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The Supreme Court to Revisit the "Fraud-on-the-Market" Theory in *Halliburton*

By Susan E. Hurd

In a move that may surprise some, the United States Supreme Court has agreed to hear yet another appeal from the securities class action pending against the Halliburton Company ("Halliburton").[1] In 2011, the Supreme Court issued a narrow decision in the first *Halliburton* appeal, rejecting the Fifth Circuit's rule that loss causation—a mandatory element of a claim brought pursuant to Section 10(b) of the Securities Exchange Act of 1934—must be proven at class certification.[2] In that earlier decision, the Supreme Court vacated the lower court's denial of class certification and remanded the case for further proceedings.[3] The Court noted, however, that "[t]o the extent Halliburton has preserved any further arguments against class certification, they may be addressed . . . by the Court of Appeals on remand."[4]

The District Court's Opinion on Remand. After the Supreme Court issued its ruling, the *Halliburton* case returned to the district court, which this time granted class certification.[5] Critical to this ruling was the court's belief that plaintiff could invoke a presumption of reliance, which is sometimes available to investors under the "fraud-on-the-market" theory and was first recognized by the Supreme Court in *Basic Inc. v. Levinson*.[6] Under the fraud-on-the-market theory, the price of a company's stock that trades in an efficient market reflects all material, publicly available information about that company and, thus, when investors buy the stock at the market price, they are presumed to have relied on the public representations subsumed within that price.[7] Defendants are, however, entitled to rebut this presumption through "[a]ny showing that severs the link between the alleged misrepresentation and either the price received

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1 *Halliburton Co. v. Erica P. John Fund*, No. 13-317, 2013 WL 4858670, at *1 (Nov. 15, 2013).

2 *Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179, 2186 (2011) ("*Halliburton I*").

3 *Id.* at 2187.

4 *Id.*

5 *Erica P. John Fund, Inc. v. Halliburton Co.*, 718 F.3d 423, 427 (5th Cir. 2013).

6 485 U.S. 224 (1988).

7 *Halliburton,* 718 F.3d at 429.

(or paid) by the plaintiff . . . ."[8] Without the ability to invoke a class-wide presumption of reliance, class certification under Fed. R. Civ. P. 23(b)(3) would be impossible for Section 10(b) claims because individualized reliance issues would necessarily predominate over issues common to all class members.[9]

In addition to ruling that the presumption of reliance applied in *Halliburton*, the district court on remand also held that Halliburton could not use evidence demonstrating that the price of its stock failed to react to any of the alleged misstatements in an attempt to rebut the presumption of reliance at class certification.[10] The district court determined that evidence showing the alleged misstatements failed to have any impact on the trading price of the stock had no bearing on the inquiry into whether common issues predominated under Rule 23(b)(3).[11] Because the court viewed all of the other Rule 23 prerequisites as having been satisfied, it concluded that the class of Halliburton investors should be certified.[12]

The Fifth Circuit Revisits the Case. Pursuant to Rule 23(f), the Fifth Circuit affirmed in all respects the second certification ruling from the district court.[13] The Fifth Circuit believed that the Supreme Court's recent decision in *Amgen Inc. v. Conn. Ret. Plans & Trust Funds*[14] from earlier this year provided the "analytical framework" for deciding whether certification was properly granted by the district court.[15]

By way of background, the Supreme Court in *Amgen* ruled that plaintiffs do not have to prove another element of a Section 10(b) claim—the materiality of the alleged misstatements—to invoke *Basic*'s presumption of reliance at class certification.[16] The Supreme Court's analysis in *Amgen* turned on what it considered to be two crucial questions: "(1) whether the question of materiality was an objective inquiry that could 'be proved through evidence common to the class;' and (2) whether there was a risk that a failure of proof on the question of materiality would 'result in individual questions predominating.'"[17] In *Amgen*, the Supreme Court concluded that materiality is established through evidence common to all class members and, thus, the failure to prove materiality would mean that the entire class cannot recover, not that individualized issues regarding materiality would predominate. Thus, as to materiality, "the class is entirely cohesive: it will prevail or fail in unison" and "[i]n no event will the individual circumstances of particular class members bear on that inquiry."[18]

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8 *Basic*, 485 U.S. at 248.

