No. 09-1403

In the Supreme Court of the United States

ERICA P. JOHN FUND, INC., PETITIONER.

v.

HALLIBURTON CO.; DAVID J. LESAR, RESPONDENTS.

On a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit.

REPLY BRIEF FOR PETITIONER

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INTRODUCTION AND SUMMARY

The district court held that plaintiff had met each of the requirements of Rule 23 for class certification. Pet. App. 4a, 54a. The court nonetheless denied class certification on the ground that plaintiff had not proven loss causation on the merits, a requirement set out in the Fifth Circuit's decision in *Oscar Private Equity Invs. v. Allegiance Telecom, Inc.*, 487 F.3d 261 (5th Cir. 2007). Pet. App. 4a, 54a.

The Fifth Circuit affirmed, reiterating that plaintiffs are "required to prove loss causation" in order to obtain class certification, Pet. App. 115a, a requirement the court described as "rigorous," *id.* at 130a. As one judge explained at oral argument, by requiring proof of loss causation, "we did away with Rule 23 virtually." Pet. 8 n.4.

The Fifth Circuit is the only court that requires plaintiffs to prove loss causation in order to trigger the fraud-on-the-market presumption at class certification. Its rule has been rejected by the Second, Third, and Seventh Circuits, *see In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474 (2d Cir. 2008); *In re DVI Inc., Sec. Litig.,* Nos. 08-8033, 08-8045, -- F.3d --, 2011 WL 1125926 (3d Cir. Mar. 29, 2011); *Schleicher v. Wendt*, 618 F.3d 679 (7th Cir. 2010); and numerous district courts in other circuits, *see* Pet. 15-17. In requiring proof of loss causation, the Fifth Circuit has acknowledged that it is conducting a "merit inquiry" at class certification, *Oscar*, 487 F.3d at 267, not to

determine whether the requirements for class certification under Rule 23 are met, but to "tighten" the requirements for class certification because class certification "bestows upon plaintiffs extraordinary leverage, and its bite should dictate the process that precedes it." *Id.* at 264-65, 267.

The Fifth Circuit's rule is wrong. The critical question at class certification under Rule 23(b) is whether common questions will predominate over individual ones. Proof of loss causation is not required to establish that common questions will predominate. Indeed, all agree in this case that "loss causation stands or falls on a classwide basis". Resp. Supp. Br. In Opp. 9. Instead, the Fifth Circuit requires proof of loss causation because it believes that class certification rules need to be "tightened." But the Fifth Circuit is not authorized to add its own requirements for class certification to those set out in Rule 23 based on its own policy preferences. And the effect of the Fifth Circuit's rule is a substantial one: it requires that district courts conduct mini-trials on the issue of loss causation under a preponderance of the evidence standard, rather than the disputed-issue-of-material-fact summary judgment standard that normally determines whether a plaintiff's case reaches a jury.

Nothing in this Court's decision in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), supports the radical approach taken by the Fifth Circuit. In *Basic*, this Court held that a plaintiff in a private securities fraud case may establish a rebuttable presumption of reliance through the fraud-on-the-market theory, which presumes that "the market

price of shares traded on well-developed markets reflects all publicly available information," including "any public material misrepresentations," and "[a]n investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price." *Basic*, 485 U.S. at 246-47. The Court said nothing about the separate element of loss causation, and it did not suggest that it was modifying any of the requirements for class certification under Rule 23.

Defendants attempt to justify the Fifth Circuit's rule by first narrowing the rule and then trying to link it to *Basic*. Despite defendants' revisionism, it is clear that the Fifth Circuit requires proof of *loss causation*, not just validation of the fraud-on-the-market theory of *reliance*. Indeed, the Fifth Circuit in this case found that plaintiff had established the prerequisites for invoking the fraud-on-the-market theory, Pet. App. 115a, but then decided the class could not be certified because plaintiff did not show loss causation. Contrary to defendants' contention, the Fifth Circuit requires plaintiffs to prove loss causation on the merits to obtain class certification, regardless of their theory of loss or whether defendants make any effort to dispute the issue.

