No. 09-1403

IN THE
Supreme Court of the United States

ERICA P. JOHN FUND, INC., FKA ARCHDIOCESE OF MILWAUKEE SUPPORTING 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 OF WASHINGTON LEGAL FOUNDATION AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

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QUESTIONS PRESENTED

Whether the court of appeals correctly affirmed the district court's denial of class certification where the evidence showed that the alleged misrepresentations had no impact on the company's stock price.

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INTERESTS OF *AMICUS CURIAE*

The Washington Legal Foundation (WLF) is a non-profit public interest law and policy center with supporters in all 50 states.[1] WLF devotes a substantial portion of its resources to defending free-enterprise, individual rights, and a limited and accountable government.

To that end, WLF has appeared before this and other federal courts in numerous cases raising issues related to the proper scope of the federal securities laws. *See, e.g., Matrixx Initiatives, Inc. v. Siracusano*, ___ U.S. ___, 2011 U.S. LEXIS 2416 (Mar. 22, 2011), *Morrison v. Nat'l Australia Bank Ltd.*, 130 S. Ct. 2869 (2010); *Stoneridge Inv. Partners, LLC v. Scientific Atlanta, Inc.*, 532 U.S. 148 (2008); *Dura Pharms., Inc. v. Broudo,* 544 U.S. 336 (2005). WLF has also participated extensively in litigation in support of its view that federal courts should not certify cases as class actions unless the plaintiffs can demonstrate that they have satisfied each of the requirements of Rule 23 of the Federal Rules of Civil Procedure. *See, e.g., Wal-Mart Stores, Inc. v. Dukes, cert. granted*, 131 S. Ct. 795 (2010).

WLF agrees with Respondent that the evidence before the district court demonstrated that the alleged misrepresentations had no impact on Halliburton's stock price and thus that Petitioners failed to demonstrate that they met Rule 23(b)(3)'s

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[1] Pursuant to Supreme Court Rule 37.6, WLF state that no counsel for a party authored this brief in whole or in part; and that no person or entity, other than WLF and its counsel, made a monetary contribution intended to fund the preparation and submission of this brief. All parties have consented to this filing; letters of consent have been lodged with the Court.

predominance requirement. WLF writes separately because it takes particular issue with the assertion of Petitioners and the United States that Respondents are not permitted, at the class certification stage, even to attempt to rebut the presumption of reliance created by the fraud-on-the-market theory. That assertion is directly contrary to *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988), which explicitly authorized defendants to attempt to defeat class certification by introducing evidence that the market did not, in fact, rely on the alleged misrepresentations. *Basic* has been settled law for more than two decades; WLF believes that if Petitioners and the United States seek to overturn *Basic*, they should take their case to Congress. WLF also believes that any such change would be inappropriate because it would substantially reduce the ability of class action defendants to resist class certification and thereby increase the already enormous pressure they face to settle the suits without regard to the underlying merits.

STATEMENT OF THE CASE

Petitioners purport to represent a class consisting of purchasers of Halliburton Co. common stock during a 2 1/2-year period (June 1999 to December 2001). They allege that Respondents (collectively, "Halliburton") violated federal securities laws by making material misrepresentations regarding the company's financial condition, and that they suffered losses after the company's true financial condition was revealed.

Five years after suit was filed, and after extensive discovery, the district court denied Petitioners' motion

to certify the class. Pet. App. 3a-55a. The parties agreed that Halliburton stock traded in an "efficient market." *Id*. at 5a. However, after considering substantial expert testimony from both Petitioners and Halliburton, the court concluded that Petitioners were not entitled to a presumption of reliance because they had failed to demonstrate that the alleged misrepresentations had an effect on Halliburton's stock price. *Id*. at 3a-55a. In the absence of such a presumption, reliance would need to be demonstrated on a individual basis, and thus Petitioners could not meet their evidentiary burden under Fed.R.Civ.P. 23(b)(3), which requires a party seeking class certification to demonstrate that "the questions of law or fact common to class members predominate over any questions affecting only individual members.

The Fifth Circuit affirmed. Pet. App. 111a-136a. The court held that a plaintiff may create a "rebuttable presumption of reliance" under the fraud-on-the-market theory by showing that: (1) the defendant made public *material* misrepresentations; (2) the defendants shares were traded in an efficient market; and (3) the plaintiff traded shares between the time the misrepresentations were made and the time the truth was revealed. *Id*. at 114a. It further held that a defendant resisting certification may seek to rebut the presumption "by any 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 fair market price." *Id*. at 114a-115a.

