

No. 09-1403

IN THE
Supreme Court of the United States

ERICA P. JOHN FUND, INC.,
Petitioner,

v.

HALLIBURTON CO., ET AL.,
Respondents.

**On Writ Of Certiorari
To The United States Court Of Appeals
For The Fifth Circuit**

**BRIEF FOR
THE AMERICAN INSURANCE ASSOCIATION,
AXIS INSURANCE COMPANY,
CONTINENTAL CASUALTY COMPANY,
AND HCC GLOBAL FINANCIAL PRODUCTS
AS AMICI CURIAE SUPPORTING AFFIRMANCE**

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QUESTION ADDRESSED BY *AMICI CURIAE*

Whether a district court must resolve disputes regarding the applicability of the fraud-on-the-market presumption at the class-certification stage.

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INTEREST OF AMICI CURIAE*

The American Insurance Association (“AIA”) is the leading property-casualty insurance trade organization, representing approximately 300 insurers that write nearly \$100 billion in premiums each year for virtually all types of property-casualty insurance. On issues of importance to the insurance industry and marketplace, AIA advocates sound public policies in legislative, regulatory, and judicial forums at the state and federal levels. AIA members are often involved in class-action litigation, both as litigants and as insurers of litigants, and have a great interest in the correct development of the law concerning class certification. AIA has therefore participated as *amicus curiae* in several recent cases on related issues, including *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148 (2008), and

* Pursuant to this Court’s Rule 37.6, counsel for *amici* represents that no counsel for a party authored this brief in whole or in part, and that no person other than *amici* and their members made a monetary contribution intended to fund the preparation or submission of this brief. Pursuant to this Court’s Rule 37.3, counsel for *amici* represents that all parties have filed letters with the Clerk giving blanket consent to the filing of *amicus* briefs.

Shady Grove Orthopedic Associates, P.A. v. Allstate Insurance Co., 130 S. Ct. 1431 (2010).

Axis Insurance Company, and its affiliate Axis Reinsurance Company, are leading providers of specialty lines insurance in the United States. Axis has become a significant issuer of directors and officers liability insurance to public companies and is involved in numerous securities class actions throughout the United States. As such, Axis has a great interest in the correct development of the law concerning class certification in cases that implicate fiduciary duty liability.

Continental Casualty Company is one of the largest commercial and property and casualty insurers in the nation. Continental specializes in underwriting of business risks in a broad range of industries. Continental was a respondent in *Ortiz v. Fibreboard Corp.*, 527 U.S. 815 (1999), and has a continued interest in the correct development of the law concerning class certification.

HCC Global Financial Products is a wholly owned subsidiary of HCC Insurance Holdings Inc., one of the world's largest and most established specialty insurance groups, with offices in the United States, the United Kingdom, Spain, and Ireland. As a leading issuer of directors and officers liability insurance policies to public companies, HCC is involved in securities class actions across the United States. HCC therefore has a great interest in the correct development of the law concerning class-action litigation and the securities laws in the United States.

STATEMENT

This is a private securities-fraud case that raises significant and far-reaching issues under Federal Rule of Civil Procedure 23, which could affect *all* class actions in federal court.

The second question presented by petitioner is whether, in determining at the class-certification stage if plaintiffs had properly “invoke[d] the fraud-on-the-market presumption,” the lower courts “improperly considered the merits of the underlying litigation, in violation of both *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156 (1974), and Federal Rule of Civil Procedure 23.” Pet. Br. i. This question, involving the interplay between the findings required by Rule 23 and the “merits” of a lawsuit, receives scant discussion in petitioner’s brief (*see id.* at 46–51), somewhat more attention in the Solicitor General’s brief, and none at all in the other *amicus* briefs advocating reversal. Yet the Court’s answer to it could have a wide-ranging impact on future class actions, in both securities cases and others. This brief therefore focuses on that question.

Petitioner—an investor in Halliburton’s common stock—alleges that Halliburton made false statements about its business and that stockholders lost money when Halliburton subsequently corrected those statements. Petitioner sought certification of “a class of all persons and entities who purchased or acquired common stock of Halliburton during the class period.” Pet. Br. 14.

The district court rejected petitioner’s class-certification bid on the ground that petitioner could not establish entitlement to the “fraud on the market” presumption that this Court recognized in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), which enables

a securities plaintiff to establish the “reliance” element of its claim without proving individual investors’ actual reliance on the allegedly fraudulent statements. *Id.* at 242–50. In making this determination, the district court considered *all* of the evidence tendered by the parties—both petitioner’s argument in support of the presumption and Halliburton’s rebuttal arguments. *See* Pet. App. 11a–54a. The Fifth Circuit affirmed. *See id.* at 111a–136a.

SUMMARY OF ARGUMENT

The decision below, affirming the district court’s resolution of the applicability of the fraud-on-the-market presumption at the class-certification stage, is correct and fully in accord with this Court’s precedents.

