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Lower Courts Missing The Point Of Halliburton II

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In Halliburton II,[1] the U.S. Supreme Court gave defendants in securities fraud class actions a potentially important defense to class certification by permitting them to rebut the fraud-on-the-market presumption of reliance with a showing that the alleged fraud had no impact on the defendant company's stock price. Early indications from the lower courts, however, suggest that defendants are being denied the full benefit of this principle because courts are misunderstanding the import of Halliburton II, and in particular how that decision requires a refined reading of two pre-Halliburton II cases: Halliburton I[2] andAmgen.[3]

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Under a proper reading of these three cases, although defendants are barred from opposing class certification on the basis of lack of loss causation or materiality, they should be permitted to prove lack of price impact through any type of admissible evidence, even if the same evidence would also show the absence of loss causation or materiality.

In Halliburton II, Chief Justice John Roberts' majority opinion reaffirmed the fraud-on-the-market presumption of reliance established in Basic Inc. v. Levinson. Under Basic, courts may presume that if the stock is traded on an efficient market, (1) the market price of a stock generally reflects all public information about the stock, and (2) investors rely on the integrity of the market price. The presumption is rebuttable, however, and Halliburton II settled that defendants are entitled to rebut the presumption at the class certification stage by disproving the fact for which the presumption is a proxy: price impact.

As the court explained in Halliburton II, if the prerequisites for the presumption are present, there is reason to believe generally that any fraudulent public statement would affect the stock price. But, the court reasoned, if the defendant can show that an alleged misstatement did not in fact affect the stock price, then there is no good reason to permit a plaintiff to obtain certification based on the presumption.

The obvious upshot of the Halliburton II ruling is to invite defendants to challenge price impact at the class certification stage by using an expert economist. The economist would perform an "event study" of the alleged misstatements and attempt to determine if they caused a statistically significant change in

the stock price. In the case of a false statement of positive new developments, the economist would investigate whether the statement caused the price to rise.

But this method arguably does not apply to two important categories of cases — ones in which the alleged fraudulent act is not a misstatement of new positive developments but rather (1) an actionable omission of negative news or (2) a statement confirming that the company's prospects are unchanged when in fact bad news is being concealed. In these situations, one would not expect the fraudulent act to cause the stock price to rise, and therefore an event study generally would not produce a positive result.

Plaintiffs have invoked a "price maintenance" theory in such cases, arguing that the omissions or statements impact the price by maintaining it at a higher level than if the truth were revealed. (Most courts that have looked at that issue so far have generally held that the price maintenance theory is valid, but the question is now being squarely presented to the Eighth Circuit in a case involving Best Buy.[4])

Because event studies as of the time of the statements usually are not informative in price maintenance cases, economists typically seek to determine whether the alleged fraudulent act had a price impact by performing an event study as of a different point in time: when the truth is revealed to the market. The logic is that if the ultimate revelation of the hidden truth caused the stock price to drop by dissipating fraudulent inflation in the stock price, that inflation must have entered the price — i.e., had a price impact — at the (earlier) time of the statement or omission that concealed that truth.

Since Halliburton II, defendants have attempted to show lack of price impact in both ways just described — by showing (1) lack of a price rise at the time of alleged affirmative false statements and (2) lack of a decline caused by revelation of allegedly concealed information — but have met with little success. The main problem seems to be that courts do not properly understand the extent to which they are authorized to consider factors on class certification that overlap with the merits. This reflects a failure to apprehend how Halliburton II requires a subtle rethink of Halliburton I and Amgen, as well as a failure to appreciate how the Supreme Court's other recent decisions under Rule 23 affect the analysis.

Note, for example, that an event study at the time of the revelation of the alleged truth is the same means by which economists address an element of the merits of a securities fraud case: loss causation. Theoretically, price impact and loss causation are separate issues — the former is measured at the time of the fraudulent act, and the latter is measured at the time of the revelation of the truth. But in the case of actionable omissions or confirmatory statements, the method used to disprove price impact and loss causation overlap.

Before Halliburton II, the few courts that had examined this issue had split on whether it was appropriate for a defendant to rebut class certification by showing that the ultimate stock drop was attributable to factors other than revelation of the fraud.

For example, in In re Moody's Corp. Securities Litigation[5] one judge in the Southern District of New York held that the defendant could make such a showing, while other judges of the same court reached the opposite conclusion in In re SLM Corp. Securities Litigation[6] and City of Livonia Employees' Retirement System v. Wyeth.[7] The main reason the latter courts believed that the defendants were not permitted to make such a showing was the Supreme Court's earlier ruling in Halliburton I, in which it held that proof of loss causation is neither required nor open to rebuttal at the class certification stage. Based on that holding, these courts concluded the defendants' event studies amounted to "loss

causation argument[s]" that were "not appropriate at the class certification stage."