Because Halliburton introduced evidence designed to sever the link between the alleged

misrepresentation and the price paid by Petitioners for their stock, the appeals court examined that issue. It explained that the requisite causal connection could be established in one of two ways: (1) an increase in stock price immediately following release of the alleged misrepresentations; or (2) a decrease in stock price following disclosure of the alleged "truth" regarding the earlier falsehood. *Id.* at 116a. Petitioners sought to demonstrate the link by employing the second option. The appeals court concluded, however, that the evidence presented to the district court failed to demonstrate such a link. *Id.* at 123a-136a. Accordingly, the court concluded that a presumption of reliance was inappropriate, and it affirmed the district court's denial of class certification. *Id.*

SUMMARY OF ARGUMENT

A party seeking certification of a class action must demonstrate by a preponderance of the evidence that he has met all the requirements of Fed.R.Civ.P. 23. In a Rule 23(b)(3) class action such as this one, those requirements include a showing that common issues of law or fact "predominate" over questions affecting only individual class members. But because plaintiffs in a securities fraud lawsuit must establish that they relied on the defendant's misrepresentation, the predominance requirement can never be met if the plaintiffs must prove reliance on a plaintiff-by-plaintiff basis – because under those circumstances, individual issues of fact would overwhelm common issues. Thus, a securities fraud lawsuit will never be an appropriate candidate for class action treatment unless the plaintiffs can demonstrate an entitlement to a presumption of

reliance under the fraud-on-the-market theory. In sum, whether a presumption of reliance is appropriate is a pivotal Rule 23 issue; certification of a class in a securities fraud lawsuit will never be warranted in the absence of that presumption.

This Court has directed district courts, when deciding whether to certify a class, to undertake a "rigorous analysis" of whether the moving party has met *all* the requirements of Rule 23, and to do so regardless whether that analysis entails an examination of issues that relate to the merits of the plaintiff's lawsuit. Accordingly, when Halliburton proffered evidence designed to demonstrate that a presumption of reliance (and thus, class certification) was inappropriate, both the district court and the Fifth Circuit appropriately undertook a "rigorous analysis" of that evidence.

In seeking reversal, Petitioners make two principal assertions. First, they assert that some of the issues addressed by the lower courts are not appropriately considered in determining whether the defendant has successfully rebutted the presumption of reliance. Second, Petitioners assert that any rebuttal should be delayed until summary judgment or trial and is not appropriately considered in connection with a motion for class certification. Both assertions directly conflict with *Basic* as well as with the great majority of courts of appeals that have considered the issue.

Petitioners claim that *Basic* authorized courts to apply a rebuttable presumption of class-wide reliance based on the plaintiff's showing that "defendants made

public misrepresentations, the company's stock traded in an efficient market, and plaintiffs traded shares after the misrepresentation and before the truth was revealed." Pet. Br. 27. That claim is inaccurate; *Basic* stated that the plaintiff must *also* show that the misrepresentation was "material." *Basic*, 485 U.S. at 241-42, 246-48 & n.27. One of the best ways for a defendant to demonstrate that an alleged misrepresentation was not "material" is, of course, to demonstrate that it had no impact on the company's stock price. After considering the extensive evidence submitted by both sides regarding stock-price impact, the lower courts determined that there was no such impact here – and thus properly concluded that Petitioners were not entitled to a presumption of reliance.

Petitioners' argument that a defendant's rebuttal evidence should not be heard at the class certification stage is similarly unavailing. "Materiality" is, of course, a merits issue that will be determined at trial and that is capable of being decided on a class-wide basis. But as *Basic* makes clear, materiality is also an essential element of the showing that must be made before a plaintiff is entitled to a presumption of reliance. Simply because an issue is merits-based and/or is capable of being decided on a class-wide basis is not a reason to excuse a plaintiff seeking Rule 23(b)(3) class certification from demonstrating class-wide reliance – and thereby demonstrating compliance with Rule 23(b)(3)'s predominance requirement.

Petitioners seek to portray the Fifth Circuit as an outlier among the federal appeals courts. To the

contrary, the two principal features of the Fifth Circuit's class-certification jurisprudence – permitting defendants to present rebuttal evidence at the certification stage and focusing on whether the alleged misrepresentation actually had an impact on stock price – place the Fifth Circuit well within the mainstream among federal appeals courts. Indeed, the Third Circuit issued an opinion just this week making clear that it stands firmly with the Fifth Circuit on those two issues. *In re: DVI, Inc. Securities Litigation*, ___ F.3d ___, 2011 U.S. App. LEXIS 6302 (3d Cir., Mar. 29, 2011). Only the Seventh Circuit disagrees with the Fifth Circuit on these issues; it stands as the real outlier. *See Schleicher v. Wendt*, 618 F.3d 679 (7th Cir. 2010).