9 *Halliburton*, 718 F.3d at 429.

10 *Id.* at 427.

11 *Id.*

12 *Id.*

13 *Id.* at 426.

14 133 S. Ct. 1184 (2013).

15 *Halliburton*, 718 F.3d at 433.

16 *Amgen*, 133 S. Ct. at 1191.

17 *Halliburton*, 718 F.3d at 431 (quoting *Amgen*, 133 S. Ct. at 1195-96).

18 *Amgen*, 133 S. Ct. at 1191.

Importantly, the Supreme Court also made clear in *Amgen* that certain prerequisites for invoking the presumption of reliance must be established at class certification, such as whether the alleged misstatements were publicly disseminated, the stock purchases were made before the truth became known, and the market for the stock at issue was efficient.[19] In contrast to materiality, the Court explained that the failure to establish these other requirements for invoking the presumption of reliance would mean the loss of the class-wide presumption, but would not necessarily mean all class members would be denied recovery. Under those circumstances, individual class members could still have a claim through proof of direct, as opposed to presumed, reliance on the alleged misstatements.[20]

The Fifth Circuit Applies the Test Articulated in *Amgen*. The Fifth Circuit began its analysis in the second *Halliburton* decision with the observation that the price impact evidence on which Halliburton sought to rely in opposing class certification "does not fit neatly into any one fraud issue, but is probative of materiality, statement publicity, and market efficiency, all of which are relevant in establishing the presumption of . . . reliance."[21] The Fifth Circuit explained that, under *Amgen*, "price impact evidence relat[ed] to market efficiency or statement publicity could be considered" at class certification, but that the same evidence related to materiality could not.[22] Thus, to resolve the appeal, the Fifth Circuit held that it would have to "determine at what issue Halliburton's price impact evidence [wa]s directed."[23]

According to the court, "Halliburton contends that its price impact evidence is not intended to rebut materiality, market efficiency, or statement publicity" but rather "is intended only to generally rebut the fraud-on-the-market presumption of reliance without necessarily attacking one of the presumption's individual elements."[24] In other words, the Fifth Circuit interpreted Halliburton's argument as follows: even if all the prerequisites for invoking the fraud-on-the-market presumption were satisfied, a defendant should nevertheless be allowed to rebut the presumption at class certification with proof that the alleged misstatements had no effect on and were not incorporated into the company's stock price.[25]

It is important to note that Halliburton really had no choice but to pursue this line of argument, given that *Amgen* precluded a direct attack on materiality and the company arguably had already conceded before the district court both that the alleged misstatements were public and that Halliburton's stock traded in an efficient market. Nevertheless, Halliburton's view that defendants should be allowed to attack the presumption of reliance in general after it has been successfully invoked at class certification finds direct support in the text of *Basic*. *Basic* was also a class certification decision and *Basic* makes clear that the presumption of reliance is based entirely on the notion that the alleged misstatements had some effect on the trading price of the stock at issue. Indeed, the Fifth Circuit, quoting *Basic*, stated its agreement with Halliburton's view that, without evidence of price impact, "'the basis for finding that fraud has been transmitted through market price would be gone.'"[26]

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19 *Id*.

20 *Id*. at 1198-99.

21 *Halliburton*, 718 F.3d at 432.

22 *Id.*

23 *Id.*

24 *Id.*

25 *Id.* at 433.

26 *Id*. (citing *Basic*, 485 U.S. at 248).