I. A class action “may only be certified if the trial court is satisfied, after a *rigorous analysis*,” that the plaintiff can meet the certification requirements set forth in Rule 23. *Gen. Tel. Co. of the Sw. v. Falcon*, 457 U.S. 147, 161 (1982) (emphasis added). Plaintiffs seeking class certification must do more than simply allege that they have met the requirements of Rule 23; they must establish that those requirements have actually been met. As pertinent here, the district court must “find[] that the questions of law or fact common to class members *predominate* over any questions affecting only individual members.” Fed. R. Civ. P. 23(b)(3) (emphasis added). Courts must address these issues as part of the Rule 23 analysis even if there is some overlap with the merits of the case. *See Coopers & Lybrand v. Livesay*, 437 U.S. 463, 469 & n.12 (1978).

II. Reliance is an essential element of a securities fraud claim. *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 341–42 (2005). Where each individual member

of a proposed class seeking damages arising from an alleged securities fraud (or some other cause) must demonstrate reliance with individualized proof that they relied on the defendant's statements, class certification is not appropriate under Rule 23 because individual issues will "predominate" over common issues. Fed. R. Civ. P. 23(b)(3). Accordingly, the "fraud on the market" presumption is the key to class certification for securities plaintiffs. *See Basic Inc. v. Levinson*, 485 U.S. 224, 242–50 (1988).

Nothing about Section 10(b) or the fraud-on-the-market presumption alters the class-certification framework or the district court's mandate at the class-certification stage. The district court in a Section 10(b) case must determine if the fraud-on-the-market presumption is available at the class-certification stage. The procedure for resolving that "reliance" issue in a Section 10(b) case is no different than in any other case: As every court of appeals has held, the district court can consider "merits" evidence—including the plaintiff's evidence and the defendant's rebuttal evidence—to resolve that question. *See, e.g., In re IPO Sec. Litig.*, 471 F.3d 24, 41–43 (2d Cir. 2006).

As both petitioner and the United States acknowledge, the applicability of the fraud-on-the-market presumption is a necessary precondition to certification of a securities fraud claim, because in the absence of the presumption individualized questions of reliance will "predominate" over any common issues in the case. Pet. Br. 48 & n.15; U.S. Br. 11.

Petitioner and the United States insist, however, that the district court may not consider evidence rebutting the fraud-on-the-market presumption until the case proceeds to summary judgment or trial.

Pet. Br. 35; U.S. Br. 17–19. That is manifestly wrong. A district court must weigh *both* sides’ evidence and make factual findings on the Rule 23 factors *before* certifying a class. *See, e.g., Falcon*, 457 U.S. at 160–61; *In re Hydrogen Peroxide Antitrust Litig.*, 552 F.3d 305, 307, 320 (3d Cir. 2009) (amended opinion). In particular, a district court “must permit defendants to present their rebuttal arguments [regarding the fraud-on-the-market presumption] before certifying a class.” *In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474, 485 (2d Cir. 2008) (internal quotation marks omitted); *see also In re DVI, Inc. Sec. Litig.*, No. 08-8033 (3d Cir. Mar. 29, 2011), slip op. at 31–32. Because that is what the courts below did in this case, the judgment of the court of appeals should be affirmed.

ARGUMENT

Reliance is an essential element of a claim for securities fraud. *Matrixx Initiatives, Inc. v. Siracusano*, No. 09-1156 (U.S. Mar. 22, 2011), slip op. at 9 (citing *Stoneridge Inv. Partners, LLC v. ScientificAtlanta, Inc.*, 552 U.S. 148, 157 (2008)). Such a claim usually cannot proceed as a class action without the “fraud on the market” presumption of reliance, because in the absence of that presumption individualized issues of reliance will “predominate” over the common issues in the case. Fed. R. Civ. P. 23(b)(3); *Basic Inc. v. Levinson*, 485 U.S. 224, 242 (1988). Therefore, the plaintiff in such a case must establish its entitlement to the *Basic* presumption at the class-certification stage, and the district court must also resolve at that stage any challenges to the applicability of the presumption put forward by the defendant.

**I. DISTRICT COURTS MUST CONDUCT A
“RIGOROUS ANALYSIS” OF CLASS-
CERTIFICATION REQUIREMENTS**

1. Petitioner acknowledges that “[t]rial courts must make a rigorous determination of whether the [Rule] 23 prerequisites are satisfied.” Pet. Br. 48. The United States, likewise, recognizes that the class-certification procedure may “involve[] considerations that are enmeshed in the factual and legal issues comprising the plaintiff’s cause of action,” and “may require analysis of the elements of the plaintiff’s claims and the manner in which those elements would ordinarily be proved.” U.S. Br. 23 (alteration in original) (quoting *Gen. Tel. Co. of the Sw. v. Falcon*, 457 U.S. 147, 160 (1982)).

This point is not contested because this Court has clearly held that a class action “may only be certified if the trial court is satisfied, after a *rigorous analysis*, that the prerequisites of Rule 23(a) have been satisfied.” *Falcon*, 457 U.S. at 161 (emphasis added); see also *Coopers & Lybrand v. Livesay*, 437 U.S. 463, 469 (1978) (“the class determination generally involves considerations that are enmeshed in the factual and legal issues comprising the plaintiff’s cause of action”) (internal quotation marks omitted). “[A]ctual, not presumed, conformance with Rule 23(a) remains ... indispensable” (*Falcon*, 457 U.S. at 160), and courts must therefore take a “close look” at the evidence and legal arguments presented before certifying a class. *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 615 (1997). This includes the predominance requirement of Rule 23(b)(3), which this Court has described as a “vital prescription.” *Id.* at 623.

