Bloomberg BNA

Securities Regulation & Law Report™

CLASS ACTIONS

Eight Propositions Regarding the Scope of *Halliburton II*

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The fraud-on-the-market presumption remains available to securities plaintiffs, but defendants may defeat the presumption—at class certification or on the merits—by establishing a lack of price impact. Thus concluded the majority in *Halliuburton II*. But is it really true that the decision ''should impose no heavy toll on securities-fraud plaintiffs with tenable claims,'' as Justice Ruth Bader Ginsburg predicted in her concurrence? We think not.

Halliburton II ushers in a new era of securities litigation in which more case-dispositive, or case-limiting, decisions will be made at the class certification stage. The Court did not put an end to securities class actions, but we believe the toll on securities plaintiffs and their lawyers has been significantly increased. To explore this hypothesis, we offer the following eight propositions regarding the case and its ramifications:

1. Some Securities Cases Are Proper Class Actions (And Some Are Not). The Court's retention of the presumption of reliance means that some securities cases will continue to be certified as class actions under Federal Rule of Civil Procedure 23. This should come as a surprise to no one: Claims analogous to a modern securities case have been recognized as potentially appropriate for collective adjudication for almost a hundred years. *Supreme Tribe of Ben-Hur v. Cauble*, 255 U.S. 356 (1921). For example, an aftermarket fraud case involving a uniform public statement about an exchange-traded stock might be suited to class treatment since all investors are similarly situated.

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This might seem like an obvious point, but it tends to get obscured by the polarizing nature of the discussion. Plaintiffs' lawyers hyperbolically say that every securities case is a natural class action, while defense counsel respond with equal exaggeration that it is unfair to aggregate any claims. The right answer lies somewhere between the two extreme positions, although there is a legitimate debate about exactly where. In our view, *Halliburton II* moved the needle farther away from ''automatic'' certification of securities cases, but it remains to be seen how far.

2. Plaintiffs Still Have the Burden of Proving the Prerequisites to Class Certification. As explained in *Halliburton II*, the Court's ''recent decisions governing class action certification . . . have made clear that plaintiffs wishing to proceed through a class action must actually *prove*—not simply plead—that their proposed class satisfies each requirement of Rule 23.'' Slip op. 14 (emphasis in original). With the exception of those rare cases in which the defendant stipulates to class certification, this means the plaintiff must come forward with *evidence* sufficient to persuade the district court, by a preponderance of the evidence, that the prerequisites to certification are met. *Comcast Corp. v. Behrend*, 133 S.

Ct. 1426 (2013); *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541 (2011). These include the numerosity, commonality, typicality, and adequacy requirements of Rule 23(a) as well as (in cases seeking money damages) the superiority and predominance requirements of Rule 23(b)(3). As to each prerequisite, and the overall entitlement to certification, the burden of persuasion rests at all times on the proponents of class certification.

The corollary to plaintiffs' obligation to introduce evidence in support of class certification is the defendant's opportunity to present evidence in response. If a defendant disputes that one or more prerequisites are met, it may introduce fact and expert testimony in support of its position. The court must resolve factual disputes, rule on *Daubert* challenges, and decide any ''battle of the experts'' to the extent necessary to decide the Rule 23 issues in the case. *In re Initial Pub. Offerings Sec. Litig.*, 471 F.3d 24 (2d Cir. 2009). This is true even if the Rule 23 issues overlap with merits issues, as the Supreme Court made clear (in footnote 6 of *Dukes*) specifically with reference to the fraud-on-the-market presumption of reliance in securities cases. As a prime example, price impact evidence—clearly fair game at the certification stage under *Halliburton II*—may not be ignored or minimized or disregarded merely because the same information may *also* be relevant to merits elements such as materiality or loss causation.

The decision in *Halliburton II* is the third in a trilogy on the plaintiff's obligation at class certification. The first case held that a plaintiff need not prove loss causation at the certification stage (*Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179 (2011)), and the second held that a plaintiff need not prove materiality at the certification stage (*Amgen Inc. v. Conn. Ret. Plans & Trust Funds*, 133 S. Ct. 1184 (2013)). The price impact evidence authorized by *Halliburton II* may very well bleed into loss causation or materiality. (In fact, the ''loss causation'' evidence in *Halliburton I* was the same as the ''price impact'' evidence in *Halliburton II*.)