The Fifth Circuit diverges somewhat from other circuits regarding the strength of the presumption created by *Basic* and what the defendant must do to overcome that presumption. The Fifth Circuit has concluded that the presumption disappears the moment the defendant makes "any showing" that severs the link between the misrepresentation and the plaintiffs' loss, and that the defendant need not go on to carry the ultimate burden of persuasion regarding the existence or non-existence of the link. *Oscar Private Equity Investments v. Allegiance Telecom, Inc.*, 487 F.3d 261, 265 (5th Cir. 2007). Some other appeals courts have concluded that *Basic* created a stronger presumption and have required defendants to make a correspondingly greater showing in order to defeat the presumption of reliance. But the Court's resolution of that issue should not affect the ultimate disposition of this case because the denial of class certification in this case was based on the lower courts' determination –

after reviewing extensive evidence submitted by both sides – that Halliburton's alleged misrepresentations did not affect the price of Halliburton's stock. In other words, the outcome would have been the same even if the lower courts had imposed a greater evidentiary burden on Halliburton.

ARGUMENT

I. IN ASSESSING PREDOMINANCE, THE DISTRICT COURT PROPERLY CONSIDERED HALLIBURTON'S EVIDENCE THAT ALLEGED MISREPRESENTATIONS HAD NO IMPACT ON ITS STOCK PRICE

A. *Basic* Established "Materiality" as a Prerequisite for Recognition of a Presumption of Class-Wide Reliance

Petitioner mistakenly asserts that *Basic* "adopted" the fraud-on-the-market theory. Pet. Br. 4. To the contrary, the Court explicitly declined to "assess the general validity of the theory." *Basic*, 485 U.S. 242.[2] Rather, the Court concluded that the theory supported application of a "rebuttable presumption of reliance"

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[2] The Court explained the theory as follows: "The fraud on the market theory is based on the hypothesis that, in an open and developed securities market, the price of a company's stock is determined by the available material information regarding the company and its business. . . . Misleading statements will therefore defraud purchasers of stock even if the purchasers do not rely on the misstatements." *Id.* at 241-42 (quoting *Peil v. Speiser*, 806 F.2d 1154, 1160-61 (3d Cir. 1986)).

when a plaintiff makes the requisite showings, *id.*, and thus that "[i]t is not inappropriate" for a district court to apply the presumption, subject to rebuttal. *Id.* at 250.

In Footnote 27, the Court approvingly cited the items the appeals court had required a plaintiff to prove in order to invoke the presumption of reliance:

> The Court of Appeals held that in order to invoke the presumption, a plaintiff must allege and prove: (1) that the defendant made public misrepresentations; (2) that the misrepresentations were *material*; (3) that the shares were traded on an efficient market; (4) that the misrepresentation would induce a reasonable, relying investor to misjudge the value of the shares; and (5) that the plaintiff traded the shares between the time misrepresentations were made and the time the truth was revealed. See 786 F.2d, at 750.
>
> Given today's decision regarding the definition of materiality as to preliminary merger discussions, elements (2) and (4) may collapse into one.

Id. at 248 n.27 (emphasis added).[3] The second paragraph of Footnote 27 indicates that the Court

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[3] As the second paragraph in Footnote 29 indicates, the *Basic* decision addressed two separate issues: (1) whether the defendant was entitled to summary judgment on the ground that information regarding potential mergers should not be deemed material; and (2) whether the plaintiff was entitled to class certification based on a presumption of market-wide reliance.

approved of the appeals court's prerequisites for invoking the presumption of reliance. The statement that "elements (2) and (4) may collapse into one" suggests that information regarding "preliminary merger discussions" should be deemed "material" if it would induce "reasonable, relying investors to misjudge the value of the shares." But Footnote 27 makes reasonably clear that the Court deemed materiality of the misrepresentation to be an essential element of any effort to invoke the presumption of reliance.

That interpretation of Footnote 27 is strongly reinforced by repeated references to "materiality" throughout the Court's opinion. For example, in defining the fraud-on-the-market theory, the Court explained that the theory "is based on the hypothesis that, in an open and developed market, the price of a company's stock is determined by the available *materia*l information regarding the company and its business." *Id.* at 241. In other words, information that is not material will have no effect on stock price. The Court also stated:

> The presumption [of reliance] is also supported by common sense and probability. Recent empirical studies have tended to confirm Congress' premise that the market price of shares traded on well-developed markets reflects all publicly available information, and, hence, any *material* misinformation.

Id. at 246. The clear implication of the quoted language is that the Court deemed materiality an essential element of any effort to invoke the presumption of

reliance. The presumption is not appropriate in cases in which misinformation is not material because such misinformation can have no effect on market price.