A plaintiff seeking certification of a class is thus required to do more than just *allege* the facts neces-

sary to satisfy Rule 23 or put forth “some evidence” that the Rule’s requirements have been met. *See In re IPO Sec. Litig.*, 471 F.3d 24, 33, 42 (2d Cir. 2006) (rejecting “some showing” burden of proof); *In re Hydrogen Peroxide Antitrust Litig.*, 552 F.3d 305, 316 (3d Cir. 2009) (amended opinion) (“the requirements set out in Rule 23 are not mere pleading rules”); *see also* 5 James Wm. Moore et al., Moore’s Federal Practice § 23.61 (3d ed. 2008) (“Pleading requirements are distinct from the requirements for certifying a case as a class action”). At class certification, “[t]ough questions must be faced and squarely decided, if necessary by holding evidentiary hearings and choosing between competing perspectives.” *West v. Prudential Sec., Inc.*, 282 F.3d 935, 938 (7th Cir. 2002). In other words, a plaintiff must *establish* that the Rule 23 requirements are “actual[ly]” satisfied. *Falcon*, 457 U.S. at 160.

The 2003 amendments to Rule 23 further clarified the scope of review required at the class-certification stage. The amendments removed from Rule 23(c)(1)(C) the provision that class certification “may be conditional,” because “[a] court that is not satisfied that the requirements of Rule 23 have been met should refuse certification until they have been met.” Fed. R. Civ. P. 23(c)(1)(C) advisory committee’s note (2003). And where Rule 23(c)(1)(A) previously stated that class certification should be decided “as soon as practicable,” it now only requires that the certification decision be made “at an early practicable time.” “Allowing time for limited discovery supporting certification motions may ... be necessary for sound judicial administration.” *Hydrogen Peroxide*, 552 F.3d at 319 (internal quotation marks omitted). Taken together, these amendments “combine to permit a more extensive inquiry into whether Rule 23 re-

quirements are met than was previously appropriate.” *IPO*, 471 F.3d at 39; *see also Hydrogen Peroxide*, 552 F.3d at 318–19.

Before the 2003 amendments, some courts shied away from a full and rigorous review of the law and evidence at class certification, invoking this Court’s statement that “nothing in either the language or history of Rule 23 ... gives a court any authority to conduct a preliminary inquiry into the merits of a suit in order to determine whether it may be maintained as a class action.” *Eisen v. Carlisle & Jacqueline*, 417 U.S. 156, 177 (1974); *see, e.g., In re Visa Check/MasterMoney Antitrust Litig.*, 280 F.3d 124, 134–35 (2d Cir. 2001); *Caridad v. Metro-N. Commuter R.R.*, 191 F.3d 283, 292 (2d Cir. 1999).

As petitioner concedes, however, this was a misreading of *Eisen* that has subsequently been corrected in the lower courts. Pet. Br. 47 (“While *Eisen* was initially construed as a blanket prohibition against consideration of the merits of the underlying claims at class certification, courts have since interpreted *Eisen* to prohibit examination of the merits except insofar as necessary to determine whether the Rule 23 prerequisites have been met”) (citing *IPO*, 471 F.3d at 41); *see also Hydrogen Peroxide*, 552 F.3d at 316–17; *In re Polymedica Corp. Sec. Litig.*, 432 F.3d 1, 6 (1st Cir. 2005); *Unger v. Amedisys, Inc.*, 401 F.3d 316, 320–21 (5th Cir. 2005); *Gariety v. Grant Thornton, LLP*, 368 F.3d 356, 366 (4th Cir. 2004); *Manual for Complex Litigation (Fourth)* § 21.14 (2004) (“A preliminary inquiry into the merits may be required to decide whether the claims and defenses can be presented and resolved on a class-wide basis”).

The district court in *Eisen* had ordered the defendants to pay 90 percent of the cost of notice to the class based on its determination that plaintiffs were likely to succeed on the merits of their claim. 417 U.S. at 168. This Court held that Rule 23 does not authorize shifting the cost of notice from the plaintiff to the defendant (*id.* at 177), and in that context rejected the district court’s “preliminary inquiry into the merits” because it would allow a class representative to adjudicate the merits of the case “without any assurance that a class action may be maintained.” *Id.* at 177–78. The Court concluded that “[i]n determining the propriety of a class action, the question is not whether the plaintiff or plaintiffs have stated a cause of action or will prevail on the merits, but rather whether the requirements of Rule 23 are met.” *Id.* at 178 (internal quotation marks omitted).