Some plaintiffs will argue that if evidence can be characterized as relevant to materiality or loss causation then it is ''off limits'' at the class certification stage. That argument overlooks the fact that the elements of the 10b-5 cause of action are not entirely discrete from one another. The Court has summarized the elements thusly:

In cases involving publicly traded securities and purchases or sales in public securities markets, the action's basic elements include:

(1) a material misrepresentation (or omission);

(2) scienter, i.e., a wrongful state of mind;

(3) a connection with the purchase or sale of a security;

(4) reliance, often referred to in cases involving public securities markets (fraud-on-the-market cases) as ''transaction causation'';

(5) economic loss, 15 U. S. C. § 78u-4(b)(4); and

(6) ''loss causation,'' i.e., a causal connection between the material misrepresentation and the loss.

Dura Pharmaceuticals, Inc. v. Broudo, 544 US 336 (2005) (citations omitted).

The Supreme Court has noted that these elements, while ''analytically distinct,'' are ''related'' to one another and discussion of one may ''merge'' with another. *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148 (2008). Thus evidence may bear on more than one element: A regression analysis, for example, may go to both reliance and loss causation. Another implication of *Halliburton II* is that such evidence is admissible on class certification if it goes to an issue in dispute at that stage, even if it might also go to another issue on the merits.

3. Reliance Remains Critical to the Predominance Requirement. In most securities class actions, the key question at the certification stage is whether the plaintiffs can satisfy the predominance requirement of Rule 23(b)(3), which requires the district court to make a finding that ''the questions of law or fact common to class members predominate over any questions affecting only individual members.'' This ''demanding'' requirement serves to ensure that the proposed class is sufficiently cohesive to permit collective adjudication. *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591 (1997).

The Supreme Court said in *Amchem* that predominance ''is a test readily met in certain cases alleging . . . securities fraud or violations of the antitrust laws.'' But we know that not *every* securities or antitrust case will clear the predominance hurdle: The Court's recent decision in *Comcast*, which decertified an antitrust class because the plaintiffs had failed to adduce an expert methodology for calculating injury on a classwide basis, illustrates the robustness of the predominance requirement. And *Basic* itself recognized that without a presumption of reliance, securities class actions would falter at predominance because of the individualized nature of the reliance inquiry, as the Court reiterated in *Halliburton II*:

> [*Basic*] also noted that requiring proof of individualized reliance from every securities fraud plaintiff effectively would prevent plaintiffs from proceeding with a class action in Rule 10b-5 suits. If every plaintiff had to prove direct reliance on the defendant's misrepresentation, individual issues then would overwhelm the common ones, making certification under Rule 23(b)(3) inappropriate.

Slip op. 6 (internal citations and punctuation omitted).

The *Halliburton II* Court, after reaffirming the *Basic* presumption, made clear that it does not relieve securities plaintiffs of their burden of proving predominance at the class certification stage:

> In securities class action cases, the crucial requirement for class certification will usually be the predominance requirement of Rule 23(b)(3). The *Basic* presumption does not relieve plaintiffs of the burden of proving—before class certification—that this requirement is met. *Basic* instead establishes that a plaintiff satisfies that burden by proving the prerequisites for invoking the presumption—namely, publicity, materiality, market efficiency, and market timing. The burden of proving those prerequisites still rests with plaintiffs and (with the exception of materiality) must be satisfied before class certification. *Basic* does not, in other words, allow plaintiffs simply to plead that common questions of reliance predominate over individual ones, but rather sets forth what they must prove to demonstrate such predominance.

Slip op. 14.

4. The Presumption of Reliance May Be Rebutted in a Variety Of Ways. In announcing the presumption of reliance, *Basic* emphasized that it could be rebutted by ''[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 Inc. v. Levinson*, 485 U.S. 224 (1988). Such a showing might include evidence that the

   ISSN 0037-0665

market for the security is not efficient (as is often the case with thinly traded bonds).