Defendants also argue that the Fifth Circuit requires proof of loss causation only to determine whether a material misrepresentation has distorted the stock's price, and contends that this showing may be required under *Basic*. They are wrong for several reasons. First, as this Court explained in *Dura Pharms, Inc. v. Broudo*, 544 U.S. 336, 342-43

(2005), loss causation and price distortion are not the same, and an inability to prove loss causation does not show that a stock's price was not distorted by fraud. Second, requiring proof of price distortion or loss causation on the merits is not appropriate at class certification. The appropriate question at class certification is whether common questions of law or fact predominate, not whether the plaintiff will prevail on the merits. Third (and related), *Basic* does not require plaintiffs to prove that a material misrepresentation distorted a stock's price or ultimately caused a loss; it *presumes* a misrepresentation would distort the stock price in an efficient market. Fourth, *Basic*'s statement that defendants may rebut the fraud-on-the-market presumption does not justify requiring plaintiffs to make a merits showing as a prerequisite for class certification; so long as rebuttal of the presumption will turn on common questions, it should be considered at summary judgment or at trial, not at class certification.

By requiring a showing of likely success on the merits on the issue of loss causation at class certification, the Fifth Circuit's rule is contrary to this Court's decision in *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156 (1974), and Federal Rule of Civil Procedure 23. As the district court's and court of appeals' lengthy factual analyses demonstrate, the burden of proving loss causation is complex. The Fifth Circuit's decision to place that burden on plaintiffs at class certification has real practical significance: it requires plaintiffs to prove an essential element of their case at a threshold stage of the litigation—often without adequate discovery—

thereby preempting the merits inquiry that occurs at summary judgment under the disputed issue of material fact standard and usurping the jury's role in resolving disputed loss-causation issues at trial. There is no basis in Rule 23 or any of this Court's decisions for such a rule.

FACTS

The district court denied defendants' motion to dismiss, holding that plaintiff had properly alleged a violation of the federal securities law. USCA5 4185-87, 6467. At class certification, the court held that plaintiff had satisfied the requirements of Rule 23(a), and that class certification would be appropriate on the ground that common issues predominated over individual interests under Rule 23(b), were it not for the Fifth Circuit's requirement of proving loss causation. Pet. App. 4a, 54a.

The defendants did not seek to rebut plaintiff's proof that the market for the stock of Halliburton, a large public company whose stock is actively traded, was efficient. Pet. App. 115a. Nor did defendants seek to rebut the presumption of reliance that *Basic* holds results from the finding of an efficient market. Nor do defendants identify any other issue that would not be common to the class members. Instead, defendants opposed class certification on the ground that plaintiff had not proven loss causation by a preponderance of the evidence. Relying on *Oscar*, defendants argued that the sufficiency of plaintiff's claim of loss causation should be tested at the class certification stage

rather than at summary judgment or at trial, and that dueling experts or disagreements about the evidence mean plaintiff loses rather than having an opportunity to try its case to a jury.

The courts' analysis of loss causation in this case makes plain how severely the Fifth Circuit's rule "tightens" the requirements for class certification. Plaintiff was required to prove almost its entire case—not just that there is a presumption that the market would account for defendant's material misrepresentations—and to do so under a uniquely exacting standard. Where defendants released other bad news on the days it made certain of its corrective disclosures, plaintiff was required to disaggregate the effects of the corrective disclosures from the other bad news and to prove that it was the material misstatements—not some other news—that caused the decline in market price. Where there was no other possible cause of a price decline, plaintiff was required to prove that the disclosure revealed that the prior representations had been not merely wrong but fraudulent, and plaintiff was required to make these showings at the class certification stage, before the completion of discovery and summary judgment motions, by at least a preponderance of the evidence (and in certain cases by excluding the possibility that a reasonable juror could find against plaintiff).

For example, Halliburton made numerous public misrepresentations regarding its asbestos exposure. On November 15, 1999, Halliburton represented that its reserves of $30 million were

"adequate to cover the estimated losses from asbestosis litigation" (pending claims only), USCA5 4240 (at ¶ 119), and on January 31, 2001, it represented that "prospective asbestos liabilities . . . should have minimal adverse impact on the company going forward." USCA5 4265 (at ¶ 157).

On July 25, 2001, Halliburton represented that accruing $60 million in loss reserves would be "prudent" for "the potential exposure we have for this asbestos litigation." USCA5 4274. On August 22, 2001, Halliburton also said that "asbestos exposure, concerns appear to be overblown" and that Halliburton's asbestos claims are a "manageable problem." USCA5 4276.