In *Eisen*, therefore, the district court “assessed the merits to decide the *collateral* issue of who should pay for the notice.” *IPO*, 471 F.3d at 34 (emphasis added). Nothing in *Eisen* suggests that a district court can avoid deciding an issue *central* to the Rule 23 requirements because that issue also relates to the merits of the case. And this Court’s decisions since *Eisen* recognize that “the class determination generally involves considerations that are enmeshed in the factual and legal issues comprising the plaintiff’s cause of action,” and “it may be necessary for the court to probe behind the pleadings before coming to rest on the certification question.” *Falcon*, 457 U.S. at 160 (internal quotation marks omitted); see also *Coopers & Lybrand*, 437 U.S. at 469 & n.12 (“Evaluation of many of the questions entering into determination of class action questions is intimately involved with the merits of the claims”) (internal

quotation marks omitted); Fed. R. Civ. P. 23(c)(1)(A) advisory committee's note (2003) ("Although an evaluation of the probable outcome on the merits is not properly part of the certification decision, ... it is appropriate to conduct controlled discovery into the 'merits,' limited to those aspects relevant to making the certification decision on an informed basis").

Neither petitioner nor the United States takes issue with the unbroken line of post-2003 appellate decisions rejecting a reading of *Eisen* that limits district courts' review of the Rule 23 requirements at class certification. On the contrary, they both cite these cases with approval as correctly stating the applicable legal rules. See Pet. Br. 47–48 (citing *IPO*, 471 F.3d at 41, and *Hydrogen Peroxide*, 552 F.3d at 311–12); U.S. Br. 23–24 (ditto). It is therefore undisputed that district courts have not just the authority but the obligation to resolve disputes that go to the Rule 23 requirements, even if they overlap with the "merits" of the dispute. See, e.g., *IPO*, 471 F.3d at 41 ("the obligation" to determine if Rule 23 is satisfied "is not lessened by overlap between a Rule 23 requirement and a merits issue, even a merits issue that is *identical* with a Rule 23 requirement") (emphasis added).

2. Where necessary to fully analyze the Rule 23 requirements, district courts must weigh the evidence presented by the parties and make factual findings regarding the evidence that is "enmeshed" with the class-certification analysis. *Falcon*, 457 U.S. at 160 (internal quotation marks omitted). "Class certification requires a *finding* that each of the requirements of Rule 23 has been met." *Hydrogen Peroxide*, 552 F.3d at 320 (emphasis added); see also, e.g., *Blades v. Monsanto Co.*, 400 F.3d 562, 575 (8th Cir. 2005).

If expert evidence is submitted at class certification—for example, an event study analyzing stock price movements—that evidence must meet the standards for admissibility of expert testimony set forth in *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579 (1993). See *Am. Honda Motor Co. v. Allen*, 600 F.3d 813, 815–16 (7th Cir. 2010) (per curiam); *Hydrogen Peroxide*, 552 F.3d at 315 n.13; *Unger*, 401 F.3d at 323 n.6. And a court must also analyze whether the expert evidence suffices to meet the plaintiff’s burden of satisfying Rule 23. See *Hydrogen Peroxide*, 552 F.3d at 323–24. Certifying a class without exercising such scrutiny would “amount[] to a delegation of judicial power to the plaintiffs, who can obtain class certification just by hiring a competent expert.” *West*, 282 F.3d at 938; see also *McLaughlin v. Am. Tobacco Co.*, 522 F.3d 215, 232 (2d Cir. 2008); *IPO*, 471 F.3d at 42; *Gariety*, 368 F.3d at 366–67.

According to petitioner, some discovery might be required to enable the parties to litigate, and the courts to resolve, the Rule 23 prerequisites. Pet. Br. 52. And the United States argues that requiring proof at class certification “requires plaintiffs to prove an essential element of their case before they have had an adequate opportunity to adduce the evidence required for such a showing.” U.S. Br. 26. But Rule 23 *specifically contemplates* pre-merits discovery, and was amended in 2003 to allow even more time before certification in order for the parties to develop the record. See Fed. R. Civ. P. 23(c)(1) advisory committee’s note (2003) (pre-certification discovery required “to identify the nature of the issues that actually will be presented at trial” in order for the judge to “mak[e] the certification decision on an informed basis”).

Discovery may therefore be proper “to illuminate issues bearing on certification, including the nature of the issues that will be tried; whether the evidence on the merits is common to the members of the proposed class; whether the issues are susceptible to class-wide proof; and what trial-management problems the case will present.” Summary of the Report of the Judicial Conference Committee on Rules of Practice and Procedure at 4 (2002); *see also* Manual for Complex Litigation (Fourth) § 21.14 (2004) (“discovery may be necessary ... when the facts relevant to any of the certification requirements are disputed, or when the opposing party contends that proof of the claims or defenses unavoidably raises individual issues”) (citations omitted). There is no basis for arguing that it is difficult or infeasible for plaintiffs to develop the evidence necessary to establish the Rule 23 requirements when the Rule specifically allows them to do so.

3. Every court of appeals to have considered the issue has concluded that the plaintiff bears the burden of proving the Rule 23 prerequisites by a preponderance of the evidence. *Hydrogen Peroxide*, 552 F.3d at 320; *Teamsters Local 445 Freight Div. Pension Fund v. Bombardier, Inc.*, 546 F.3d 196, 202 (2d Cir. 2008); *see also Alaska Elec. Pension Fund v. Flowserve Corp.*, 572 F.3d 221, 228 (5th Cir. 2009) (*per curiam*). These decisions correctly state the applicable standard of proof.