Applying the first prong of the *Amgen* test, the Fifth Circuit considered whether "price impact evidence is common to the class."[27] The court concluded that it was, noting that price impact is "simply a measure of the effect of a misrepresentation on a security's price" and "undoubtedly an objective inquiry."[28] Thus, the Court of Appeals held that the first *Amgen* consideration suggests that price impact evidence could not be considered on rebuttal at class certification.[29] The Fifth Circuit then considered the second inquiry suggested by *Amgen*—whether there is any risk that a later failure of proof on price impact will result in individual questions predominating.[30] The Court of Appeals held that applying this factor meant that it "must determine whether the failure to prove price impact will necessarily cause all plaintiffs' claims to fall together."[31]

Halliburton had argued on appeal that a failure by plaintiffs to prove price impact would not cause all claims to fail because, unlike materiality, price impact is not a required element of a Section 10(b) claim. Accordingly, a failure to prove price impact at class certification would mean that plaintiffs "would only lose the class-wide presumption of reliance, leaving individual plaintiffs with viable fraud claims."[32] Even though this argument is well-grounded in the methodology employed in *Amgen*, the Fifth Circuit rejected the argument and chose instead to rely on the very issue on which it had been reversed previously by the Supreme Court—the separate requirement of proof of loss causation.[33]

The Fifth Circuit agreed that price impact was not an element of a Section 10(b), but noted that "a plaintiff must nevertheless prevail on this fact in order to establish . . . loss causation."[34] The Fifth Circuit reasoned that, to show the absence of any price impact, Halliburton would have to demonstrate "both that the stock price did not increase when the misrepresentation was announced, and that the price did not decrease when the truth was revealed."[35] The Fifth Circuit believed that, if Halliburton could prove that there was no price impact, then Halliburton would have essentially disproven loss causation because plaintiff would not be able to show a stock price decline when the supposed "truth" was revealed. Thus, "if Halliburton were to successfully rebut the fraud-on-the-market presumption by proving no price impact, the claims of all individual plaintiffs would fail because they could not establish [loss causation, which is] an essential element of the fraud action."[36] Based on this logic, the Fifth Circuit reasoned that the second *Amgen* consideration leads to the conclusion that rebuttal evidence regarding price impact cannot be addressed at class certification.[37]

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27 *Id.*

28 *Id.*

29 *Id.*

30 *Id.* at 433-34.

31 *Id.* at 434.

32 *Id.*

33 The Fifth Circuit's decision to inject loss causation issues into this debate is surprising, given that, in the first *Halliburton* appeal, the Supreme Court specifically observed 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." *Halliburton I*, 131 S. Ct. at 2187.

34 *Halliburton*, 718 F.3d at 434.

35 *Id.*

36 *Id.*

37 *Id.* at 434-35.

The Parties' Positions Before the Supreme Court. Halliburton's petition for a writ of certiorari specifically requests that the Supreme Court overrule or substantially modify its holding in *Basic* to the extent that it recognizes a class-wide presumption of reliance derived from the fraud-on-the-market theory. Indeed, Halliburton has made many of the same arguments offered in *Amgen* regarding how the efficient market theory on which the presumption of reliance is based has been subject to extensive scholarly and empirical attack.

It is important to bear in mind that four Justices filed separate opinions in *Amgen*, all of which seemed to invite some level of reconsideration of *Basic*'s presumption of reliance. Halliburton argued in its certiorari submissions that, unlike *Amgen*, the second appeal in *Halliburton* provides the perfect vehicle to revisit the wisdom of *Basic*. If the Court is not willing to overrule *Basic*, Halliburton has asked the Court to modify the presumption of reliance such that the presumption will not apply unless and until a plaintiff can show through affirmative proof that the market price was in fact distorted by the particular misrepresentations at issue.

Not surprisingly, much of the parties' certiorari briefing focused on the issue of whether Halliburton had adequately preserved the arguments it now seeks to assert on appeal. The Fifth Circuit had previously rejected the notion that Halliburton was precluded from arguing in the second appeal that price impact evidence was relevant to establishing a presumption of reliance when it had previously argued this evidence related to the separate element of loss causation. [38] Plaintiff repeated this same attack in its certiorari papers and also argued that Halliburton should be estopped from suggesting that *Basic* should be overturned or modified because the company had never previously attacked that decision.