Other federal appeals courts have interpreted *Basic* as precluding a presumption of reliance when the alleged misrepresentation is determined to be immaterial. The Third Circuit recently stated that evidence that the defendant's "statements were immaterial [is] a distinct basis for rebuttal." *In re: DVI*, 2011 U.S. App. LEXIS at *36. The Second Circuit interprets *Basic* as imposing on plaintiffs the burden of demonstrating that the alleged misrepresentation is "material," and "a prima facie showing will not suffice to meet that burden." *In re: Salomon Analyst Metromedia Litigation*, 544 F.3d 474, 481 (2d Cir. 2008). If that burden is met, the Second Circuit permits the defendant to rebut the presumption of reliance by "show[ing] that the allegedly false statements did *not* measurably impact the market price of the security." *Id.* at 486 n.9.

The Seventh Circuit is the outlier; it is the only federal appeals court that has rejected the relevance of materiality to the presumption of reliance. *Schleicher*, 618 F.3d at 687 (criticizing *Salomon Analyst* and *In re PolyMedica Corp. Securities Litigation*, 432 F.3d 1, 8 n.11 (1st Cir. 2005), for imposing "materiality as a condition to class certification"). The Seventh Circuit interpreted Footnote 27 in *Basic* as merely stating that the appeals court had deemed materiality essential, not that the Court itself reached the same conclusion. *Id.* That interpretation fails to explain *Basic*'s other references to materiality (cited above). The Seventh

Circuit also argued that by the Second Circuit's logic, proof that the defendant's statements were false must also be a condition of class certification (because the existence of a "misrepresentation" is also an element listed in Footnote 27), yet no court has ever so held. *Id.* But that effort to draw a parallel between materiality and falsity makes little sense; the former bears a close relationship with reliance, the latter does not. Material statements are by definition ones on which reasonable people are likely to rely. In contrast, the likelihood that reasonable people will rely on a statement is poorly correlated with whether the statement is true or false. Reasonable people will rely on a material and seemingly authoritative statement, regardless whether the statement is true or false. Accordingly, the most reasonable interpretation of *Basic* is that entitlement to a presumption of reliance requires the plaintiff, as part of class certification, to show materiality but not falsity.

B. The Right of Rebuttal Endorsed by *Basic* Is Quite Broad and Encompasses the Proceedings in the Courts Below

While endorsing adoption of a rebuttable presumption of reliance in appropriate cases, *Basic* made clear that defendants are entitled to attempt to rebut that presumption and thereby demonstrate the absence of predominance. The Court said:

> Any 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 price, will be sufficient to rebut

> the presumption of reliance. For example, if [the defendant] could show that the "market makers" were privy to the truth about the merger discussions . . ., and thus that the market price would not have been affected by their misrepresentation, the causal connection could be broken; the basis for finding that the fraud had been transmitted though market price would be gone.

Basic, 485 U.S. at 248.

The Court's "any showing" language indicates that the Court contemplated that defendants be provided a broad range of options in seeking to rebut the presumption of reliance. A demonstration that the alleged misrepresentation was not material falls comfortably within the "any showing" language. Proof that a misrepresentation was not material severs the link between the misrepresentation and the price paid for stock, because common sense suggests that a non-material misrepresentation will have no effect on the price the market as a whole is willing to pay for a company's stock.

One of the best ways for a defendant to demonstrate that an alleged misrepresentation was not "material" is, of course, to demonstrate that it had no impact on the company's stock price. *See Salomon Analyst*, 544 F.3d at 484 (defendants may rebut presumption of reliance "by showing, for example, the absence of a price impact"). As the Third Circuit explained, "Evidence an allegedly corrective disclosure did not affect the market price undermines the fraud-

on-the-market presumption of reliance for several reasons. . . . Even if a plaintiff could establish the market was efficient notwithstanding a lack of market impact, under our precedents the lack of market impact may indicate the misstatements were immaterial – a distinct basis for rebuttal." *In re: DVI*, 2011 U.S. App. LEXIS 6302, at *35-*36.

Demonstrating that the alleged misrepresentations had no effect on stock price is precisely what Halliburton did in the district court. It introduced significant evidence that neither the alleged misrepresentations nor the subsequent "corrective" statements caused movement in Halliburton's stock price.[4] The district court's finding of fact that it was more likely than not that the alleged misrepresented had not moved the market price (either when made or at the time of the corrective disclosure) was well supported by the evidence.