The government does not take issue with this unanimity in the lower courts on the preponderance standard. U.S. Br. 10 n.1 (“The courts that have addressed the question have held that facts relevant to whether the Rule 23 requirements have been met must be established by a preponderance of the evidence”). Petitioner does not even mention the appro-

priate standard, thus conceding that preponderance of the evidence—as articulated in cases such as *Hydrogen Peroxide*, with which petitioner expresses agreement—is the correct standard.

Preponderance of the evidence is the default standard in civil cases, as it “allows both parties to ‘share the risk of error in roughly equal fashion.’” *Herman & MacLean v. Huddleston*, 459 U.S. 375, 390 (1983) (quoting *Addington v. Texas*, 441 U.S. 418, 423 (1979)). Departures from the preponderance standard usually involve the application of a *higher* standard of proof where “particularly important individual interests or rights are at stake.” *Id.* at 389.

There is no basis for adopting a *lesser* burden of proof for the Rule 23 prerequisites at class certification. Rule 23’s requirements are more than “mere pleading rules” (*Hydrogen Peroxide*, 552 F.3d at 316), and thus require a standard more stringent than “plausibility.” *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1949–50 (2009); *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555–57 (2007). This Court’s statements that a district court must “rigorous[ly]” analyze (*Falcon*, 457 U.S. at 161), and take a “close look” (*Amchem*, 521 U.S. at 615), at whether Rule 23 is satisfied are plainly incompatible with imposing a minimal burden on plaintiffs seeking class certification. And the important interests of the absent class members (*see Amchem*, 521 U.S. at 629) preclude any ratcheting down of the standard of proof from the baseline “preponderance” standard.

The United States argues that analyzing the substantive issues in the case at class certification under the preponderance standard “shoehorn[s] a motion-to-dismiss inquiry into the class-certification analy-

sis,” which it suggests “usurp[s] the role of juries” in resolving substantive legal issues. U.S. Br. 26–27. But that argument proves too much: Pretrial motions *always* entail judicial resolution of issues that might otherwise be submitted to a jury, and if such motions are authorized by law there is no “usurpation” (and no Seventh Amendment concern). *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 326–27 (2007) (internal quotation marks omitted). In any event, the leading decisions indicate that judicial determinations made at the class-certification stage are not binding on later proceedings in the case. *See, e.g., Hydrogen Peroxide*, 552 F.3d at 318; *IPO*, 471 F.3d at 41.

4. These foregoing principles of class-certification law are critical to ensuring that class-wide adjudication “leaves the parties’ legal rights and duties intact and the rules of decision unchanged.” *Shady Grove Orthopedic Assocs., P.A. v. Allstate Ins. Co.*, 130 S. Ct. 1431, 1443 (2010) (plurality). Class actions depart from the general rule that litigation is conducted only by the named parties and binds only them. *See Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 846 (1999); *Califano v. Yamasaki*, 442 U.S. 682, 700–01 (1979). And while class actions may in some cases promote efficiency, they must also be fair to absent class members (*see, e.g., Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 811–12 (1985)), as well as defendants. *See Coopers & Lybrand*, 437 U.S. at 476.

A class representative can lose just as easily as it can win. *See Falcon*, 457 U.S. at 161 (courts cannot assume that “all will be well for surely the plaintiff will win and manna will fall on all members of the class”) (citation and internal quotation marks omitted); *Schleicher v. Wendt*, 618 F.3d 679, 685 (7th Cir.

2010) (even when “[c]ertification is appropriate” a class can “lose on the merits”). And when the named plaintiff loses, so does the certified class, which is bound by the judgment. *See Cooper v. Fed. Reserve Bank of Richmond*, 467 U.S. 867, 874 (1984). The class-certification inquiry must therefore ensure that, should such a judgment issue, absent class members are sufficiently protected. *See Taylor v. Sturgell*, 553 U.S. 880, 900–01 (2008); *Amchem*, 521 U.S. at 621–22, 629. Rule 23(b)(3)’s predominance requirement, in particular, has been deemed a “vital prescription” by the Court. *Amchem*, 521 U.S. at 623. And rigorous analysis is needed to ensure that those who aspire to bind others to a judgment do so in a way that is fair to those being bound.

A court must also be mindful that “[c]ertification of a large class may so increase the defendant’s potential damages liability and litigation costs that he may find it economically prudent to settle and to abandon a meritorious defense.” *Coopers & Lybrand*, 437 U.S. at 476; *see also, e.g., Hydrogen Peroxide*, 552 F.3d at 310; *Newton v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 259 F.3d 154, 162, 167–68 & n.8 (3d Cir. 2001); *Castano v. Am. Tobacco Co.*, 84 F.3d 734, 746 (5th Cir. 1996); *In re Rhone-Poulenc Rorer, Inc.*, 51 F.3d 1293, 1298 (7th Cir. 1995). As the Seventh Circuit put it, “class certification turns a \$200,000 dispute ... into a \$200 million dispute[,]” which “puts a bet-your-company decision to [a defendant] and may induce a substantial settlement even if the [plaintiff’s] position is weak.” *Szabo v. Bridgeport Machs., Inc.*, 249 F.3d 672, 675 (7th Cir. 2001); *see also CE Design Ltd. v. King Architectural Metals, Inc.*, No. 10-8050 (7th Cir. Mar. 18, 2011), slip. op. at 2 (Posner, J.) (“Certification as a class action can coerce a defendant into settling on highly disadvanta-