Properly understood, Halliburton II has resolved this disagreement in the defendants' favor. Chief Justice Roberts' opinion in Halliburton II recognized that the evidence of price impact could be the same as the evidence of loss causation. The plaintiffs in Halliburton II argued that price impact is a merits issue, not an issue for class certification, because "absent price impact, there is no loss causation." The Supreme Court accepted the premise of that argument, but rejected the plaintiffs' conclusion. The court wrote that it was "[f]air enough" for the plaintiffs to point out that lack of price impact would be dispositive on the merits issue of loss causation, but it nonetheless held that the same issue could be dispositive of class certification. And the court also has emphasized in several other recent cases that class certification determinations "frequently" will overlap with the merits.

Therefore, it should now be open to defendants to disprove that allegedly fraudulent positive statements impacted stock price in any reliable manner — including, in cases based on alleged omissions or confirmatory statements, by proving that the ultimate revelation of the allegedly hidden truth did not cause the relevant stock drop.

But in the few relevant decisions since Halliburton II, district courts appear to have not properly understood that case's impact. For example, in one recent case in which the district court was instructed by the Eleventh Circuit to reexamine class certification in light of Halliburton II, the court declined to credit the opinion of a defense expert that there had been no price impact because the relevant drop in stock price was the result of market factors, not revelation of fraud, because that issue was "for a jury to decide."[8] That ruling cannot be squared with Halliburton II. Nor can it stand against the court's other recent decisions emphasizing the stringent nature of the class certification analysis.[9]

Similarly, the courts in both Local 703 and Wallace v. Intralinks[10] ruled that they could not consider the defendants' expert opinions of no price impact because the experts' reasoning — that the truth was already known to the public and therefore the misrepresentations could not have affected the stock price — went to a merits issue, namely, materiality. These courts based their conclusion on another recent, pre-Halliburton II Supreme Court decision — Amgen. And it is true that in Amgen, the Supreme Court rejected the defendant's attempt to do just what the defendants in Local 703 and Wallace sought to do — defeat the fraud-on-the-market presumption at the certification stage by showing "truth on the market."

But the primary defense argument in Amgen was that the plaintiff should bear the burden of proving materiality at class certification. The court's rejection of that position remains good law under Halliburton II. In its secondary ruling that Amgen was also barred from rebutting the plaintiffs' entitlement to certification, the court focused on Amgen's concession that it "aimed to prove" that the alleged misstatements "were immaterial." The defendants did not frame the case as raising the issue of "price impact," nor was that concept mentioned in the court's opinion.

Now, however, under Halliburton II, the Supreme Court has instructed that lack of price impact — for whatever reason — is fair game for a defendant to prove at the certification stage. That holding requires us to refine our understanding of the secondary holding of Amgen.

The most obvious reason that a stock trading in an efficient market would not react to a false statement of positive news is that the statement was not significant to investors. That such a showing might also disprove materiality should have no effect on the conclusion that price impact has been disproved. That result is no different from the pattern endorsed by the Supreme Court in Halliburton II — disproving

price impact through an event study of the revelation of the hidden fact that would also disprove loss causation.[11]

In conclusion, as courts struggle to implement Halliburton II, they must think more carefully about how that decision requires a new understanding of Halliburton I and Amgen. Under the correct understanding of Halliburton II, defendants should be permitted to oppose class certification with any evidence of lack of price impact, even if the same evidence would also disprove an element of plaintiffs' claims on the merits.

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[1] Halliburton Co. v. Erica P. John Fund, Inc.,134 S.Ct. 2398 (2014).

[2] Erica P. John Fund, Inc. v. Halliburton Co., 131 S. Ct. 2179 (2011).

[3] Amgen Inc. v. Conn. Ret. Plans & Trust Funds, 133 S. Ct. 1184 (2013).

[4] IBEW Local 98 Pension Fund v. Best Buy Co., Inc., No. 14-3178 (8th Cir.).

[5] 274 F.R.D. 480 (S.D.N.Y. 2011).

[6] 2012 WL 209095 (S.D.N.Y. Jan. 24, 2012).

[7] 284 F.R.D. 173 (S.D.N.Y. 2012).

[8] Local 703, I.B. of T. Groc. & Food Emp. Welfare Fund v. Regions Fin. Corp., 2014 WL 6661918 (N.D. Ala. Nov. 19, 2014).

[9] Wal-Mart Stores Inc. v. Dukes, 131 S. Ct. 2541 (2011); Comcast Corp. v. Behrend, 133 S. Ct. 1426 (2013).

[10] 302 F.R.D. 310 (S.D.N.Y. 2014).

[11] The Best Buy case now pending in the Eighth Circuit poses yet another permutation of the same general principle. In that case the defendants argue that they disproved price impact by showing that the disclosure that caused the ultimate price drop was not truly corrective — i.e., it did not reveal that the earlier allegedly false statements were in fact false — and therefore cannot show that the statements had a price impact. Although this is another argument typically deployed against allegations of loss causation, it should be available to defeat class certification as well.

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