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[4] As Respondents demonstrate, the courts below did not require Petitioners to demonstrate "loss causation" as a prerequisite to class certification. Resp. Br. 17-19. Indeed, the Fifth Circuit stated explicitly that Plaintiffs could meet their evidentiary burden by showing *either* that the alleged misrepresentation resulted in an inflated stock purchase *or* that the stock price dropped following disclosure of corrective information. Pet. App. 116a.

II. THE DISTRICT COURT PROPERLY GRANTED HALLIBURTON AN OPPORTUNITY FOR REBUTTAL AT THE CLASS CERTIFICATION STAGE

A. Certification of a Class Is Improper Unless the Movant Demonstrates By a Preponderance of the Evidence That He Has Met All the Requirements of Rule 23, Including Predominance

Petitioners assert the right to sue Halliburton not only on their own behalf but also as a representative of the thousands of others who purchased Halliburton stock during a 2 1/2-year period beginning in June 1999. Fed.R.Civ.P. 23 imposes numerous requirements on those seeking to maintain such a representative action, including the prerequisites of Rule 23(a) (numerosity, commonality, typicality, and fair/adequate representation) as well as (under the circumstances of this case) a judicial finding "that the questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy." Fed.R.Civ.P. 23(b)(3).

The Court has held that "any" 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." *General Tel. Co. Southwest v. Falcon,* 457 U.S. 147, 161 (1982). Although the language from *Falcon* refers specifically to Rule 23(a),

federal appeals courts have generally understood the Court's "rigorous analysis" directive to apply to all of the requirements imposed by Rule 23. *See, e.g., In re: Initial Public Offering Securities Litigation* ["*In re: IPO*"], 471 F.3d 24, 33 n.3 (2d Cir. 2006) ("We see no reason to doubt that what the Supreme Court said about Rule 23(a) requirements applies with equal force to all Rule 23 requirements, including those set forth in Rule 23(b)(3)."). *See also, id*. at 40 (prohibiting certification of a class unless the district court explicitly finds that each Rule 23 requirement has been met, and overturning a prior Second Circuit standard under which it was sufficient to make "some showing" with respect to each requirement); *Szabo v. Bridgeport Machines, Inc.,* 249 F.3d 672, 676 (7th Cir. 2001) ("Before deciding whether to allow a case to proceed as a class action, . . . a judge should make whatever factual and legal inquiries are necessary under Rule 23."); *Gariety v. Grant Thornton, LLP*, 368 F.3d 356, 367 (4th Cir. 2004) (reversing class certification order because district court failed to undertake "a rigorous analysis" of each Rule 23 requirement).

Of particular relevance to this case is the Rule 23(b)(3) "predominance" requirement. To prevail in a securities fraud action, a plaintiff must demonstrate, among other things, that he *relied* on the defendant's misrepresentation. *Dura Pharms.*, 544 U.S. at 341-42. Thus, to meet Rule 23(b)(3)'s predominance requirement, a plaintiff needs to demonstrate that reliance can be established on a class-wide basis, because if reliance can only be established on a plaintiff-by-plaintiff basis, questions of law or fact common to class members could never be deemed to "predominate"

over questions affecting only individual members. *See Basic*, 485 U.S. at 242 ("Requiring proof of individualized reliance from each member of the proposed plaintiff class effectively would have prevented respondents from proceeding with a class action, since individual issues then would have overwhelmed the common ones."). In sum, whether Petitioners are entitled to a presumption of reliance is very much a Rule 23(b)(3) class certification issue, because Petitioners cannot meet the "predominance" requirement (and thus are not entitled to certification) unless they are afforded that presumption.

B. That Reliance and Materiality Are Also Merits Issues Does Not Diminish the Importance of Examining Those Issue Closely in Connection with a Determination of Whether Petitioners Can Show Predominance

As noted above, reliance and materiality also "merits" issues: Petitioners cannot prevail on its securities fraud claim unless they can establish that they purchased Halliburton securities at an inflated price in reliance on Halliburton's material misrepresentations. Petitioners assert that that delving into those issues at the class certification stage is premature, violates Rule 23, and deprives them of the opportunity for full discovery prior to a decision on merits-based issues. Pet. Br. 46-56.

Those assertions are not well taken. While the Supreme Court has cautioned against weighing the strength of the merits of a plaintiff's claims as a basis

for granting or denying class certification, it has stated unequivocally that a district court should not shy away from considering evidence that goes to the merits in determining whether the plaintiff has met each of the Rule 23 requirements. *Falcon*, 457 U.S. at 160 ("the class determination generally involves considerations that are enmeshed in the factual and legal issues comprising the plaintiff's cause of action"). The Court has explained that:

> Evaluation of many of the questions entering into determination of class action questions is intimately involved with the merits of the claims. The typicality of the representative's claims or defenses, the adequacy of the representative, and the presence of common questions of law or fact are obvious examples. The more complex determinations required in Rule 23(b)(3) class actions entail even greater entanglement with the merits.