geous terms regardless of the merits of the suit”). While this pressure alone might not be a reason to deny certification (*see Rhone-Poulenc*, 51 F.3d at 1299), it warrants careful attention in the class-certification analysis. *See, e.g., Newton*, 259 F.3d at 192 (“class certification would place hydraulic pressure on defendants to settle which weighs in the superiority analysis [under Rule 23(b)(3)]”).

This is particularly true in the context of securities class actions using the fraud-on-the-market presumption, which already “reallocates the risks of mistaken adjudications” in a plaintiff’s favor. *In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474, 483 (2d Cir. 2008) (internal quotation marks omitted). We turn now to that particular implementation of this Court’s rigorous analysis mandate.

II. THE APPLICABILITY OF THE FRAUD-ON-THE-MARKET PRESUMPTION IS A CLASS-CERTIFICATION REQUIREMENT

1. In a private federal securities action, a plaintiff must show, among other things, that it *relied* on a material misstatement made by the defendant. *See Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 341 (2005); *Basic*, 485 U.S. at 243. “Reliance provides the requisite causal connection between a defendant’s misrepresentation and a plaintiff’s injury.” *Basic*, 485 U.S. at 243. But the need to satisfy reliance in a securities action would ordinarily preclude class treatment, “since individual issues would ... overwhelm[] the common ones.” *Id.* at 242.

This Court’s 4-2 decision in *Basic*, however, recognized the “fraud on the market” presumption, which creates a rebuttable presumption of class-wide reliance if a material public misstatement is made about a security that trades in a well-developed, effi-

cient market. *See* 485 U.S. at 247–48; *see also, e.g., Salomon*, 544 F.3d at 483. The presumption rests on the economic theory that, in an efficient securities market, the price of a security will reflect publicly available information about that security, including statements made by the issuing company, and thus, one who buys at the market price will have indirectly relied on that publicly available information. *See Basic*, 485 U.S. at 241–42, 246–47; *see also Stoneridge*, 552 U.S. at 159.

The fraud-on-the-market *presumption* is meant “to assist courts in managing circumstances in which direct proof, for one reason or another, is rendered difficult.” *Basic*, 485 U.S. at 245. But if the presumption cannot be established, then reliance cannot be proved in the aggregate and the class may not be certified because individual questions will predominate. *See id.* at 242; *IPO*, 471 F.3d at 43 (“Without the *Basic* presumption, individual questions of reliance would predominate over common questions”); *see also Salomon*, 544 F.3d at 485; *Gariety*, 368 F.3d at 362–64. Petitioner acknowledges as much. *See* Pet. Br. 48 (“determining whether plaintiffs have met the requirements for invoking the presumption ... is crucial to showing [that] common issues predominate”).

The fraud-on-the-market presumption is rebuttable on “[a]ny showing that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff, or his decision to trade at a fair market price.” *Basic*, 485 U.S. at 248. Such a showing breaks the “causal connection” between the alleged misrepresentation and investor reliance. *Id.* at 248–49.

2. Because establishing the availability of the fraud-on-the-market presumption is a necessary predicate to a finding that common issues predominate, a court must determine if a plaintiff is entitled to that presumption *before* certifying the class. *See IPO*, 471 F.3d at 43. Petitioner here relied on the fraud-on-the-market presumption to satisfy Rule 23(b)(3)'s predominance requirement, squarely presenting the issue at class certification. J.A. 147a–148a. The lower courts were, accordingly, correct to scrutinize it as they did. *See* Pet. App. 3a–54a, 111a–136a; *see also Basic*, 485 U.S. at 242; *Falcon*, 457 U.S. at 160–61; *Hydrogen Peroxide*, 552 F.3d at 307, 320; *Unger*, 401 F.3d at 321; *Gariety*, 368 F.3d at 365–66.

Indeed, both petitioner and the United States accept that the plaintiff bears the burden of showing, at the class-certification stage, that the predicates of the *Basic* presumption are met. Pet. Br. 48 (court must “determin[e] whether plaintiffs have met the requirements for invoking the presumption, in particular by showing that the market in question is efficient”); U.S. Br. 11 (“To invoke that presumption at the class-certification stage, petitioner was required to show that respondents’ alleged misrepresentations were made publicly, that the company’s shares were traded in an efficient market, and that the plaintiff traded shares between the time the misrepresentations were made and the time the truth was revealed”).

Petitioner argues, however, that “the proper time to rebut the presumption of reliance ... is at *trial*, not class certification.” Pet. Br. 35; *but see id.* at 48 n.15. The United States likewise argues that a court need not permit a defendant to rebut the fraud-on-the-market presumption at class certification. U.S. Br.