The *Halliburton II* Court explained another way that the presumption can be rebutted: ''[A] defendant could show that the alleged misrepresentation did not, for whatever reason, actually affect the market price'' of the security. Slip op. 7. If such a showing is made, the presumption is rebutted and the plaintiffs must prove ''eyeball'' reliance.

Successfully rebutting the presumption of reliance will generally preclude class certification. As the *Halliburton II* Court explained, if the defendant rebuts the presumption then the ''plaintiff would have to prove that he directly relied on the defendant's misrepresentation in buying or selling the stock.'' Slip op. 7. Without a presumption of reliance, a fraud case generally cannot be certified as a class action because individualized reliance issues will overwhelm any common issues. *McLaughlin v. Am. Tobacco Co.*, 522 F.3d 215 (2d Cir. 2008).

5. Rebuttal Evidence May Include Absence of Price Impact. Aside from reaffirming *Basic*, the core holding of *Halliburton II* is that one way of rebutting the presumption, by showing that the challenged misstatement did not affect the market price, is for the defendant to introduce ''evidence of a *lack* of price impact, not only at the merits stage . . . but also before class certification.'' Slip op. 16 (emphasis in original). That is because, as the Court explained, ''[i]n the absence of price impact, *Basic*'s fraud-on-the-market theory and presumption of reliance collapse.'' *Id.* at 17.

To elevate the importance of price impact evidence, the *Halliburton II* Court put an interesting—and important—doctrinal gloss on the *Basic* presumption. The Court first reiterated that, to invoke the presumption, ''a plaintiff must prove that: (1) the alleged misrepresentations were publicly known, (2) they were material, (3) the stock traded in an efficient market, and (4) the plaintiff traded the stock between when the misrepresentations were made and when the truth was revealed.'' Slip op. 16. The Court then observed that ''[t]he first three prerequisites are directed at price impact'' (*id.* at 17)—an observation it supported by disaggregating the *Basic* presumption:

> What is called the *Basic* presumption actually incorporates two constituent presumptions: First, if a plaintiff shows that the defendant's misrepresentation was public and material and that the stock traded in a generally efficient market [*i.e.*, predicates (1), (2), and (3)], he is entitled to a presumption that the misrepresentation affected the stock price. Second, if the plaintiff also shows that he purchased the stock at the market price during the relevant period [predicate (4)], he is entitled to a further presumption that he purchased the stock in reliance on the defendant's misrepresentation.

Id. at 17-18.

Price impact evidence serves to rebut the first constituent presumption—that the misrepresentation affected the price. If the plaintiff establishes the first three predicates, the defendant may show—through an event study or other regression technique—that the misrepresentation did not *in fact* affect the stock price. As the Court explained, ''market efficiency and the other prerequisites for invoking the presumption constitute an indirect way of showing price impact.'' Slip op. 20. While it is ''appropriate to allow plaintiffs to rely on this indirect proxy for price impact,'' such ''an indirect proxy should not preclude direct evidence when such evidence is available.'' *Id.* And if the defendant introduces such direct evidence, the plaintiff will have to adduce its own event study or other direct evidence to counter it.

The *Halliburton II* Court announced, in unequivocal terms, that ''without the presumption of reliance, a Rule 10b-5 suit cannot proceed as a class action: Each plaintiff would have to prove reliance individually, so common issues would not 'predominate' over individual ones, as required by Rule 23(b)(3).'' Slip op. 20. Since evidence that the challenged statement did not actually affect the stock price is sufficient to defeat the presumption, then price impact evidence may end—or substantially limit—a securities fraud class action. It obviously will not do so in every case, but in some cases it will be dispositive or nearly so.

6. Price Impact Must Be Evaluated on a Statement-By-Statement Basis. One significant consequence of the *Halliburton II* Court's approach to the presumption is to shift the focus, at class certification, from the entire class period to each misrepresentation. Securities plaintiffs often offer generic evidence that the securities traded on an efficient market during the entire class period, and little more. *See Cammer v. Bloom*, 711 F. Supp. 1264 (D.N.J. 1989) (articulating five ''factors'' for evaluating market efficiency). This amounts to the ''indirect'' proxy for price impact that *Basic* allows, and that *Halliburton II* essentially reaffirms.

