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# United States Supreme Court Holds that Securities Fraud Plaintiffs Need Not Establish Loss Causation to Certify a Class

In *Erica P. John Fund, Inc. v. Halliburton Co.*,No. 09-1403, 2011 WL 2175208 (U.S. June 8, 2011), the United States Supreme Court held that securities fraud plaintiffs need not prove loss causation in order to invoke the presumption of investor reliance at the class certification stage. The Court's unanimous ruling, which reversed the United States Court of Appeals for the Fifth Circuit, focused narrowly on the need to prove loss causation at the class certification stage and expressly declined to address other issues regarding class certification in securities fraud class actions.

Lead plaintiff Erica P. John Fund, formerly known as the Archdiocese of Milwaukee Supporting Fund, Inc., brought this action against Halliburton and one of its executives under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5, 17 C.F.R. § 240.10b-5, alleging that they made various misrepresentations designed to inflate Halliburton's stock price. The lawsuit contends that investors were damaged when Halliburton later made corrective disclosures that caused the company's stock price to drop.

The United States District Court for the Northern District of Texas declined to certify a class under Rule 23 of the Federal Rules of Civil Procedure. The district court held that although the parties agreed that all of the elements of Rule 23(a) were met, the class could not proceed under Rule 23(b)(3) because the lead plaintiff had "failed to establish loss causation with respect to any" of its claims as required for class certification by *Oscar Private Equity Investments v. Allegiance Telecom, Inc*.,487 F.3d 261 (5th Cir. 2007). On appeal, the Fifth Circuit affirmed. The Supreme Court granted *certiorari* to address the question of whether plaintiffs in a securities fraud action must establish loss causation at the class certification stage to invoke the fraud-on-the-market presumption of investor reliance.

Securities fraud plaintiffs seeking to certify a class rely routinely upon the presumption of class-wide investor reliance set forth in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988). In *Basic*, the Supreme Court established a rebuttablepresumption of class-wide investor reliance based upon the fraud-on-the-market theory. [*See* our prior blog articles on this topic here and here.]  The fraud-on-the-market theory is based upon the hypothesis that in an open and developed securities market (such as the New York Stock Exchange or NASDAQ), the price of a company's stock will be determined by all public material information about the company. Under the theory, because investors are presumed to rely upon the "integrity" of that market price in making their investment decisions, courts may presume for purposes of certifying a class that investors relied upon on public material misrepresentations or omissions. *Basic* adopted the theory, reasoning that requiring proof of individualized reliance from each member of a proposed class would effectively prohibit a suit from proceeding as a class action because "individual issues then would . . . overwhelm[] the common ones."

Since its holding in *Oscar*, the Fifth Circuit has stood alone among the other Circuits in requiring plaintiffs to establish loss causation in order to trigger the fraud-on-the-market presumption. In other words, plaintiffs had to establish a causal link between the alleged falsehoods at issue and their losses in order to invoke the presumption of reliance. Other Circuits, such as the Seventh, Third and Second, have declined to place such a burden on plaintiffs, expressly or impliedly rejecting *Oscar. See* *Schleicher v. Wendt*,618 F.3d 679, 687 (7th Cir. 2010); *In re DVI Inc. Securities Litigation*, Nos. 08-8033 & 08-8045, 2011 WL 1125926, at *7 (3d Cir. Mar. 29, 2011) [*see* blog article here]; *In re Salomon Analyst Metromedia Litig.*,544 F.3d 474, 483 (2d Cir. 2008).

In a fairly terse opinion by Chief Justice Roberts, the Supreme Court rejected unanimously the Fifth Circuit's view on this issue, holding that lead plaintiff was not required to prove loss causation in order to establish the fraud-on-the-market presumption. The Court held that such a requirement was "not justified by *Basic* or its logic."

Importantly, the Court declined to address other issues raised by the parties affecting class certification in securities cases, deciding instead to remand the case to the Fifth Circuit to address those issues in the first instance. The Court thus did not disturb the determinations in *Salomon* and *DVI* that a defendant may rebut the fraud-on-the-market presumption at the class certification stage by demonstrating that the alleged misrepresentations did not affect the market price. Nor did the Court reject other aspects of rebuttal, including by proof that alleged misrepresentations would not have been material to investors. The Supreme Court did appear to recognize, however, that in order to invoke the *Basic* presumption plaintiffs must demonstrate more than mere market efficiency. For example, plaintiffs must also demonstrate that the alleged misrepresentations were publicly known and that the relevant transactions took place "between the time the misrepresentations were made and the time the truth was revealed." Further, the Court went to lengths to acknowledge that the fraud-on-the-market presumption could be rebutted.

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