19 n.3. The government’s position is entitled to no deference, since government prosecutions need not comply with Rule 23 and, in any event, the government takes the position that reliance is not an element of an enforcement action. *See Piper v. Chris-Craft Indus., Inc.*, 430 U.S. 1, 42 n.27 (1977). And both the government and petitioner are wrong in this respect.

The leading decision on the rebuttal issue is *Salomon*, from the Circuit that hears more securities cases than any other and that announced (in *IPO*) the definitive treatment of a district court’s authority to resolve disputes that go to the Rule 23 requirements. The *Salomon* court recognized that the district court must consider not only plaintiff’s proof of entitlement to the *Basic* presumption, but also any rebuttal evidence offered by the defendant, *before* certifying the class. *See* 544 F.3d at 485 (the required “definitive assessment that the Rule 23(b)(3) predominance requirement has been met ... cannot be made without determining whether defendants can successfully rebut the fraud-on-the-market presumption”) (internal quotation marks omitted). While petitioner tries to square *Salomon* with its position (*see, e.g.*, Pet. Br. 24 & 45), the government maintains that *Salomon*’s ruling on rebuttal evidence was “err[oneous].” U.S. Br. 19 n.3. It is the government, however, that errs.

The Third Circuit very recently agreed that “rebuttal of the presumption of reliance falls within the ambit of issues that, if relevant, should be addressed by district courts at the class certification stage.” *In re DVI, Inc. Sec. Litig.*, No. 08-8033 (3d Cir. Mar. 29, 2011), slip op. at 31. The court explained that because the presumption of reliance “is necessary to meet the Rule 23(b)(3) predominance requirement, a

district court should conduct a rigorous market efficiency analysis.” *Id.* at 19. “This may, in some cases, include weighing conflicting expert testimony and making factual findings.” *Ibid.* Although the court expressed the view that “loss causation considered separate and apart from the presumption of reliance will rarely defeat the Rule 23(b)(3) predominance requirement,” it recognized that “evidence introduced by a defendant at the class certification stage demonstrating ... that there was no market impact and therefore no loss causation” can “rebut the presumption of reliance and in turn defeat predominance.” *Id.* at 32–33. Therefore such evidence—that is, evidence related to causation-cum-reliance—must be considered by the district court at the certification stage.

Salomon and *DVI* are applications of the proper rule that a district court *must* consider a defendant’s rebuttal arguments, at the class-certification stage, because this is the only way to conduct the “close look” that ensures “actual ... conformance” with Rule 23. *Amchem*, 521 U.S. at 615; *Falcon*, 457 U.S. at 160–61. As *Basic* held, rebuttal of the presumption means that a class cannot be maintained. *See* 485 U.S. at 242, 248. Because a court must make a “definitive assessment” (*IPO*, 471 F.3d at 41), of whether the Rule 23 requirements are satisfied, it must consider a defendant’s evidence rebutting the fraud-on-the-market presumption at class certification. *See Salomon*, 544 F.3d at 485; *Gariety*, 368 F.3d at 366–67. The court’s analysis is not limited to the plaintiff’s evidence in support of class certification; if the defendant can successfully rebut the presumption, then the court cannot allow the plaintiff to present its case at trial on a class-wide basis and therefore cannot certify the class. *See Fed. R. Civ. P.*

23(c)(1)(B); *Salomon*, 544 F.3d at 485 (“The *Basic* Court explained that a successful rebuttal *defeats* certification by defeating the Rule 23(b)(3) predominance requirement”) (citing 485 U.S. at 249 n.29); *see also DVI*, slip op. at 31–32.

3. The United States mistakenly claims that “[f]or purposes of Rule 23, a defendant’s attempt to rebut the fraud-on-the-market presumption is no different from an effort to contest any other element of the plaintiff’s claim, or to establish an affirmative defense.” U.S. Br. 17. According to the United States, a plaintiff need only raise common questions regarding class-wide reliance to obtain certification. *See id.* at 18, 24.

This argument conflates the question whether a plaintiff can prove the *element* of reliance—ultimately a merits inquiry—with the question whether a representative plaintiff can invoke the fraud-on-the-market *presumption* in order to show reliance on a class-wide basis, a question essential to class certification. *See Falcon*, 457 U.S. at 160–61; *Eisen*, 417 U.S. at 177–78. Petitioner acknowledges that “[t]he proper analysis under Rule 23(b)(3) is how the putative class members will attempt to prove their case.” Pet. Br. 25. Here, petitioner proposes to use the *Basic* presumption, and therefore the availability of the presumption must be tested on certification. *See Basic*, 485 U.S. at 242; *IPO*, 471 F.3d at 43; *Polymedica*, 432 F.3d at 7–8; *Unger*, 401 F.3d at 321–22; *Gariety*, 368 F.3d at 363–64. That is a Rule 23 issue, not a “merits” inquiry.