Halliburton II dodged the question of what facts must be adduced to actually establish ''market efficiency.'' Indeed, the Court went to some pains to say that the ''debate'' over this question is ''not new,'' but that it was not the Court's role to resolve it—only to uphold *Basic*'s core principle that ''public information generally affects market prices.'' How, though, do courts measure that? Similarly, the Court alludes to the idea that public information is absorbed ''within a reasonable time period''—but what does that mean? These and other key *economic* questions, the Court said, are ''largely beside the point.'' And the Court did not address the *Cammer* factors, which have been used so often by district courts to determine whether a market is efficient. Although some commentators on the plaintiffs' side have taken this silence to be an implicit approval of the *status quo*, the better reading of the decision is that these issues simply were not before the Court. Rather, *Halliburton II* assumed that the plaintiff could prove market efficiency somehow, and focused on the consequences of such a showing.

The price impact evidence specifically endorsed by *Halliburton II*—an event study—is a far more tailored approach to the effect of a particular statement in the market. Even assuming market efficiency during the class period, an event study relies on regression techniques to isolate the effect (if any) of a particular statement on stock price. As an example, an issuer's stock price might increase 5% on the date a challenged statement was made, but if the entire market (or a relevant segment of the market) also rises by the same amount the assumption that the individual stock price increase was attributable to the misstatement will be negated. An event study can demonstrate, using statistical analyses, the price impact of each challenged statement—or other discrete event—as distinguished from broader market movements and economic circumstances. This

type of analysis can be performed on each allegation of wrongdoing in the complaint.

The *Halliburton II* Court explained this critical statement-by-statement standard under Rule 23 in a hypothetical:

> Suppose a defendant at the certification stage submits an event study looking at the impact on the price of its stock from six discrete events, in an effort to refute the plaintiffs' claim of general market efficiency. . . . Suppose one of the six events is the specific misrepresentation asserted by the plaintiffs. . . . Now suppose the district court determines that, despite the defendant's study, the plaintiff has carried its burden to prove market efficiency, but that the evidence shows no price impact with respect to the specific misrepresentation challenged in the suit. The evidence at the certification stage thus shows an efficient market, on which the alleged misrepresentation had no price impact.

Slip op. 19-20.

In this respect *Halliburton II* fits hand-in-glove with the Private Securities Litigation Reform Act of 1995. ''Under the PSLRA's heightened pleading instructions, any private securities complaint alleging that the defendant made a false or misleading statement must . . . specify each statement alleged to have been misleading [and] the reason or reasons why the statement is misleading.'' *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 127 S. Ct. 2499 (2007). The statement-by-statement approach mandated by Congress at the pleading stage is now required to be replicated at the certification stage, giving the defendant the opportunity to offer a statement-by-statement rebuttal to any presumption of price impact or market effect on the basis of *evidence*, not conjecture.

The statement-by-statement approach demanded by *Halliburton II* can have a dramatic impact on securities suits alleging multiple misstatements. It is not uncommon that one statement has price impact but another statement does not. Under *Basic*, a plaintiff can secure class certification and proceed to trial on both statements because market effect is presumed. Under *Halliburton II*, however, the defendant could knock out the second statement—and thus narrow the scope of the class (by date, investors, geography, etc.). This will help focus the issues for trial and ensure that juries are not presented with evidence of alleged misstatements that did not affect market price.

7. The Burden of Persuasion Always Remains on Class Proponents. In the immediate wake of *Halliburton II*, some commentators have suggested that the Court has ''shifted'' the burden of proving (or disproving) reliance from plaintiffs to defendants. That is incorrect.

Reliance is an element of the Rule 10b-5 class action. The plaintiff has the burden of proving that element at the trial on the merits, and the Rules Enabling Act precludes relieving the plaintiff of that burden simply because the case is proceeding as a class action—or depriving the defendant of any defense to that element, including evidence that negates the presumption. As *Halliburton II* explained, the *Basic* presumption allows the plaintiff to carry that burden by proving the predicates to the presumption. At certification, the plaintiff must similarly prove those predicates (other than materiality) to clear the predominance hurdle.

