



## Defeating Class Certification: Halliburton II Ruling Impacts Securities Class Action Issues

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In its June 23, 2014 opinion in *Halliburton Co. v. Erica P. John Fund, Inc.* (“Halliburton II”), the United States Supreme Court addressed two securities class action issues:

1. It affirmed the validity of the fraud-on-the-market theory as a method of proving reliance in order to establish securities fraud; and
2. It held that, at class certification, a defendant may introduce evidence to rebut the presumption of reliance, the touchstone of the fraud-on-the-market theory.

In *Halliburton II*, Erica P. John Fund (“Plaintiff”) sought to certify a class of all investors who purchased Halliburton common stock after Halliburton allegedly made a series of misrepresentations that artificially inflated Halliburton’s stock price. Plaintiff asserted that Halliburton’s alleged misrepresentations constituted securities fraud in violation of section 10(b) of the Securities Exchange Act of 1934 and the Securities and Exchange Commission’s Rule 10b-5.

To recover damages for violations of section 10(b) and Rule 10b-5, a plaintiff must prove the following:

- A material misrepresentation or omission by the defendant;
- Scienter/intent;
- A connection between the misrepresentation or omission and the purchase or sale of a security;
- Reliance upon the misrepresentation or omission;
- Economic loss; and
- Loss causation.

The reliance element ensures that a defendant’s misrepresentation and a plaintiff’s injury are properly connected. In the securities context, the most direct way that a plaintiff can demonstrate reliance is by showing that he or she was aware of a company’s specific statement and purchased stock in that company in reliance on that statement. In *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), the Court held that a plaintiff can also establish a “presumption” of reliance based on the fraud-on-the-market theory.

The fraud-on-the-market theory states that “the market price of shares traded on well-developed markets reflects all publically available information, and hence, any material misrepresentations.” The fraud-on-the-market theory presumption of reliance is rebuttable rather than conclusive, however. “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 market price, will be sufficient to rebut the presumption of reliance.”

Focusing on *Halliburton II*, Halliburton argued to the district court that class certification was inappropriate because Halliburton’s evidence demonstrated that none of the alleged misrepresentations had actually affected Halliburton’s stock price. Because Halliburton’s evidence demonstrated the absence of any “price impact,” Halliburton argued that it had rebutted the *Basic* presumption of reliance. Halliburton argued that, without the *Basic* presumption of reliance, class certification was inappropriate under Rule 23(b)(3) because individualized questions of reliance predominated over common issues. The district court declined to consider Halliburton’s “price impact,” argument at class certification and certified Plaintiff’s proposed class pursuant to Rule 23(b)(3).

On appeal, the Fifth Circuit affirmed the district court’s decision. The Fifth Circuit held that, while Halliburton’s price impact argument could be used at trial to rebut the *Basic* presumption, it had no bearing on the question of predominance and was not appropriate for consideration at the class certification stage of the proceedings.

The Supreme Court disagreed with the trial court and the Fifth Circuit concerning Halliburton’s price impact class certification argument and vacated the Fifth Circuit’s judgment. The Supreme Court held that the trial court should have considered Halliburton’s evidence that the alleged misrepresentations at issue did not actually affect the market price of the stock in determining whether to certify the proposed class. Without the presumption of reliance, a Rule 10b-5 suit cannot proceed as a class action, as each plaintiff would have to prove reliance individually, so common issues would not “predominate” over individual ones as required by Rule 23(b)(3). In addition, the Court noted that allowing defendants to introduce price impact evidence at the class certification stage for the purpose of countering a plaintiff’s showing of market efficiency, but not allowing that evidence to directly rebut the reliance presumption, could create absurd results. Specifically, the Court observed that, under the Fifth Circuit’s analysis, a defendant could use a study to refute evidence of general market efficiency, a prerequisite for the reliance presumption, at the class certification stage, but could not use the same study to demonstrate that an alleged misrepresentation had no impact on the price of the stock at issue at the class certification stage. *Halliburton II* now prevents such an evidentiary inconsistency.

Based on the Supreme Court’s ruling in *Halliburton II*, defendants in a private securities fraud class action can now introduce evidence at the class certification stage that an alleged misrepresentation did not actually affect the stock’s market price. With this ruling, defendants have an additional tool to use in defeating class certification.

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