No. 09-1403

In the Supreme Court of the United States

ERICA P. JOHN FUND, INC., FKA ARCHDIOCESE OF MILWAUKEE SUPPORTING FUND, INC., PETITIONER

v.

HALLIBURTON CO., ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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QUESTION PRESENTED

Whether, in a private action 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, a plaintiff who invokes the fraud-on-the-market presumption of reliance must prove loss causation in order for the suit to be maintained as a class action.

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INTEREST OF THE UNITED STATES

This brief is submitted in response to the Court's order inviting the Acting Solicitor General to express the views of the United States. In the view of the United States, the petition for a writ of certiorari should be granted.

STATEMENT

1. Section 10(b) of the Securities and Exchange Act of 1934 makes it unlawful for any person "[t]o use or employ, in connection with the purchase or sale of any security * * * , any manipulative or deceptive device or contrivance in contravention of" rules promulgated by the Securities and Exchange Commission (SEC). 15 U.S.C. 78j(b). The SEC's Rule 10b-5 implements

Section 10(b). As relevant here, the Rule makes it unlawful for any person, in connection with the purchase or sale of a security, "[t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading." 17 C.F.R. 240.10b-5(b).

This Court has construed Section 10(b) to provide a private right of action. See *Dura Pharms., Inc.* v. *Broudo*, 544 U.S. 336, 341 (2005) (citing cases). In order to recover in a private action under Section 10(b) and Rule 10b-5(b), a private plaintiff must prove the following elements: (1) the defendant made a material misrepresentation or omission; (2) the defendant acted with scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) the plaintiff's reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation, meaning that the defendant's misrepresentation or omission proximately caused the plaintiff's loss. *Id.* at 341-342; see, *e.g.*, *Stoneridge Inv. Partners, LLC* v. *Scientific-Atlanta*, 552 U.S. 148, 157 (2008).

In *Basic Inc.* v. *Levinson*, 485 U.S. 224 (1988), this Court discussed the manner in which plaintiffs in a securities-fraud class action may establish reliance. *Id.* at 241-248. The Court recognized that "[r]equiring proof of individualized reliance from each member of the proposed plaintiff class" often would "prevent[] [plaintiffs] from proceeding with a class action, since individual issues then would * * * overwhelm[] the common ones." *Id.* at 242. The Court held that plaintiffs may overcome that obstacle by invoking a rebuttable presumption of reliance based on the fraud-on-the-market theory. *Id.* at 242-247. Under that theory, the Court

explained, the price of a stock in an efficient market reflects "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." *Id.* at 247. The Court noted that a defendant may rebut the presumption of reliance arising from that theory through "[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." *Id.* at 248.

2. Petitioner is the lead plaintiff in a putative securities-fraud class action against Halliburton Co. and one of its officers (respondents in this Court). Pet. App. 113a-114a. Petitioner alleges that respondents attempted to inflate Halliburton's stock price by downplaying the company's estimated asbestos liabilities, overstating its revenue in its engineering and construction business, and overstating the benefits of its merger with Dresser Industries. *Id.* at 4a-5a, 11a. Petitioner alleges that respondents subsequently made corrective disclosures about these matters that caused Halliburton's stock price to decline. *Id.* at 5a, 11a.

Petitioner sought to certify a class of all persons who purchased Halliburton common stock between June 3, 1999, and December 7, 2001. See Pet. App. 4a, 66a-67a. The district court denied the class-certification motion. *Id*. at 3a-55a. The court determined that "the Proposed Class satisfied Federal Rule of Civil Procedure 23 as to numerosity, commonality, typicality, and adequacy of [petitioner] as a class representative," and that a class action generally "would be the superior method for adjudicating the claims of these class members." *Id.* at 3a-4a. The court held, however, that it could not certify the

class because petitioner had failed to prove loss causation. *Id.* at 4a.