On December 4, 2001, Halliburton disclosed a $65 million verdict by a Texas jury, and three other judgments totaling $35.7 million against Dresser (Halliburton's subsidiary) on behalf of 100 asbestos plaintiffs arising from an alleged breach of a purported settlement agreement. USCA5 6959. Halliburton's stock dropped 3.7% on December 4 and 3.8% on December 5. USCA5 6960. On December 7, 2001, Halliburton disclosed a $30 million asbestos verdict, handed down on December 5 against Dresser. USCA5 6961-62, 7752-54. Halliburton's stock plummeted that day by 42.7%. USCA5 6963.

Several analysts issued reports on December 7 that sounded the alarm about Halliburton's asbestos liability. TheStreet.com declared: "Halliburton Buried as Investors Stopped Believing": "Halliburton's share dove to nine-year lows . . . as

investors lost faith in the company's claims." USCA5 4577. An analyst for Salomon Smith Barney dropped his price target to $20 from $36, citing mounting asbestos liabilities and noted: "The specter of lawsuits spiraling out of control is likely to adversely impact the stock for the foreseeable future . . . ." USCA5 6962. Another analyst with Jefferies & Co. said: "We now believe [Halliburton's] asbestos-related net liabilities could be significantly higher than currently estimated," and an analyst from UBS Warburg downgraded his price target from $38 to $24 because of Halliburton's asbestos liability. *Id.*

Defendants' own expert acknowledged that she was not aware of any other adverse news released on December 7, except a change in Moody's rating of Halliburton, which she admitted reflected the recent information regarding Halliburton's asbestos exposure. USCA5 8105, 8107-08. Nevertheless, the courts below held there was no loss causation.

ARGUMENT

I. PROOF OF LOSS CAUSATION IS NOT A PREREQUISITE TO THE FRAUD-ON-THE-MARKET PRESUMPTION

A. The Fifth Circuit Requires Plaintiffs to Prove Loss Causation

Defendants are wrong to contend (Br. 9 & n.2) that the Fifth Circuit does not require plaintiffs to prove loss causation as a prerequisite for class

certification. As the Fifth Circuit said in *Oscar*: "Essentially, we require plaintiffs to establish loss causation in order to trigger the fraud-on-the-market presumption." *Oscar*, 487 F.3d at 265. The court reiterated that rule here, Pet. App. 115a-116a, and in other cases as well. *See Fener v. Operating Eng'rs Constr. Indus. & Misc. Pension Fund (Local 66*), 579 F.3d 401, 408-11 (5th Cir. 2009); *Alaska Elec. Pension Fund v. Flowserve Corp.*, 572 F.3d 221, 228-29 (5th Cir. 2009); *Luskin v. Intervoice-Brite Inc.*, 261 Fed. App'x 697, 698 (5th Cir. 2008). The district court well understood the Fifth Circuit requirement that at the class certification stage: "Plaintiffs in this case must demonstrate loss causation." Pet. App. 4a; 6a.

Defendants nonetheless suggest (Br. 9 n.2) that the Fifth Circuit uses the term "loss causation" as a "shorthand" for price distortion. They are wrong. As this Court explained in *Dura,* price distortion and loss causation are different: price distortion concerns the initial effect of a defendants material misstatements on a stock's price, i.e., whether it distorts the price (whether by increasing the price or, as in this case, maintaining a price level that would otherwise have dropped), while loss causation concerns the cause of a later decline in the stock's price following the revelation of the truth. *See Dura*, 544 U.S. at 342-43.

Moreover, the detailed analysis performed by the district court and the court of appeals in this case clearly was one concerning loss causation: for each set of alleged misstatements and corrective

disclosures, the courts asked whether the decline in the stock's price was "related to the false, non-confirmatory positive statement made earlier" and whether it is "more probable than not that it was this related corrective disclosure, and not any other unrelated negative statement, that caused the stock price decline." Pet. App. 119a-120a. This is an analysis of loss causation.