Coopers & Lybrand v. Livesay, 437 U.S. 463, 469 n.12 (1978) (emphasis added) (quoting 15 C. Wright, A. Miller & E. Cooper, *Federal Practice and Procedure*, § 3911 n.45 (1976)).

Petitioners' discovery complaints ring hollow. They did not seek class certification for nearly five years following the filing of the complaint; if they believed that that was an inadequate period of time to complete all discovery relevant to class certification, they should have delayed filing their certification motion until that discovery could be completed. Moreover, the decision denying class certification does not prevent Petitioners

from proceeding forward on the merits; nothing prevents them, before trial, from undertaking whatever discovery they deem necessary to establish loss causation or any other merits-based issue. In any event, Petitioners' discovery complaints are newly minted; they failed to raise them in the lower courts in connection with the class certification motion and should not be permitted to do so now for the first time.

While conceding that *Basic* envisions permitting a defendant to rebut the presumption of reliance, the United States asserts that:

> [T]he *Basic* Court's analysis reflects an expectation that any rebuttal will occur at summary judgment or at trial, not at the outset of the case. A defendant who rebuts the presumption of reliance defeats the plaintiffs' claims on the merits by preventing him from establishing an essential element of his cause of action. So long as the evidence by which the defendant seeks to rebut the presumption is likely to be common to class members generally, the possibility of a successful rebuttal does not render the case unsuitable for class treatment.

U.S. Br. 7.

The United States cites no case law in support of its assertion, which makes little sense. It may sometimes be true that a defendant who rebuts the presumption of reliance "defeats the plaintiffs' claims on the merits." But if, as the United States would surely concede, such a rebuttal also defeats a claim for

class certification by demonstrating the absence of the predominance required by Rule 23(b)(3), what possible grounds would there be for allowing class certification to proceed? It is illogical to suggest that a court should make it easier for a plaintiff to win certification in those situations in which the plaintiff may have evidence demonstrating that the entire securities fraud claim is meritless.

Moreover, it will not necessarily be the case that an individual plaintiff cannot proceed to trial in the face of findings that the market was not defrauded and that the presumption of reliance is unwarranted. For example, the potential tort litigation liabilities of companies such as Halliburton are often highly uncertain. Even if the company makes statements that could be interpreted by some as downplaying to an unwarranted degree the potential for large jury verdicts, major market players are unlikely to be misled – they know full well the uncertain nature of litigation and thus are likely to bid the price of the company's down to a level that fully factors in the potential for adverse jury verdicts. Under those circumstances, the market cannot be said to have been defrauded, and the presumption of reliance is unwarranted. But some individual investors may have actually relied on the company's statements and purchased the company's stock at a price they would have been unwilling to pay had they fully appreciated the risks of litigation. Such individuals could establish individual reliance and proceed with their individual claims even without the benefit of the presumption of reliance.

Basic established a defendant's right to rebut the

presumption of reliance without providing any indication that exercise of that right would have to be deferred to summary judgment or trial. The Court summarized its findings in *Basic* as follows: (1) "it is not inappropriate to apply a presumption of reliance supported by the fraud-on-the-market theory"; (2) that presumption is "rebuttable"; and (3) the district court's initial certification of the class "was appropriate when made but is subject on remand to such adjustment, if any, as developing circumstances demand." *Id.* at 250. Nothing in the Court's summation of its holdings indicated a belief that a defendant's efforts to rebut the presumption of reliance are premature at the class certification stage.

Petitioners nonetheless pointed to *Basic*'s Footnote 29 for the proposition that once a plaintiff establishes that a security trades in an efficient market, a defendant's effort to rebut the presumption of reliance should be delayed until trial, or until the summary judgment stage at the earliest. Pet. Br. 35. That interpretation of Footnote 29 is untenable; Petitioners read far more into the footnote than the Supreme Court could possibly have intended.

Footnote 29 follows the Court's lengthy explanation of numerous methods by which a defendant might rebut the presumption of reliance. It states, in substantial part:

> We note there may be a certain incongruity between the assumption that Basic shares are traded on a well-developed, efficient, and information-hungry market, and the allegation

> that such a market could remain misinformed, and its valuation of Basic shares depressed, for 14 months, on the basis of three public statements. Proof of that sort is a matter for trial, throughout which the District Court retains the authority to amend the certification order as may be appropriate.

Basic, 485 U.S. at 249 n.29.