The district court enumerated the elements of a private securities-fraud claim and noted that, "[i]n class action securities cases such as this one, plaintiffs can satisfy the reliance requirement through the fraud-on-the market theory." Pet. App. 6a. The court explained, however, that the Fifth Circuit had recently "tightened" the requirements for class certification by requiring "[p]laintiffs * * * to demonstrate loss causation in order to trigger the fraud-on-the-market presumption of class reliance." *Ibid.* (citing *Oscar Private Equity Invs.* v. *Allegiance Telecom, Inc.*, 487 F.3d 261, 265 (5th Cir. 2007) (*Oscar*)). Under the Fifth Circuit's decision in *Oscar*, the district court observed, loss causation must be "established at the class certification stage by a preponderance of all admissible evidence." *Ibid.* (quoting *Oscar*, 487 F.3d at 269). The court reviewed the evidence in this case and concluded that petitioner had failed to satisfy that requirement. *Id.* at 11a-54a. The court stated that, but for petitioner's failure to prove loss causation, it would have certified the class. *Id.* at 4a, 54a.

3. The court of appeals affirmed. Pet. App. 111a-136a. Relying on its prior decision in *Oscar*, the court stated that "[i]n order to obtain class certification on its claims, [petitioner] was required to prove loss causation, i.e., that the corrected truth of the former falsehoods actually caused the stock price to fall and resulted in losses." *Id.* at 113a. The court explained that, even when a putative securities-fraud class representative "create[s] a rebuttable presumption of reliance under the fraud-on-the-market theory" by validating the assumptions set out in *Basic*, it may not actually "take

advantage of the fraud-on-the-market presumption of reliance" unless it also shows loss causation. *Id.* at 114a-115a. The court characterized this additional requirement as a "rigorous" one that typically "requires both expert testimony and analytical research or an event study that demonstrates a linkage between the culpable disclosure and the stock-price movement." *Id.* at 130a. After reviewing all of the evidence in this case, the court of appeals concluded that petitioner had failed to meet this burden, and the court affirmed the denial of class certification. *Id.* at 123a-136a.

DISCUSSION

The court of appeals held that, when the named plaintiff in a putative securities-fraud class action relies on the fraud-on-the-market theory to establish a presumption of reliance, the plaintiff must demonstrate loss causation to obtain class certification. The court erred at the outset by considering loss causation at the class-certification stage without determining that it was relevant to any of the prerequisites for class certification under Federal Rule of Civil Procedure 23. The court then compounded that error by requiring plaintiffs to prove loss causation by a preponderance of the evidence. As a result, the court requires plaintiffs to prove a significant element of their case at the class-certification stage, without the benefit of full discovery and without consideration of their claims by a jury.

Nothing in *Basic Inc.* v. *Levinson*, 485 U.S. 224 (1988), supports the Fifth Circuit's approach. The Court in *Basic* approved the fraud-on-the-market theory as a way for a plaintiff class to show that common issues of fact and law predominate on the question of reliance. The Court in *Basic* did not address the separate element

of loss causation, and this Court's later decision in *Dura Pharmaceuticals, Inc.* v. *Broudo*, 544 U.S. 336 (2005), makes clear that the two elements are conceptually distinct. In particular, the Court in *Basic* did not suggest that, where the evidence regarding loss causation will be common to all members of the putative class, a court may nevertheless deny class certification based on the plaintiffs' inability to prove that element of their case.

The Fifth Circuit's approach to class certification in securities-fraud cases conflicts with the decisions of two other courts of appeals. The Seventh Circuit has expressly rejected the Fifth Circuit's approach. The Second Circuit, while allowing some consideration of the merits at the class-certification stage, does not require the putative class representative to prove loss causation. The question presented is a recurring and important one, and this case provides a suitable vehicle for addressing it. Accordingly, the petition for a writ of certiorari should be granted.

A. The Court Of Appeals Erred By Considering Loss Causation At The Class-Certification Stage Without Relating That Inquiry To The Rule 23 Requirements

