Securities Litigation ADVISORY ■

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Halliburton on Remand – Defendants Defeat Certification for the Vast Majority of Plaintiff's Claims

By Susan E. Hurd

On July 25, 2015, the Honorable Barbara M. Lynn of the United States District Court for the Northern District of Texas entered the much anticipated ruling on class certification in *Erica P. John Fund, Inc. v. Halliburton Co.*[1] The District Court certified a class of investors in Halliburton stock under Rule 23(b) of the Federal Rules of Civil Procedure, but agreed to do so only as to one of the six alleged curative disclosures identified by the plaintiff.[2] This decision provides a clear road map for defendants seeking to challenge certification in securities fraud suits and proves, as many had predicted, that the road to certification has become more difficult and costly for plaintiffs in securities cases. Plaintiffs must now offer expert opinions on "price impact" whenever defendants choose to challenge certification with their own expert on pricing issues.

Background on Prior *Halliburton* Rulings from the Supreme Court.

The Supreme Court has twice been called upon to rule on whether a class should be certified in *Halliburton*. The first *Halliburton* decision from the Supreme Court in 2011 overturned Fifth Circuit precedent that required plaintiffs to prove "loss causation" – a mandatory requirement for Section 10(b) claims – to certify a class for alleged violations of Section 10(b) of the Securities Exchange Act of 1934 and Securities and Exchange Commission Rule 10b-5.[3] The Supreme Court vacated the District Court's opinion refusing to certify the class because it held that loss causation need not be proven at class certification.[4]

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1 Case No. 3:02-CV-1152-M, 2015 WL 4522863 (N.D. Tex. July 25, 2015).

2 *Id*. at *1.

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

4 *Halliburton I*, 131 S. Ct. at 2185-86. The "loss causation" requirement for Section 10(b) claims requires plaintiffs to prove a causal connection between the defendants' alleged misstatements and the plaintiffs' economic losses.

The most recent *Halliburton* decision from the Supreme Court was issued in 2014 and was generally hailed as a victory for defendants because the Court made clear that defendants were entitled to challenge and potentially defeat the predominance requirement for certification under Fed. R. Civ. P. 23(b)(3) through evidence that the alleged misstatements in the case had no impact on the trading price of the stock at issue.[5]

When asked to consider certification for a second time, the District Court chose to certify the class and refused to consider defendants' evidence that the alleged misstatements failed to have any impact on Halliburton's stock price. The Supreme Court disagreed and, in *Halliburton II*, held that defendants must be given the opportunity to submit evidence showing "that the asserted misrepresentation (or its correction) did not affect the market price."[6]

Plaintiffs' hopes of certification in putative securities fraud class actions rest entirely on their ability to invoke a rebuttable presumption of reliance that allows reliance on the alleged misstatements to be presumed on behalf of all class members. If the prerequisites for invoking the presumption are established by plaintiffs, they can avoid the individualized reliance issues that would otherwise predominate and necessarily defeat certification.

In *Halliburton II*, the Supreme Court made clear that evidence of no price impact from the alleged misstatements is sufficient to rebut the presumption of reliance because the required connection between the alleged misstatements and the supposedly inflated stock price is missing.[7] Thus, under *Halliburton II*, certification must be denied if a defendant successfully rebuts the presumption of reliance through evidence showing that the claimed misstatements had no effect on the price at which investors purchased their shares.[8] As a result of the ruling that the defendants' rebuttal evidence should have been considered, the Supreme Court in *Halliburton II* remanded the case to the District Court for further proceedings consistent with its opinion.[9]

The District Court's Ruling on Certification on Remand.

The District Court first considered on remand what it described as "two threshold legal issues" relevant to analyzing the "event studies"[10] submitted by the parties' experts: "(1) who has the burden of production

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5 *Halliburton, Co. v. Erica P. John Fund, Inc.*, 134 S. Ct. 2398, 2414-17 (2014) ("*Halliburton II*").

6 *Id.* at 2414.

7 *Id.* at 2414-17.

8 *Id.*

9 *Id.* at 2417.

10 "Event studies are used by academics to determine whether and how stock prices respond to new information, and they typically measure movement in a stock price after an event, adjusting for movement in the overall market and/or industry." *Halliburton*, 2015 WL 4522863, at *10.

and persuasion" and "(2) whether the Court should … rule as a matter of law that particular disclosures [by the defendants] are corrective."[11]

On the first issue, the District Court decided based on *Halliburton II* that "the burdens of production and persuasion to show lack of price impact are properly placed on [the defendant]."[12] The Court believed that placing these burdens on plaintiffs would mean that plaintiffs would have "to prove price impact directly at class certification[,]" a step that the Supreme Court rejected in *Halliburton II* because it would be a "radical" departure from existing practices.[13] Thus, under the District Court's allocation of burdens, Halliburton would prevail if it could "persuade the Court that its expert's event studies are more probative of price impact than the Fund's expert's event studies."[14]

The Court next addressed Halliburton's contention that the presumption could be rebutted in the case through evidence showing that the allegedly corrective disclosures cited by the plaintiff were not, in fact, corrective (i.e., that the risks at issue were previously disclosed to the market and, thus, the market was already aware of what was later disclosed). Halliburton argued that a defendant should be able to rebut the presumption "by showing there was no *correction* [of a prior falsehood] that [could have] affected the market price."[15] The District Court disagreed, "find[ing] that class certification is not the proper procedural stage for the Court to determine, as a matter of law, whether the relevant disclosures were corrective."[16]

Citing to the Supreme Court's opinion in *Amgen, Inc. v. Connecticut Retirement Plans and Trust Funds*,[17] the District Court described Halliburton's argument as "a veiled attempt to assert the 'truth on the market' defense, which pertains to materiality. . . ."[18] The Supreme Court had previously ruled in *Amgen* that a plaintiff need not prove the materiality of alleged misstatements for class certification.[19] Based on *Amgen* and *Halliburton II*, the District Court concluded that, at class certification, it was required to assume "that the asserted misrepresentations were, in fact, misrepresentations, and … the asserted corrective disclosures were corrective of the alleged misrepresentations."[20] Although a finding that a statement was not corrective

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11 *Id*. at *4.