B. The Fifth Circuit Requirement to Prove Loss Causation Is Contrary to *Basic*

In *Basic*, this Court held that a plaintiff in a private securities fraud case may invoke a rebuttable presumption of reliance upon a showing that investors traded in an efficient market. *Basic*, 485 U.S. at 241-42, 247-48; *see also Matrixx Initiatives, Inc. v. Siracusano*, Case No. 09-1156, -- S. Ct. --, 2011 WL 977060 (Mar. 22, 2011); *Stoneridge Investment Partners LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 159 (2008). The Court did not require plaintiffs to prove loss causation to invoke the presumption. (Indeed, the Court did not even mention loss causation.) Rather, the Court explained that the fraud on the market theory is based on the "hypothesis" that in an efficient 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 directly rely upon the misstatements." *Id.* at 241-42 (quoting *Peil v. Speiser*, 806 F.2d 1154, 1160-61 (3d Cir. 1986)); *see also id.* at 247 ("an investor's reliance

on any public material misrepresentation . . . may be *presumed*") (emphasis added). This presumption allows reliance to be presumed on a classwide basis, because each investor is presumed to rely on the material misstatements when he or she buys or sells at the market price. Accordingly, once a proposed plaintiff class invokes the presumption and supports its underlying assumption (an efficient market), the issue of reliance will turn on common proof, and class certification is appropriate.

Nothing in *Basic* supports requiring proof of loss causation on the merits at class certification. The Court said nothing about loss causation; the fraud on the market theory is a way to prove the separate element of *reliance*. And on the element of reliance, the Court stated that reliance could be *presumed* in an efficient market, not that it must be proven on the merits at class certification. By requiring proof of loss causation on the merits for class certification, the Fifth Circuit requires *proof* of what Basic allows courts to *presume*—and proof not of reliance, but of loss causation. *See Oscar,* 487 F.3d at 274 (Dennis J., dissenting) ("court is to presume that the defendants' material misstatement distorted the market price of the stock at issue"). Nothing in *Basic* allows the court of appeals to require plaintiffs to *prove* an element of their case at class certification, especially the fact-intensive, "rigorous" (Pet. App. 130a) element of loss causation.

Defendants argue (Br. 12, 27) that the Fifth Circuit's rule is permissible because *Basic* allows a defendant to rebut the fraud-on-the-market

presumption of reliance, and they should be allowed to do that at class certification. The first problem with defendants' argument is that rebuttal of the fraud-on-the-market theory is relevant at class certification only to the extent it relates to the question whether common questions of fact or law predominate. *See* Rule 23(b). If the defendants' proposed rebuttal would turn on common questions of fact or law, then class certification is appropriate, and the question whether the presumption actually is rebutted is one for a merits stage such as summary judgment or trial. *Basic* allows the plaintiff to establish a presumption of reliance by showing that defendant made public statements in an efficient market. *See Basic*, 485 U.S. at 241-42, 247-48. Defendants may contest the prerequisites for establishing the presumption at class certification—for example, by showing the market is inefficient. (Defendants here did not even attempt to do so. *See* Pet. App. 115a.) If plaintiff proves an efficient market, the classwide nature of reliance is presumed. Its existence or nonexistence is determined at trial.[1]

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[1] Defendants claim (Br. at 38) that courts have "always understood" that the presumption established in *Affiliated Ute* is rebuttable at class certification. Although the court in *Ross v. Bank South, N.A.*, 837 F.2d 980, 990-91, 996-98 (11th Cir. 1988), the case defendants cite, considered rebuttal evidence of non-reliance under *Affiliated Ute* at the class certification stage, it considered evidence of the named plaintiffs' non-reliance to ascertain whether their claims were common and typical. No court of appeals has held that the presumption is rebuttable at class certification, and the case law suggests it is not. *See*, *e.g.*, *Miera v. First Sec. Bank of Utah, N.A.*, 925 F.2d 1237, 1241 (10th Cir. 1991) (defendant rebutted *Affiliated Ute*'s presumption of reliance after bench trial); *Emrich v. Touche*

Defendants' contrary argument rests on an excerpt from *Basic*, which says the presumption of reliance may be rebutted by any "showing that severs the link between the alleged misrepresentation and . . . the price received (or paid) by the plaintiff." *Basic*, 485 U.S. at 248. However, the context of the Court's assertion makes clear that rebuttal takes place at trial, not at class certification. Rebuttal is reserved for trial because anything that severs the link—such as independent negative news about the company—is a classwide phenomenon, and hence not relevant to determining whether common issues predominate in the first place. Tellingly, footnote 29 says, when discussing one way to rebut the presumption of classwide reliance: "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." *Id.* at 249 n. 29. Defendants suggest (Br. 39) that this footnote refers to the district court's ability to amend the certification order at trial *and* entertain rebuttal evidence at class certification. But that is not what the *Court* said;

