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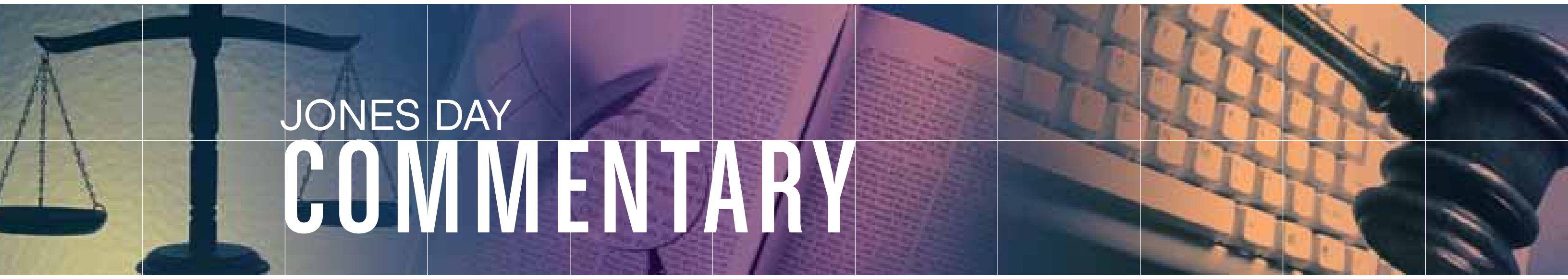


# SUPREME COURT RESOLVES CIRCUIT SPLIT ON PROOF OF LOSS CAUSATION AT THE CLASS CERTIFICATION STAGE

In *Erica P. John Fund Inc. v. Halliburton Co.*, --- S. Ct. ----, No. 09–1403, 2011 WL 2175208, at *3 (U.S. June 6, 2011), the Supreme Court unanimously rejected the Fifth Circuit's requirement that a securities fraud plaintiff prove loss causation before a class can be certified under Rule 23. The Court's opinion was narrowly framed, and it specifically did not address other issues relating to the presumption of reliance in securities fraud cases or how and when that presumption can be rebutted.

As discussed in an April 2011 Jones Day publication entitled "Supreme Court to Consider Circuit Split on Proof of Loss Causation at the Class Certification Stage," issued prior to oral argument in this case, conflicting opinions in the past three years from the Second, Fifth, and Seventh Circuits had created uncertainty regarding the extent to which, in a private action under Section 10(b) of the Securities Exchange Act of 1934, a plaintiff who seeks to invoke the fraud-on-the-market presumption of reliance must prove loss causation at the class certification stage to be able to proceed on behalf of a class.

In a securities fraud action, Rule 23(b)(3)'s requirement that common questions of law or fact predominate generally could not be satisfied if each class member separately had to prove reliance on the alleged misrepresentation. The fraud-on-the-market doctrine articulated by the Supreme Court in *Basic v. Levinson*, 485 U.S. 224 (1988), provides a mechanism to satisfy the predominance requirement in certain circumstances by establishing a classwide rebuttable presumption of reliance for widely traded securities, based on the theory that the market price of the security automatically incorporates the impact of any material misrepresentations. To invoke this presumption, a plaintiff must establish, among other things, that the alleged misrepresentation was publicly known and that the security was traded in an efficient market. In *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336, 342 (2005), the Supreme Court ruled that there must be a "logical link between the inflated share purchase price and any later economic loss." The Dura decision led some courts to question whether a class could be certified if a plaintiff could not prove that her losses were logically linked to the alleged misrepresentations or omissions. Unlike certain other courts that addressed the issue, the Fifth Circuit took the position that a plaintiff seeking class certification must also prove loss causation to trigger the fraud-on-the-market presumption—and thus avoid having individual issues of reliance predominate, which would bar a Rule 23(b)(3) class.

In *Halliburton*, the Supreme Court resolved this question. It noted the distinction between (i) whether an investor relied on a misrepresentation (or the market price, which reflects the impact of the misrepresentation) in making a purchase or sale of a security (sometimes referred to as "transaction causation") and (ii) whether the alleged misrepresentation subsequently caused economic loss ("loss causation"). The Court concluded that the latter question was not relevant to class certification because "[l]oss causation has no logical connection to the facts necessary to establish the efficient market predicate to the fraud-on-the-market theory." *Halliburton*, 2011 WL 2175208, at *6.

During oral argument, Halliburton conceded that a securities fraud plaintiff need not prove loss causation in order to invoke Basic's presumption of reliance at the class certification stage, but suggested that the Fifth Circuit's actual inquiry was whether plaintiffs had demonstrated "price impact"—*i.e.*, whether the alleged misrepresentation affected the market price in the first instance. The Supreme Court rejected this interpretation of the Fifth Circuit's ruling based on "the Court of Appeals' repeated and explicit references to 'loss causation.'" *Id.* at *7.

The Supreme Court, however, limited its holding to the narrow issue of whether a securities plaintiff must prove loss causation at the class certification stage, and the Court explicitly avoided addressing "any other question about Basic, its presumption, or how and when it may be rebutted." *Id.* at *8. The Court noted that "Basic's fundamental premise" is that "an investor presumptively relies on a misrepresentation *so long as it was reflected in the market price at the time of his transaction*." *Id.* at *6 (emphasis added). This formulation—and the Court's opinion—thus leaves open the possibility that a defendant may seek to present evidence that a misrepresentation did not affect the security's market price in order to rebut the fraud-on-the-market presumption and defeat class certification. *See, e.g.*, *In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474 (2d Cir. 2008).

*Halliburton* and the Supreme Court's other major securities decision from this term, *Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309 (2011), do not appear to represent any radical shift in the Court's thinking about securities class actions. In both cases, the Court refused to impose new burdens on plaintiffs in securities class actions, whether those be proving loss causation at class certification or showing statistical significance to show materiality at the pleading stage. Both were unanimous opinions that were not ideologically charged and generally maintained the status quo.

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