1. In order to certify a case as a class action, a federal district court must determine that the proposed class satisfies all of the requirements contained in Federal Rule of Civil Procedure 23. See, *e.g.*, *Shady Grove Orthopedic Assocs., P.A.* v. *Allstate Ins. Co.*, 130 S. Ct. 1431, 1437 (2010) (*Shady Grove*); *Eisen* v. *Carlisle & Jacquelin*, 417 U.S. 156, 162-163 (1974). Under Section (a) of that rule, the named plaintiff must show that "the class is so numerous that joinder of all members is impracticable"; that "there are questions of law or fact common to the class"; that "the claims or defenses of the

representative parties are typical of the claims or defenses of the class"; and that "the representative parties will fairly and adequately protect the interests of the class." Fed. R. Civ. P. 23(a). The named plaintiffs must also establish that the suit falls within one of the three categories of class actions described in Section (b) of the rule. Here, petitioner sought class treatment on the ground that "questions of law or fact common to class members predominate over any questions affecting only individual members" and "a class action is superior to other available methods for fairly and efficiently adjudicating the controversy." Fed. R. Civ. P. 23(b)(3); see Pet. Mot. for Class Certification 14-19 (Sept. 17, 2007) (Docket entry No. 341).

2. In *Oscar Private Equity Invs.* v. *Allegiance Telecom, Inc.*, 487 F.3d 261 (2007), the Fifth Circuit offered essentially three justifications for its rule that the named plaintiff in a securities-fraud suit must establish loss causation for a class to be certified. First, the court viewed *Basic* as "allow[ing] each of the circuits to develop its own fraud-on-the-market rules," and stated that it had "used this room" in several cases to "tighten the requirements" for class certification to counteract the "extraordinary leverage" class certification bestows upon plaintiffs. 487 F.3d at 264-265, 267 (internal quotation marks omitted). Second, the court stated that placing the burden on plaintiffs to prove loss causation at the class-certification stage was consistent with the *Basic* Court's recognition that a defendant may rebut the presumption of reliance. *Id.* at 265. Third, the court suggested that a plaintiff's inability to prove loss causation may indicate that the alleged misrepresentations did not actually affect the company's stock price, even if

the plaintiff has established the prerequisites to invocation of the fraud-on-the-market theory. *Id.* at 269-270.

None of those rationales links proof of loss causation to the prerequisites for class certification under Rule 23. First, the Fifth Circuit's view that class actions bestow "extraordinary leverage" upon plaintiffs (*Oscar*, 487 F.3d at 267) does not authorize it to impose requirements above and beyond those specified in Rule 23. As this Court recently explained, "by its terms" Rule 23 "creates a categorical rule entitling a plaintiff whose suit meets the specified criteria to pursue his claim as a class action." *Shady Grove*, 130 S. Ct. at 1437. To the extent that policy concerns counsel in favor of "tighten[ing]" the availability of securities-fraud class actions, the responsibility for addressing those concerns rests with Congress rather than the courts. See, *e.g.*, *Tellabs, Inc.* v. *Makor Issues & Rights, Ltd.*, 551 U.S. 308, 313 (2007) (noting heightened pleading requirements imposed in the Private Securities Litigation Reform Act of 2005 (PSLRA), 15 U.S.C. 78u-4); *Schleicher* v. *Wendt*, 618 F.3d 679, 686 (7th Cir. 2010) (noting steps Congress has taken in the PSLRA and Securities Litigation Uniform Standards Act of 1998, 112 Stat. 3227, and stating that the court "do[es] not think it appropriate for the judiciary to make its own further adjustments by reinterpreting Rule 23 to make likely success on the merits essential to class certification in securities-fraud suits").

The *Oscar* court's second and third rationales likewise provide no sound basis for requiring a plaintiff to prove loss causation to make class treatment appropriate. To be sure, the fraud-on-the-market theory is relevant to the district court's class-certification decision. In securities-fraud cases where the fraud-on-the-market presumption is inapplicable, each plaintiff must offer

particularized proof that it relied on the defendant's misstatements; individual issues will predominate over the common ones; and class certification will not be appropriate under Rule 23(b)(3). See *Basic*, 485 U.S. at 242; *Schleicher*, 618 F.3d at 685 ("If something about 'the merits' also shows that individual questions predominate over common ones, then certification may be inappropriate."). But so long as the plaintiff has established that the fraud-on-the-market theory is applicable—generally by showing that the defendant's alleged misrepresentations were made publicly, that the company's shares were traded in an efficient market, and that the plaintiff traded shares between the time the misrepresentations were made and the time the truth was revealed, see *Basic*, 485 U.S. at 241-242, 247-248—then the plaintiff has shown that common questions predominate on the question of reliance. If the plaintiffs are subsequently unable to prove that they suffered any loss as a result of the alleged misrepresentations, the defendant will prevail on the merits, but the presence or absence of such proof is irrelevant to the question of class certification.