Ross & Co., 914 F.2d 262 (9th Cir. 1990) (defendant rebutted *Affiliated Ute*'s presumption at summary judgment stage); *Sharp v. Coopers & Lybrand*, 649 F.2d 175, 189 (3d Cir. 1981) (defendant failed to rebut *Affiliated Ute*'s presumption at jury trial), *overruled in part on other grounds*, *In re Data Access Sys. Sec. Litig.*, 843 F.2d 1537, 1550 (3d Cir. 1988); *Blackie v. Barrack*, 524 F.2d 891, 905–06 & n.22 (9th Cir. 1975) (affirming class certification and noting in dicta that the right of rebuttal does not defeat class certification, stating: "The right of rebuttal, however, does not preclude the predominance of common questions.").

the footnote addresses only trial, not class certification.

Second, defendants did not attempt to rebut the existence of an efficient market; they argued the common question of whether in an efficient market there was loss causation and the Fifth Circuit did not limit the plaintiff's burden to the element of reliance. Instead, it required a showing on the *different* element of loss causation. Even if defendants were permitted to rebut the presumption of reliance by affirmative proof that particular plaintiffs did not rely on the market price (an individual issue that could be relevant to the requirement of predominance), there is no relevance at the class certification of a common issue such as loss causation (unless it is to confirm predominance).

Third, the Fifth Circuit did not simply allow defendants to make a rebuttal showing. It placed the burden on the *plaintiff*, even if the defendant makes no showing whatsoever. Defendants do not attempt to justify this burden-shifting.[2]

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[2] This case provides no occasion to reconsider this Court's holding in *Basic*. By the time this Court issued its opinion in *Basic*, all eight circuit courts that had considered the issue had adopted the fraud-on-the-market presumption of reliance. Petitioner's Brief 4. The courts have applied the holding in *Basic* for more than two decades, and no court of appeals has suggested that *Basic* should be abandoned. Congress has not seen fit to change the fraud-on-the-market presumption even though Congress has been very active in passing legislation governing private securities actions. The fraud-on-the-market presumption makes commonsense, as this Court noted, *see Basic*, 485 U.S. at 246, and reflects the fundamental principles underlying the securities laws. *See* Brief Of Public Justice As

C. Proof of Loss Causation Requires a Merits Inquiry Not Tied To Rule 23

The Fifth Circuit did not base its rule that class certification requires proof of loss causation on any of the requirements in Rule 23. Instead, it adopted the rule because, in its view, "a district court's certification order often bestows upon plaintiffs extraordinary leverage, and its bite should dictate the process that precedes it." *Oscar*, 487 F.3d at 267. Significantly, the court never suggested that common issues would not predominate on the element of loss causation. *See* Brief of Law Professors As Amicus Curiae In Support of Petitioner ("Professors Br."), at 9-10. Indeed, defendants have conceded that "loss causation stands or falls on a classwide basis". Resp. Supp. Br. In Opp. 9. That should have ended the matter.

But the Fifth Circuit nonetheless decided to require a "rigorous" (Pet App 130a) "merit inquiry" (*Oscar*, 487 F.3d at 267) as a prerequisite for class certification (Pet. App. 113a, 115a). The Fifth

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Amicus Curiae In Support Of Petitioner ("Public Justice Br.") 8-16, 21-25. Notably, defendants did "not dispute the efficiency of the market" in this case, *see* Pet. App. at 115a, which itself makes irrelevant any debates about the possibility of market anomalies—theoretical debates that in any event do not detract from the widespread view among finance academics that U.S. markets for public securities efficiently incorporate information. *See* Brief Of Financial Economists As Amici Curiae In Support Of Petitioner 10-11; Public Justice Br. 28-29. Moreover, the criticisms of the efficient market hypothesis began before the decision in *Basic* was issued and were known to the Court at the time it issued its decision. *See* Public Justice Br.19-21, 26-28.