12 *Id.*

13 *Id.* at *5.

14 *Id.* at *7.

15 *Id.* (emphasis in original).

16 *Id.*

17 133 S. Ct. 1184 (2013).

18 *Halliburton*, 2015 WL 4522863, at *7.

19 *Id.* at *8.

20 *Id.* at *9.

would, as a matter of law, sever the link between the price paid by investors and the alleged misstatement, the District Court nevertheless held that it was "unable to unravel such a finding from the materiality inquiry."[21]

The Court next framed the required price impact analysis as "typically focus[ed] on a price change at the time of a corrective disclosure."[22] In the District Court's view, "[i]f a particular disclosure causes the stock price to decline at the time of disclosure, then the misrepresentation must have made the price higher than it would have otherwise been without the misrepresentation."[23] The Court then addressed the event studies supplied by the two competing experts and determined whether they showed statistically significant stock price declines on the days with supposed corrective disclosures.[24]

After reviewing each day on which supposedly corrective disclosures were made, the Court concluded consistent with the defense expert that there were no statistically significant price reactions for any of the alleged curative disclosures except for the disclosures made on December 7, 2001.[25] According to the Court's analysis, the failure of the other curative disclosures to cause any price impact meant that Halliburton had rebutted the presumption of reliance as to the allegedly corrective disclosures made on those dates.[26]

Even though its expert conceded that there had been a significant stock price decline on December 7, 2001, Halliburton argued that this was not the end of the inquiry. According to Halliburton, "the question is whether there was price impact *from the alleged misrepresentation*, not simply whether the price dropped from the announcement."[27] According to Halliburton, the price reaction registered on December 7, 2001, could not be attributed to any alleged misstatements because the reaction was caused by factors other than the piece of news that plaintiffs asserted was corrective.[28] Although the Court found that "at least some of Halliburton's stock price decline on that date is likely attributable to [other non-fraud related factors] that also impacted other companies with asbestos exposure," it nevertheless found that "Halliburton has not demonstrated that [these other factors] caused the entirety of Halliburton's substantial price decline."[29] Thus, the Court concluded that Halliburton had not carried its burden of showing no price impact with respect to that particular curative disclosure.

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21 *Id.*

22 *Id.*

23 *Id.*

24 The Court explained that an event study is generally composed of two parts: "(1) a calculation of the market-adjusted price change in the issuer's share price at the time the corrective disclosure became public…; and (2) a determination of whether the corrective disclosure is among the news [about the company] that affected the price on the date the disclosure became public.…" *Id.*

25 *Id.* at *16 - *28.

26 *Id.*

27 *Id.* at *24 (emphasis in original).

28 *Id.* at *25.

29 *Id.* at *28.

Observations and Lessons Learned.

As predicted, class certification on remand in *Halliburton* became the classic battle of the experts. To assess the competing price impact evidence submitted by both sides, the Court examined in detail various aspects of each expert's methodology. For example, the Court specifically chose between the experts' conflicting views on what control period should be used for the event study, what market indices should be used to attempt to predict Halliburton's price movements and whether one- or two-day windows for price changes should be considered.[30]

An evidentiary hearing at which both experts testified was also held by the Court to explore the details of each expert's opinions and methodologies. Also predictably, both sides filed *Daubert* challenges seeking to exclude the testimony of the opposing party's expert, which the District Court denied. *Halliburton II* virtually insures that both sides will secure price impact experts whose opinions must be reviewed and analyzed by the Court before certification can be decided. The proceedings on remand in the wake of *Halliburton II* demonstrate that the path to certification is now more difficult and expensive for plaintiffs.

One other observation favorable to defendants can be gleaned from this most recent *Halliburton* opinion. Although, as noted above, the District Court repeatedly stressed that it was refusing to rule on whether any particular disclosure by Halliburton was, in fact, "corrective" of the alleged fraud, the Court nevertheless ruled that Halliburton had carried its burden of showing no price impact as to certain statements because the plaintiff "ha[d] not shown that Halliburton disclosed any information … that was not already impounded in the market price of the stock.…"[31] The District Court, thus, acknowledged that the prior disclosure of the same information that supposedly constitutes the corrective disclosure is directly relevant to showing no price reaction to that disclosure and, by extension, no price impact from the corresponding alleged misstatement.[32]

The Court emphasized that it was the prior disclosure of the corrective information combined with the fact that the supposedly corrective statement did not cause a statistically significant price reaction that it found most compelling.[33] The Court explained that, under the efficient market theory, it was "required to assume that the market had already absorbed [the previously disclosed] information by the time Halliburton made [the later] announcement[s]."[34] Defendants in securities cases can often show that the market already knew the information that plaintiffs claim led to a later stock price decline. In this respect, the recent opinion is very supportive of arguments that defendants are likely to raise in opposition to class certification. Indeed, on the whole, the decision is a "win" for defendants in securities cases who have every incentive to mount a serious challenge to certification and are now armed with more tools to do so.

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30 *Id.* at *12 - *16.

31 *Id.* at *20.

32 *Id.* at *28.

33 *Id.*

34 *Id.* at *22.

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