The availability of the presumption must be tested at class certification, as it bears on whether and how the claim can be tried as a class. *See Fed. R. Civ. P. 23(c)(1)(B)* (certification order must set out

the “claims, issues, [and] defenses” to be adjudicated at trial); *Hohider v. United Parcel Serv., Inc.*, 574 F.3d 169, 202 (3d Cir. 2009). If reliance cannot be presumed class-wide via the fraud-on-the-market presumption, then the class may not be certified. *See, e.g., IPO*, 471 F.3d at 43. That is because if the “elements [of a claim] include individualized inquiries that cannot be addressed in a manner consistent with Rule 23, then the class cannot be certified.” *Hohider*, 574 F.3d at 184; *see also Hydrogen Peroxide*, 552 F.3d at 311 (if “proof of the essential elements of the cause of action requires individual treatment, then class certification is unsuitable”) (quoting *Newton*, 259 F.3d at 172); *McLaughlin*, 522 F.3d at 223–25.

This is not, therefore, a case where merely raising common questions will suffice. Rather, a plaintiff bears the burden of showing that it can prove reliance in an aggregated proceeding and that individualized inquiries regarding this element will not predominate. Richard A. Nagareda, *Class Certification in the Age of Aggregate Proof*, 84 N.Y.U. L. Rev. 97, 132 (2009) (“What matters to class certification ... is not the raising of common ‘questions’ ... but, rather, the capacity of a class-wide proceeding to generate common *answers* apt to drive the resolution of the litigation”).

Postponing the question whether a plaintiff is entitled to the fraud-on-the-market presumption would also implicate the Rules Enabling Act. As the Court has cautioned, Rule 23 may not be interpreted in a way that runs afoul of the Act. *See Ortiz*, 527 U.S. at 845–46; *Amchem*, 521 U.S. at 629. In particular, a class may not be certified if doing so would relieve a plaintiff of the burden of proving an element of its claim. *See, e.g., Hohider*, 574 F.3d at 196; *McLaugh-*

lin, 522 F.3d at 231. Nor, for that matter, does due process countenance the elimination of any defense that would otherwise be available to a defendant in a single-plaintiff action. See *Philip Morris USA, Inc. v. Scott*, 131 S. Ct. 1, 3–4 (2010) (Scalia, J., in chambers).

The fraud-on-the-market presumption was explicitly adopted to facilitate class certification of securities claims that the reliance requirement would otherwise preclude from such treatment. See *Basic*, 485 U.S. at 242; *Salomon*, 544 F.3d at 483. But the Court did not—and indeed *could not*—relieve a plaintiff of the ultimate burden of proving reliance. See 28 U.S.C. § 2072(b); *Amchem*, 521 U.S. at 629. Thus, the presumption is—and must be—rebuttable. See *Basic*, 485 U.S. at 248–49.

The only real question before the Court in this case, then, is *when* the presumption may be rebutted: at class certification or at trial? If entitlement to the presumption is not resolved at class certification, then a plaintiff comes very close to improperly “circumvent[ing] the reliance requirement” (*Cent. Bank of Denver N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 180 (1994)), in violation of the Court’s admonition that Rule 23 must be construed in harmony with the Rules Enabling Act. See *Ortiz*, 527 U.S. at 845. Accordingly, fraud on the market—a presumption crafted to facilitate certification—must be tested where its inapplicability would defeat certification, and not later (when it might be too late as a practical matter). See Resp. Br. 32–35.

4. Evidence that “severs the link between the alleged misrepresentation” and a plaintiff’s decision to invest can rebut the fraud-on-the-market presumption, rendering a claim unsuitable for class treat-

ment. *Basic*, 485 U.S. at 248. Whether or not loss causation is necessarily a component of the fraud-on-the-market presumption, in many cases evidence bearing on loss causation also bears on the class-certification question of whether the “link” has been “sever[ed].” And because a court is obligated to determine if Rule 23 is satisfied before certifying a class, a plaintiff’s *theory of causation* at class certification must be rigorously analyzed where such evidence is relevant to the applicability of the fraud-on-the-market presumption.

Petitioner tries to avoid this conclusion by insisting that “reliance and loss causation are distinct concepts” (Pet. Br. 42; *see also* U.S. Br. 20 (same)), but this Court disagrees. *See Stoneridge*, 552 U.S. at 160 (“reliance is tied to causation”). Indeed, *Basic* itself recognized the close tie between reliance and causation. 485 U.S. at 248; *see also Cent. Bank*, 511 U.S. at 180; *DVI*, slip op. at 33.

The Court held in *Basic* that the presumption could be rebutted by a defense showing “that the misrepresentation in fact did not lead to a distortion of price.” 485 U.S. at 248. Halliburton made such a showing in this case, which petitioner failed to rebut. *See* Resp. Br. 25–27.

Contrary to petitioner’s abbreviated argument on the second question presented, in reviewing the certification evidence and resolving petitioner’s entitlement to the presumption the courts did not conduct an impermissible inquiry into the merits. While loss causation is an element of petitioner’s substantive claim under the securities laws, the courts below determined in this case that causative evidence was also a necessary predicate to petitioner’s entitlement to the fraud-on-the-market presumption (Pet. App.

6a, 115a); negating the predicate disentitled petitioner to the presumption, and therefore destroyed the basis for class certification. This is exactly the “rigorous analysis” of the Rule 23 prerequisites that this Court has required. *Falcon*, 457 U.S. at 161.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

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