Circuit is not authorized to impose requirements above and beyond those specified in Rule 23. This court has made clear that courts "are not free to alter" Rule 23's requirements. *Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 861 (1999); *see Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 620 (1997). Any concerns about abusive or meritless class actions are for Congress to address. And Congress has been very active in this area. For example, Congress has facilitated the use of motions to dismiss to weed out nonmeritorious private securities-fraud cases by imposing heightened pleading requirements, 15 U.S.C. 78u-4(b)(1)-(2); and by requiring an automatic stay of discovery pending resolution of a motion to dismiss, 15 U.S.C. 78u-4(b)(3)(B). Further, Congress has specifically addressed class actions by, for example, establishing procedures for the appointment of lead plaintiffs and lead counsel, 15 U.S.C. 78u-4(a)(3). Congress's recent and repeated efforts to adjust the standards for private securities-fraud suits particularly illustrate why the Fifth Circuit erred in making "likely success on the merits essential to class certification in securities-fraud suits." *Schleicher*, 618 F.3d at 686.

Defendants suggest (Br 6-7, 10, 23, 25) that it is appropriate to require plaintiffs to prove loss causation in cases where the plaintiffs allege that there was no initial price increase when the material misstatements were made, but there was a stock price decrease when the corrective disclosures were issued. As an initial matter, that is not the Fifth Circuit's rule; the Fifth Circuit requires *all* plaintiffs who allege that they will establish reliance using the

fraud-on-the-market theory to prove loss causation to obtain class certification. *See Oscar*, 487 F.3d at 265, 276 n.3. In any event, the proposed rule cannot be justified under Rule 23 and *Basic*. *Basic* allows plaintiffs to invoke a presumption of reliance, and because of that presumption common issues will predominate on the element of reliance and class consideration of the claims is appropriate. Countless securities lawsuits allege, like this one, that defendants' misrepresentations concealed negative information, and thus kept the stock price from falling. *See* Br. of Financial Economists As Amici Curiae In Support of Petitioner at 28-29, 31 (providing examples of material misrepresentations that do not cause the stock price to rise). In that situation, the defendant's material misrepresentation has still distorted the stock's price, even though the price did not increase. And *Basic* allows courts to *presume* that distortion in stock price; it does not require plaintiffs to prove it at class certification. *See Schleicher*, 618 F.3d at 687.

Defendants argue (Br. 31-35) that the courts below did not improperly reach the merits of plaintiff's claims, but instead simply required plaintiff to show that reliance was a common issue by proving that the representations "distorted the market price." But if a plaintiff cannot demonstrate loss causation, that does not mean that loss causation is an individualized issue; it means that plaintiffs as a class cannot establish an element of their case. Loss causation is not a class certification requirement that happens to overlap with the

merits; rather, it is a merits issue that applies equally to the lead plaintiff and all absentee class members; and because it raises a common issue of proof, it cannot be a basis under Rule 23 of defeating class certification. *See* Br. for U.S. 19 n.2

While the Fifth Circuit candidly admits it requires plaintiffs to prove loss causation and imposes on them the burden of doing so, defendants repeatedly use linguistic formulations (e.g. the "evidence shows") that elide whether plaintiffs bear that burden of demonstrating loss causation or defendants may rebut the presumption by showing an absence of loss causation. *See*, *e.g.*, Br. 2, 11, 13, 14, 16, 23, 43, 50, 51. Moreover, both formulations are wrong because they entail a merits inquiry that is not linked to the requirements of Rule 23 and therefore should be reserved for trial.[3]

Defendants argue that Federal Rule of Evidence 301 means that they only need to produce enough evidence so that "a reasonable fact-finder could believe that the 'link' between the alleged misrepresentation and the price has been 'sever[ed]'"

[3] Defendants quarrel with the Fund's citation to the Advisory Committee Notes to Rule 301. (Br. 20.) The Court cited to these very same Committee Notes. *See Basic*, 485 U.S. at 245 (stating "see also FED. R. EVID. 301 and Advisory Committee Notes, 28 U.S.C. App., p. 685."). And the proposition for which the Notes have been cited cannot be disputed. While Congress ultimately adopted the Senate, not the House, version of Rule 301, the difference concerned the continuing effect of the presumption, not the quantum of evidence required to rebut it. *See Sheridan v. El DuPont de Nemours and Co.*, 100 F.3d 1061, 1080 (3d Cir. 1996) (Alito J. concurring and dissenting) (tracing history of Rule 301).

