by *Basic* or its logic."[17] The Court explained that the term "loss causation" was not used in the *Basic* opinion and was never a precondition for class certification.[18] Furthermore, the Court explained that loss causation and reliance (*i.e.*, "transaction causation") are distinct concepts that serve different purposes in the law.[19]

The Court rejected Halliburton's argument that the Fifth Circuit had not actually required "loss causation" but had instead required a showing that the price at the time of purchase was distorted by misstatements.[20] The Court instead took the Fifth Circuit at its word that it had meant to require a showing of "loss causation."[21] In deciding that loss causation need not be proved as a precondition to class certification, the Court was clear in reaffirming the requirement that "loss causation" must be shown to prevail on the merits. [22]

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individual members..."

11 *Id.* at *4.

12 *Id.*

13 485 U.S. 224 (1988).

14 *Id.* at *5.

15 *Id.* (citing *Basic*, 485 U.S. at 246).

16 *Id.*

17 *Id.* at *6.

18 *Id.*

19 *Id.* at *7-8.

20 *Id.* at *9.

21 *Id.*

22 *Id.* at *1, *7 ("[T]he fact that a stock's price on the date of purchase was inflated because of a misrepresentation does not necessarily mean that the misstatement is the cause of a later decline in value.") (internal quotations omitted) (citing *Dura Pharmaceuticals*, 544 U.S. at 342). *See also Schleicher*, 618 F.3d at 685 ("It is possible to certify a class under Rule 23(b)(3) even though all statements turn out to have only trivial effects on stock prices.").

III. Significance of the Decision

The main significance of this ruling is that it eliminates one hurdle to class action certification in private securities fraud class actions in the Fifth Circuit. The existing law in other circuits is unchanged.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Jon Mark at 212.701.3100 or jmark@cahill.com; John Schuster at 212.701.3323 or jschuster@cahill.com; or Jason Hall at 212.701.3154 or jhall@cahill.com.