Petitioners apparently interpret the phrase "proof of that sort" as encompassing *any* effort by a defendant to rebut the presumption of reliance. Order at 19. But it is highly unlikely that the Court intended the phrase to sweep that broadly. Rather, it is much more likely that "proof of that sort" was intended to refer only to proof of the sort described in the first sentence of Footnote 29 – that is, a defendant's proof that *any* "well-developed, efficient, and information-hungry market" is highly unlikely to remain misinformed (and thus overvalued or undervalued) for an extended period of time based on a handful of misleading statements. Had the Court really intended the phrase "proof of that sort" to encompass the types of rebuttal evidence described at length in the main text, it is far more likely that the Court would have included the phrase in the main text instead of relegating it to a footnote.[5]

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[5] Courts have been acutely aware of the need to impose some limits on the quantity of evidence that can be introduced at a class certification hearing, in order to avoid mini-trials that consume too much of the courts' resources. *See, e.g., Salomon,* 544 F.3d at 486. The Court may have deemed the type of rebuttal evidence described in the first sentence of Footnote 29 to be too

Moreover, the Court's statement that "proof of that sort is a matter for trial" may simply have been an acknowledgment that the case before it was well-advanced (*e.g.*, discovery had been completed) and that the most sensible time for that particular defendant to offer rebuttal evidence would be at the impending trial.

Most importantly, Petitioners' reading of Footnote 29 is inconsistent with the remainder of the Court's opinion, which repeatedly emphasized that a class certification order was subject to revision at all times prior to final judgment. For example, the Court stated that class certification was subject on remand to adjustments "as developing circumstances demand." *Id.* at 250. The quoted phrase indicates that the Court contemplated that defendants should *not* be required to wait for trial before attempting to rebut the presumption of reliance.

The Third Circuit this week concluded that defendants should be permitted to challenge class certification by attempting to rebut the presumption of reliance: "We believe 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*. The District Court did not err in evaluating Deloitte's rebuttal arguments." *In re: DVI*, 2011 U.S. App. LEXIS 6302, at *36 (emphasis added). The appeals court rejected the plaintiffs' argument that Footnote 29 of *Basic* precluded raising rebuttal arguments at the certification stage:

This footnote appears to have responded to the

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extensive to be feasibly included in a class certification hearing.

> dissent in *Basic* and was not essential to *Basic*'s holding. *See* [485 U.S.] at 259-63 (White, J., concurring in part and dissenting in part) (discussing the factual peculiarities of the trades in issue). Taken literally, note 29 may even appear to preclude a court from evaluating evidence presented by a defendant at class certification to demonstrate the market is inefficient. But this widespread practice is permitted even in circuits that do not allow the examination of rebuttal evidence at the class certification stage. *See, e.g., Polymedica*, 432 F.3d at 17-19.

Id. at *35. The Second Circuit has similarly interpreted *Basic* as permitting defendants to rebut the presumption of reliance "prior to class certification, by showing, for example, the absence of price impact." *Salomon Analyst*, 544 F.3d at 484.

The Fifth Circuit diverges somewhat from other circuits regarding the strength of the presumption created by *Basic* and what the defendant must do to overcome that presumption. The Fifth Circuit has concluded that the presumption disappears the moment the defendant makes "any showing" that severs the link between the misrepresentation and the plaintiffs' loss, and that the defendant need not go on to carry the ultimate burden of persuasion regarding the existence or non-existence of the link. *Oscar Private Equity Investments v. Allegiance Telecom, Inc.*, 487 F.3d 261, 265 (5th Cir. 2007). Some other appeals courts have concluded that *Basic* created a stronger presumption and have required defendants to make a

correspondingly greater showing in order to defeat the presumption of reliance.

WLF takes no position regarding which circuit more accurately characterizes the strength of the presumption the Court intended to create in *Basic*.[6] But this relatively minor disagreement between the Fifth Circuit and other circuits should not be allowed to obscure the close similarity of the Fifth Circuit's approach to the approach of most other circuits. Rejecting the Fifth Circuit's entire approach to securities law class certification issues – which is what Petitioners and the United States are asking the Court to do – would entail rejecting the substantially similar approaches adopted by most other circuits.

