

## U.S. Supreme Court Rules That A Securities Fraud Class Action Can Be Certified Without Pre-Certification Proof Of Loss Causation

On June 6, 2011, a unanimous Supreme Court decided in *Erica P. John Fund, Inc. v. Halliburton Co.* that a class action plaintiff need not prove, for purposes of establishing that issues common to all class members predominate over individual issues, loss causation at the class certification stage of a securities fraud action.<sup>1</sup> In doing so, the Court reversed the Fifth Circuit's stricter standard for obtaining class certification in a securities fraud case, originally set forth in *Oscar Private Equity Investments v. Allegiance Telecom, Inc.*, which held that establishing loss causation was a prerequisite for establishing commonality of issues and thus for certifying a class.<sup>2</sup>

### I. Background

To obtain certification of any federal class action, the putative lead plaintiff must show that, among other things, "the questions of law or fact common to class members predominate over any questions affecting only individual members."<sup>3</sup> To determine whether this requirement is met, courts normally look to the elements of the claim that is asserted. A securities fraud claim under Section 10(b) of the Securities Exchange Act of 1934 requires, among other elements, proof of a material misrepresentation or omission by the defendant, reliance by the plaintiff upon that misrepresentation or omission and loss causation, meaning that the loss alleged was caused by the misrepresentation or omission at issue.<sup>4</sup> The Supreme Court previously ruled in *Basic Inc. v. Levinson* that a lead plaintiff may establish a rebuttable presumption of reliance for the entire class if the lead plaintiff can show that the

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<sup>1</sup> *Erica P. John Fund, Inc. v. Halliburton Co.*, No. 09-1403, 563 U.S. \_\_\_ (2011) (available at <http://www.supremecourt.gov/opinions/10pdf/09-1403.pdf>).

<sup>2</sup> *Oscar Private Equity Invs. v. Allegiance Telecom, Inc.*, 487 F.3d 261, 269 (5th Cir. 2007).

<sup>3</sup> Fed. R. Civ. P. 23(b)(3). The lead plaintiff also must establish the numerosity of the proposed class, the existence of common questions of fact or law with respect to the class, that the claims or defenses of the lead plaintiff are typical of those of the class, and that the lead plaintiff will fairly and adequately represent the interests of the class. See Fed. R. Civ. P. 23(a).

<sup>4</sup> See *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336, 342 (2005). The other elements are scienter, a connection between the misrepresentation or omission and the purchase or sale of a security and economic loss. *Id.*

security at issue traded in an efficient market.<sup>5</sup> In *Oscar*, the Fifth Circuit held that to invoke the *Basic* theory of reliance and establish the predominance of issues common to the entire class, as required by Rule 23(b)(3), a lead plaintiff must also prove loss causation.<sup>6</sup> Other Courts of Appeals had disagreed with *Oscar*, ruling that a putative lead plaintiff in a securities fraud class action need only establish that loss causation could be proven on a class-wide basis in order to obtain class certification.<sup>7</sup>

## II. The *Halliburton* Case

The *Halliburton* litigation began when the Erica P. John fund, then known as the Archdiocese of Milwaukee Supporting Fund, Inc., filed a securities fraud class action against Halliburton Company in the Northern District of Texas, alleging violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and SEC Rule 10(b)-5, and then moved for class certification pursuant to Rule 23 of the Federal Rules of Civil Procedure. Bound by the Fifth Circuit’s *Oscar* precedent, the District Court denied class certification because there was no showing that the alleged misstatements actually caused a decline in Halliburton’s share price. Based upon its prior *Oscar* ruling, the Fifth Circuit affirmed.

## III. The Supreme Court’s Decision

The Supreme Court reversed the lower courts’ rulings, in a unanimous opinion written by Chief Justice Roberts, holding that, for purposes of establishing predominance, a putative securities class action lead plaintiff need not show loss causation in order to trigger the *Basic* presumption of reliance, leaving intact the obligation to establish, at the class certification stage, that loss causation was provable on a class-wide basis. The Court reasoned that the Fifth Circuit’s ruling was “not justified by *Basic* or its logic,” stating that the *Basic* reliance inquiry focuses on “facts surrounding the investor’s decision to engage in the transaction,” whereas the loss causation requirement focuses on whether a misrepresentation “also caused a subsequent economic loss.”<sup>8</sup> The Court noted that a plaintiff could, for example, purchase stock at an inflated price and therefore be presumed to have relied on a misrepresentation, but could also ultimately be unable to show that the misstatement caused a subsequent decline in the stock’s value. It therefore rejected the Fifth Circuit’s conclusion that reliance and loss causation are interrelated, stating that “[t]he fact that a subsequent loss may have been caused by factors other than the revelation of a

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<sup>5</sup> See *Basic, Inc. v. Levinson*, 485 U.S. 224, 243 (1988).

<sup>6</sup> See *Oscar*, 487 F.3d at 269.

<sup>7</sup> See, e.g., *Schleicher v. Wendt*, 618 F.3d 679, 687 (7th Cir. 2010); *In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474, 483 (2d Cir. 2008).

<sup>8</sup> *Erica P. John Fund*, Slip. Op. at 6-7 (emphasis in original).

misrepresentation has nothing to do with whether an investor relied on the misrepresentation in the first place . . . . Loss causation has no logical connection to the facts necessary to establish the efficient market predicate to the fraud-on-the-market theory.”<sup>9</sup>

Nonetheless, the Court left open the question whether a loss causation inquiry may be appropriate at the class certification stage if a defendant can rebut the *Basic* presumption of reliance. Loss causation also remains relevant at the class certification stage to, for example, demonstrate that the lead plaintiff’s claims are not typical of those of the entire class. Moreover, the Court left open the question whether there is a requirement that plaintiffs demonstrate price impact in order to show reliance at the class certification stage. Indeed, the Court implicitly suggested that if a misrepresentation does not impact the price of the stock, investors may be unable to invoke the *Basic* presumption of reliance.<sup>10</sup>

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<sup>9</sup> *Id.* at 7-8.

<sup>10</sup> *See id.* at 5, 7-9.

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