Whether any of these waiver arguments will find traction before the Supreme Court remains to be seen. It seems unlikely, however, that the Supreme Court would have granted certiorari for a second time in this case if the bulk of the arguments raised on appeal had not been adequately preserved. Moreover, it makes perfect sense that Halliburton did not argue before the lower courts that *Basic* should be overturned when those courts simply do not have the power to grant that type of relief.

The other item worth noting in the certiorari papers is Halliburton's reliance on other recent class certification decisions from the Supreme Court, all of which make clear the rigorous nature of the inquiry into predominance required at class certification.[39] Halliburton correctly pointed out the inherent tension between allowing a presumption of reliance in securities cases for purposes of satisfying the predominance requirement and the Supreme Court's recent certification decisions in other contexts that have emphasized the need for actual proof of predominance before certification may be granted. Halliburton has argued that it is simply impossible to reconcile the holding in *Basic*, which eases plaintiffs' burden by essentially allowing certification based on a presumption of predominance, and the Supreme Court's more recent pronouncements that make clear that actual proof of predominance is required.

What the Second *Halliburton* Decision Might Mean. The Supreme Court certainly has the opportunity in *Halliburton* to provide guidance on the type of evidence that may be used by defendants to rebut the presumption of reliance at class certification. The Supreme Court had, however, the same opportunity to comment on these issues in the prior *Halliburton* appeal, but instead chose to resolve that appeal on narrow grounds without reaching the issue.

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[38] *Id.* at 435-36. The Fifth Circuit refused to penalize Halliburton for its prior reliance on loss causation when the issues were first briefed because the case law that existed at that time required the company to focus on loss causation. *See id*. at 436 ("[W]e decline to penalize Halliburton for framing its evidence in the manner we [previously] instructed."). Moreover, under the Fifth Circuit authority in existence at the time of the first appeal, "evidence directed at loss causation was by definition directed at fraud-on-the-market reliance." *Id.*

[39] *See, e.g., Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541 (2011); *Comcast Corp. v. Behrend*, 133 S. Ct. 1426 (2013).

Handicapping the potential outcome of the new appeal is made all the more difficult because the Supreme Court continues to accept appeals from securities cases where, like here, the defendants failed to mount a direct challenge to market efficiency. The Supreme Court has stated unequivocally that a securities plaintiff must prove market efficiency at class certification and, thus, any evidence offered by a defendant for the purpose of challenging the existence of an efficient trading market would find support in several prior Supreme Court decisions, *Amgen* included. One can argue that a case in which market efficiency is directly challenged would present a better opportunity for the Court to revisit *Basic* than a case like *Amgen* or *Halliburton* where market efficiency was conceded. This is so because *Basic*'s presumption of reliance is premised entirely on the notion that the stock at issue traded in an efficient market during the class period.

Even if the Court is not yet prepared to overturn *Basic*, the Fifth Circuit's opinion is vulnerable on appeal if for no other reason than it appears the Circuit Court again conflated at class certification the requirement of proof of reliance on alleged misstatements with the separate requirement of proof of loss causation. In the first *Halliburton* appeal, the Supreme Court rejected the Fifth Circuit's view that proof of loss causation was required to show that common reliance issues would predominate. Now in the second *Halliburton* appeal, the Fifth Circuit has again determined that the inquiry into whether individualized reliance issues will predominate is dependent upon whether loss causation can be shown.

The Fifth Circuit essentially viewed the inquiry into price impact for purposes of establishing a presumption of reliance at class certification as being the same thing as proof of loss causation on the merits. In *Halliburton I*, the Supreme Court went to great lengths to make clear that reliance and loss causation are distinct concepts and, thus, it remains to be seen how the Supreme Court will react to the Fifth Circuit's suggestion for a second time that these concepts are interchangeable.

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