(Br. 21). Evidence that the link *might* have been severed and thus that the misrepresentation *might* not have affected the price is not the same as evidence that in fact "severs the link" and shows that the misrepresentation in fact did not impact the price. And it is this latter showing which *Basic* requires of defendants "to rebut or meet the presumption." *Basic*, 485 U.S. at 248.

Moreover, whether the link has been severed is a merits determination regarding whether plaintiffs ultimately met their burden of proof on an element of their claim; it is not a question of predominance for class certification.

D. The Fifth Circuit Rule Requires Mini-Trials at Class Certification, Denying Plaintiffs Full Discovery And Preempting The Jury's Fact Finding

The Fifth Circuit's rule regarding loss causation converts Rule 23 proceedings into mini-trials on the merits under the wrong standard of proof and without merits discovery.

Here, the district court held a mini-trial on the merits, preempting the merits inquiries that should be undertaken at summary judgment or at trial, including ruling on issues not relevant to determining whether common issues predominate under Rule 23—and did so under a preponderance of the evidence standard. *Cf. Schleicher*, 618 F.3d at 683.

The Fifth Circuit suggested that loss causation can be demonstrated at class certification because proof of loss causation requires little, if any, discovery. *See Oscar*, 487 F.3d at 267. That is not correct. Under this Court's holding in *Dura*, which discussed loss causation as a proximate cause issue, merits discovery and a trial (or summary judgment) is necessary because proximate cause is fact intensive, and requires complete discovery. *See* Pet. Br. 52-56; Brief of 16 Public Pension Funds As Amici Curiae In Support of Petitioner 5 n.3. Elements of loss causation requiring such discovery and proof on the merits include the causal relationship between the alleged corrective disclosure and the prior misrepresentation, whether the truth leaked out in the interim, and whether the stock drop was a reasonably foreseeable result of the prior misstatement. Even if some or all of these issues could, in some cases, be resolved with limited discovery, there is no reason why they should be resolved at class certification. Because the Rule 23 hearing operates under a higher standard of proof than summary judgment does, a merits inquiry at class certification preempts the merits inquiries that should occur at summary judgment or at trial. Indeed, under the Fifth Circuit's rule, even members of a proposed plaintiff class that could survive summary judgment on the issue of loss causation, and who therefore are entitled to have their claims resolved by a jury, would not be able to obtain class certification.

E. The Fifth Circuit Applies A Flawed Loss Causation Test, Aggravating The Prejudice To Plaintiffs

The Fifth Circuit's loss causation test effectively requires that plaintiffs prove scienter through a corrective disclosure that admits wrongdoing, *see*, *e.g.*, Pet. App. 121a ("corrective disclosure" must show "the misleading or deceptive nature of the prior positive statements"). That is why the Fifth Circuit claims that loss causation can be decided on material in the public record. *See Oscar*, 487 F.3d at 267 ("Its 'proof' is drawn from public data and public filings"). The district court and court of appeals in this case repeatedly held that plaintiff failed to prove loss causation because the corrective admissions did not themselves reveal scienter. *See*, *e.g.*, Pet. App. 122a ("When confronted with allegedly false financial predictions and estimates, the district court must decide whether the corrective disclosure more probably than not shows that the original estimates or predictions were designed to defraud."); *id.* 122a ("the truth revealed by the corrective disclosure must show that the defendant more likely than not misled or deceived the market with earnings misstatements that inflated the stock price and are actionable"); *id.* 126a (did not show "prior reserve estimates were intentionally misleading"); *id.* 126a-27a ("we can discern no indication from the June 28, 2001 press release that Halliburton's prior asbestos reserve estimates were misleading or deceptive"); *id.* 129a ("undermines any conclusion . . . the company acted with deception"); *id* 132a ("Plaintiff fails to show these announcements . . . revealed deceptive

practices in Halliburton's accounting assumptions."); *see also* Pet. 25 n.20.