With respect to loss causation, the only relevant question at the class-certification stage is whether resolution of the loss-causation issue can be expected to turn on proof that is common to class members generally. So long as the loss-causation issue "affects investors in common" and therefore "can be made on a class-wide basis," a court may not deny class certification based on its view that the plaintiffs cannot prove that element of their claims. *Schleicher*, 618 F.3d at 687. In neither *Oscar* nor in this case, however, did the Fifth Circuit suggest that the loss-causation inquiry would vary from plaintiff to plaintiff in a way that would prevent common issues

from predominating. Rather, the clear thrust of the court's analyses in both cases was that proof of loss causation was lacking with respect to *all* members of the class. The Fifth Circuit erred by denying class certification on a ground unrelated to the requirements of Rule 23.

B. The Court Of Appeals Compounded Its Error By Requiring Plaintiffs To Prove Loss Causation By A Preponderance Of The Evidence At The Class-Certification Stage

1. In *Eisen*, this Court considered whether Rule 23 allows a district court to consider the merits of a plaintiff's claims "as part of the determination whether a suit may be maintained as a class action." 417 U.S. at 177-179. In that case, the district court had conducted a "preliminary hearing on the merits" to determine whether the plaintiff or the defendants should bear the cost of notice to the class. *Id.* at 168. This Court disapproved that approach, "find[ing] nothing in either the language or the history of Rule 23" to support conducting such an inquiry before certifying a case as a class action. *Id.* at 177.

The Court explained that, at the class-certification stage, "the question is not whether the plaintiff or plaintiffs have stated a cause of action or will prevail on the merits, but rather whether the requirements of Rule 23 are met." *Eisen*, 417 U.S. at 178 (quoting *Miller* v. *Mackey Int'l*, 452 F.2d 424, 427 (5th Cir. 1971)). Accordingly, *Eisen* concluded that courts may consider the merits of the plaintiff's claims at the class-certification stage only when necessary to determine whether the proposed plaintiff class meets the requirements of Rule 23. See *id.* at 177-178; see also, *e.g.*, Fed. R. Civ. P. 23(c)(1) advisory committee's note (2003) ("an evaluation

of the probable outcome on the merits is not properly part of the certification decision").

2. The court below, relying on *Oscar*, stated that a plaintiff in a putative securities-fraud class action is required to prove loss causation "at the class certification stage by a preponderance of all admissible evidence." Pet. App. 115a (quoting *Oscar*, 487 F.3d at 269). Because petitioner alleged that respondents had made false statements followed by corrective disclosures that resulted in losses to the class members, the court stated that petitioner must show that respondent's alleged corrective disclosures were "*related* to the false, non-confirmatory positive statement made earlier" and "that 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." *Id.* at 119a-120a (internal quotation marks omitted). The court called this showing "rigorous" and stated that it generally "requires both expert testimony and analytical research or an event study that demonstrates a linkage between the culpable disclosure and the stock-price movement." *Id.* at 130a; see *Oscar*, 487 F.3d at 270-271. The court then conducted a thorough (and thoroughly premature) merits analysis, addressing each alleged misstatement and corrective disclosure in turn before concluding that petitioner had failed to prove that the class losses were likely caused by respondents' corrective disclosures. Pet. App. 123a-136a.

As explained above, the court of appeals erred at the outset by going beyond the Rule 23 criteria and assessing the putative class members' ability to prove their case on the merits. The court compounded that error through the standard of proof that it imposed. The court of appeals did not simply ask whether petitioner

had adequately *alleged* loss causation or whether petitioner had established a *prima facie* case on that element (either of which would have exceeded the court's authority at the class-certification stage), but instead required petitioner to prove loss causation by a preponderance of the evidence. That approach improperly preempts the merits inquiries that occur at the summary-judgment stage and at trial.