More importantly, the Court's resolution of the Rule 301 issue should not affect the ultimate disposition of this case because the denial of class certification was based on the lower courts' determination – after

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[6] WLF notes, however, that in discussing the presumption, *Basic* makes reference to Rule 301 of the Federal Rules of Evidence. *Basic*, 485 U.S. at 245. Rule 301 describes a weak form of presumption – one that shifts to the opposing party the burden of coming forward with evidence, not the burden of persuasion. *See, e.g., St. Mary's Honor Center v. Hicks*, 509 U.S. 502 (1993) (when a Title VII discriminatory treatment plaintiff establishes a prima facie case of racial discrimination, the presumption thereby created is governed by FRE 301, and only the burden of coming forward with evidence – not the burden of proof – shifts to the defendant). Were Rule 301 to apply to the presumption of reliance, the presumption would (per the Fifth Circuit's *Oscar* decision) disappear the moment a securities class action defendant filed *any* evidence designed to demonstrate a severance of the link between the alleged misrepresentation and the price paid by purchasers of Halliburton stock.

reviewing extensive evidence submitted by both sides – that Halliburton's alleged misrepresentations did not affect the price of Halliburton's stock. In other words, the outcome would have been the same even if the lower courts had imposed a greater evidentiary burden on Halliburton.

III. BECAUSE CLASS CERTIFICATION DECISIONS ARE SO OFTEN OUTCOME-DETERMINATIVE, THE COURT SHOULD BE PARTICULARLY VIGILANT IN ENFORCING STRICT ADHERENCE TO RULE 23

Empirical research demonstrates the crucial role that class certification decisions play in the outcome of high-stakes class action lawsuits. Litigation costs make it very difficult for the party that loses the class certification decision to continue with the litigation – with the result that erroneous certification decisions are often effectively unreviewable. In light of that concern, WLF respectfully urges the Court to use this case to adopt clear rules that will encourage district judges to grant class certification motions only after they have determined that all the requirements of Rule 23 have been satisfied.

As numerous courts have recognized, companies that face a large certified class and hence enormous potential damages are "under intense pressure to settle." *In re Rhone-Poulenc Rorer, Inc.*, 51 F.3d 1293, 1298 (7th Cir.) (Posner, C.J.), *cert. denied*, 516 U.S. 867 (1995). If they do not want to "roll the dice," they settle, such that "the class certification – the ruling that

will have forced them to settle – will never be reviewed." *Id.* Such settlements can in many instances legitimately be deemed "blackmail settlements." H. Friendly, *Federal Jurisdiction: A General View* 120 (1973); *see also Castano v. American Tobacco Co.*, 84 F.3d 734, 746 (5th Cir. 1996) (pressure emanating from certification of big classes amount to "judicial blackmail," creating "insurmountable pressure on defendants to settle"; "the risk of facing an all-or-nothing verdict presents too high a risk, even when the probability of an adverse judgment is low").

Securities fraud class action litigation presents particular problems for defendants because they are especially prone to asymmetrical discovery costs: though they possess few relevant documents subject to discovery, plaintiffs can routinely demand that millions of pages of documents be produced by the defendants. J. Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497, 548-49, 571 (Feb. 1991). Moreover, because securities fraud cases often require the attention and participation of senior corporate executives, defendants in such actions can face costly and debilitating disruptions of their business activities. R. Bone & D. Evans, *Class Certification and the Substantive Merits*, 51 DUKE L.J. 1251, 1299 (Feb. 2002). The costs of a certified class action become prohibitive long before a summary judgment motion can be prepared. Alexander, 43 STAN. L. REV. at 585-87 (case study); D. Towns, *Merit Based Class Certification*, 78 VA. L. REV. 1001, 1031 (1992). One study concluded that, driven largely by litigation costs, "the vast majority of certified class actions settle, most soon after certification." Bone &

Evans, 51 DUKE L. J. at 1291.

The tendency of securities fraud class actions to settle without any relation to the underlying merits of the suits undermines the aims of the federal securities laws. The federal securities fraud statutes aim to deter securities fraud or manipulation, and "to achieve a high standard of business ethics in the securities industry." *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 151 (1972). But economists doubt that those laws can achieve their purpose given the consensus view that there is little correlation between being named in a securities fraud lawsuit and the incidence of fraud. *See, e.g.*, M. Johnson, *et al.*, In re Silicon Graphics Inc.: *Shareholders Wealth Effects Resulting from the Interpretation of the Private Securities Litigation Reform Act's Pleading Standard*, 73 S. CAL. L. REV. 773, 782 (May 2000).

In their zeal to promote a plaintiff-friendly outcomes in securities law cases, Petitioners and the United States have espoused a rule that is directly contrary to this Court's holding in *Basic*. That decision explicitly authorized defendants to attempt to defeat class certification by introducing evidence that the market did not, in fact, rely on the alleged misrepresentations. *Basic* has been settled law for more than two decades; WLF respectfully submits that if Petitioners and the United States seek to overturn *Basic*, they should take their case to Congress.

CONCLUSION

Amicus curiae requests that the Court affirm the the judgment below.

Respectfully submitted,

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