The price impact evidence authorized by *Halliburton II* does not alter the plaintiff's burden of proof, either on certification or at the merits. The Court held that, given the nature of the *Basic* presumption, the burden of *production* of ''direct'' evidence should be placed on defendants. In other words, a plaintiff need not come forward with direct evidence of price impact, but instead may continue to rely on the indirect proxy afforded by *Basic*. Slip op. 17-18. If the plaintiff does so, the defendant may come forward with direct evidence that each challenged misstatement did not affect market prices. It will then be up to the plaintiff to meet its burden of persuasion by refuting defendant's direct evidence, presumably with direct evidence of its own. The Court has adopted similar burden-shifting frameworks in other areas of the law. *See*, *e.g.*, *McDonnell Douglas Corp. v. Green*, 411 U.S. 792 (1973) (Title VII).

8. Class Certification Just Got Even More Expensive. One predictable consequence of *Halliburton II* is that *both* plaintiffs *and* defendants will introduce event studies and other regression analyses as direct evidence of price impact. These statistical tools use different assumptions and models, and different experts may come to different conclusions about whether a particular statement affected the market price of the security. District courts will have to resolve *Daubert* challenges to expert methodologies and, if presented with two admissible but conflicting opinions on price impact, resolve the ''battle of the experts'' to the extent it pertains to the Rule 23 predicates. In doing so, district courts will have to articulate their reasons for accepting (or rejecting) the presumption of reliance, to enable appellate review of the ensuing order certifying (or refusing to certify) the class. *See* Fed. R. Civ. P. 23(f).

Price impact evidence of the sort contemplated by *Halliburton II* may also require some amount of discovery to, among other things, identify the market reaction to the statements at issue, changes to analysts' earnings models or price targets in response to the allegedly misleading disclosures, patterns in trading volumes or short positions following the allegedly misleading statements, news media coverage, micro- and macroeconomic conditions at the time, and other indicators of price impact. Expert economists and statisticians performing the event studies will need this information as inputs for the regression analyses.

District courts will also have to adopt case management techniques to ensure the orderly presentation of competing expert opinions and event studies. For example, while a plaintiff is not *required* to adduce direct evidence of price impact, if the plaintiff intends to do so it may make sense for its expert report to be produced first since it bears the ultimate burden of persuasion on the issue. There are also legitimate concerns with plaintiffs ''sandbagging'' the defendant on this issue. In some cases, an evidentiary hearing—perhaps with testimony from the competing experts—may be required. In this sense, the certification stage in some cases will become a ''mini-trial'' on price impact, with the possibility of appellate review following the ensuing order.

All of this is in keeping with the Supreme Court's recent emphasis on the importance of the class certification stage in complex litigation, including the need for actual *evidence* to support *findings* that the Rule 23 requirements have been met, as exemplified in *Dukes* and *Comcast*. While the plaintiff need not prove the whole case on certification—as *Halliburton I* and *Amgen* establish—it will have to prove significant components, including its entitlement to the presumption of reliance. If nothing else, *Halliburton II* makes clear that this is-

   ISSN 0037-0665

sue can and will be contested in more cases, leading to increased challenges and opportunities for securities plaintiffs and defendants alike.

It has been suggested that perhaps *Halliburton II* will chasten plaintiffs' counsel into pleading narrower, more intellectually honest claims or class periods. In our view this is a dubious proposition. On the contrary, it is highly predictable that the same ''stock drop'' that has been the basis for countless securities class actions will, *ipse dixit*, be alleged to show the ''price impact'' of allegedly false statements that otherwise had no measurable impact on stock price. In this sense, we expect ''business as usual'' from the securities plaintiffs' bar. What *Halliburton II* offers is the possibility of an earlier exit from some meritless cases where economic *evidence* overcomes the assumption that alleged wrongdoing is reflected in a security's market price. Like many Supreme Court rulings, it likely will take years of district court and appellate decisions to sort out the standards for determining price impact and applying this new tool in actual cases.