Under the Fifth Circuit's flawed test of loss causation, defendants can defeat loss causation by wording their corrective disclosure so that on their face they do not appear related to the prior misrepresentations, or by avoiding a corrective disclosure altogether. Defendants argue, for instance, that Halliburton's June 28, 2001 announcement that it would need to increase its asbestos reserves by $50 to $60 million because of Harbison-Walker's request for assistance was not a corrective disclosure because it "simply revealed new information." Br. 50. Plaintiff, however, claimed that Halliburton knew throughout the class period that Harbison-Walker would need financial assistance, USCA5 4576 (at ¶ 38); Halliburton, through Dresser, was insured on the same policies as Harbison-Walker and so was privy to information regarding Harbison-Walker's demands on their common lines of insurance. USCA5 4622 (at ¶ 241). Thus, plaintiff needs merits discovery to find out when Halliburton first learned about Harbison-Walker's mounting asbestos exposure and increased financial difficulties, including as reflected by claims on their shared insurance. [4]

[4] Defendants claim that plaintiff here enjoyed "extensive discovery" during the five years between the filing of its complaint and moving for class certification. Br. 6, 44. That is not correct. First, plaintiff was not permitted discovery until surviving a motion to dismiss years after the original complaint was filed. Second, the majority of the production was composed of documents produced to the SEC regarding Halliburton's

The Fifth Circuit held that defendants' disclosure that it would increase its asbestos reserves to include 165,000 claims against Harbison-Walker did not constitute a corrective disclosure because defendants' statement did not indicate that Halliburton previously knew but failed to disclose that Harbison-Walker would need financial assistance, Pet. App. 124a-125a, and because raising reserves "does not show those prior reserve estimates were intentionally misleading." Pet. App. 126a. Unless the Court is willing to permit defendants to immunize themselves by the wording of their public statements, plaintiffs should be permitted to establish loss causation by establishing through merits discovery and at trial (or summary judgment) what defendants knew and when they knew it. Similarly, the Fifth Circuit found that an adverse asbestos verdict that caused Halliburton's stock price to plummet 42.7% did not constitute a corrective disclosure because "the district court must decide whether the corrective disclosure more probably than not shows that the original estimates or predictions were designed to defraud." Pet. App. 122a.[5] But the only way for the plaintiff to rebut

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accounting practices only, and then for only part of the class period.

[5] The Fifth Circuit also cited boilerplate disclosures in Halliburton's SEC filings about litigation risks but acknowledged that such "cautionary language" is not "dispositive" and is "relevant to materiality." Pet. App. 128a. The adequacy of allegations of materiality are resolved on a motion to dismiss, *Lormand v. US Unwired, Inc.,* 565 F.3d 228,

such an argument is by showing scienter (that the company anticipated the high expected liability and deliberately chose to misrepresent it), which is a common issue requiring merits discovery and a trial (or summary judgment decision).[6]

Defendants claimed at the petition stage that the Fifth Circuit rule eliminates only meritless cases. *See* Supp. Br. In Opp. 5 (only question is "whether certain meritless class actions should be certified"). Defendants' contention is based on the unfounded assumption that a case is meritless if a plaintiff cannot meet the Fifth Circuit's excessively strict test for loss causation. Because the Fifth Circuit applied the wrong test at the wrong time under the wrong standard of proof, failure to satisfy the Fifth Circuit test indicates nothing about whether a claim is meritorious. In any event, because the issue of loss causation is a merits issue

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244-48 (5th Cir. 2009); *Rosenzweig v. Azurix Corp.*, 332 F.3d 854, 869-70 (5th Cir. 2003).

[6] Plaintiff also needs discovery to establish loss causation for their accounting claims. For instance, the Fifth Circuit held that plaintiff had not established loss causation for Halliburton's October 24, 2000 announcement that it would undertake a massive restructuring of its construction business because the "press release does not mention fixed price contracts, unapproved claims or the methods for recognition of revenue from such claims." Pet. App. 132a-133a. With discovery, plaintiff could seek evidence to demonstrate that the restructuring was made to correct problems with Halliburton's cost overruns on long-term, fixed-price contracts. For other examples of why discovery is necessary to show loss causation, *see* Professors Br. at 27-29.

common to the class, it was wrong to use it to deny class certification under Rule 23.

II. CONCLUSION

For the reasons stated here and in plaintiff's opening brief, the opinion of the Fifth Circuit should be reversed and this case remanded for entry of an order certifying the class.

Respectfully submitted,

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