The Fifth Circuit's rule requires plaintiffs to adduce significant admissible evidence at an unduly early stage of the litigation. Under *Oscar*, a plaintiff may not simply allege a theory of loss causation, or even produce analysts' reports opining that a drop in the stock price was attributable to the defendant's correction of a prior misrepresentation. 487 F.3d at 270-271. Instead, simply to obtain class certification, the plaintiff must do what would otherwise be done at the merits stage after full discovery—the plaintiff must produce empirical evidence such as an event study to analyze all possible causes of the drop in stock price, and must prove that it is "more probable than not" that the corrective disclosure, and not some other piece of bad news, caused the drop in stock price. *Id.* at 270.

The lengthy analyses of loss causation performed by the courts below attest to the fact that full consideration of loss causation is a detailed and complex inquiry. Under Rule 23, however, class certification is to be decided "[a]t an early practicable time after a person sues or is sued as a class representative." Fed. R. Civ. P. 23(c)(1). At that point, discovery may not be complete, or even substantially underway. The Fifth Circuit erred by re-

quiring plaintiffs to prove loss causation at that early stage of the lawsuit.[1]

Even in cases where discovery would not meaningfully supplement the range of available evidence bearing on loss causation, the Fifth Circuit's approach improperly requires district courts to usurp the role of juries in resolving disputed loss-causation issues. In order to obtain summary judgment, a defendant must show that, viewing the evidence in the light most favorable to the plaintiff, there are no genuine issues of material fact for trial. See, *e.g.*, *Celotex Corp.* v. *Catrett*, 477 U.S. 317, 323-324 (1986); *Adickes* v. *S.H. Kress & Co.*, 398 U.S. 144, 157 (1970); Fed. R. Civ. P. 56(c). Summary judgment is not appropriate if "there are any genuine factual issues that properly can be resolved only by a finder of fact because they may reasonably be resolved in favor of either party." *Anderson* v. *Liberty Lobby, Inc.*, 477 U.S. 242, 250 (1986). Under the Fifth Circuit's approach, however, the district court must decide at the class-certification stage whether the named plaintiff has proved loss causation by a preponderance of the evidence, not simply whether a reasonable fact-finder could so conclude. That standard denies class plaintiffs in securities-fraud suits the opportunity to have loss-

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[1] A named plaintiff's lack of access to discovery at the class-certification stage of a securities-fraud suit is particularly significant if the Fifth Circuit's opinion in this case is read to require proof of scienter as well as (or as a supposed component of) loss causation. Compare Pet. App. 123a n.35 (plaintiff need not prove "intentional fraud" at class certification) with *id.* at 121a-122a (loss-causation showing requires proof that "the corrective disclosure shows the misleading or deceptive nature of the prior positive statements" and that "the corrective disclosure more probably than not shows that the original estimates were designed to defraud"). Proof that the defendant acted with scienter may be particularly difficult to adduce before discovery has taken place.

causation issues resolved by a jury. See *Tellabs*, 551 U.S. at 326-328 (recognizing that plaintiffs are entitled to have their securities-fraud claims decided by a jury once a sufficient initial showing has been made).

C. Nothing In *Basic* Or The Fraud-On-The-Market Theory For Presuming Reliance Supports The Fifth Circuit's Requirement That Plaintiffs Prove Loss Causation At The Class-Certification Stage Of A Securities-Fraud Suit

In defending the court of appeals' approach, respondents contend (Br. in Opp. 23) that this Court's decision in *Basic* requires a named plaintiff to show that the defendant's misrepresentations actually affected stock prices in order to obtain class certification. Respondents further contend that "[l]oss causation * * * is central to the presumption of reliance" (*ibid.*), and they suggest (*id.* at 9-11) that the Fifth Circuit appropriately placed on petitioner the burden of proving loss causation. Each of those propositions is incorrect.

1. As explained above, a court in ruling on a class-certification request may consider the merits of the named plaintiff's claims only to the extent that merits-related issues bear on the criteria set forth in Rule 23. *Basic* did not generally suggest that securities-fraud suits are an exception to that general principle, nor did it specifically hold that the class-certification decision in a securities-fraud suit turns on whether the defendant's alleged misrepresentations actually affected the price of the relevant security. To be sure, if the defendant seeks to rebut the fraud-on-the-market presumption, the finder of fact may ultimately be required to determine whether actual market distortion occurred. But so long as the market-distortion inquiry turns on factual or legal

issues that are common to the members of the putative class, class certification is appropriate regardless of the perceived likelihood at that early stage that the plaintiffs will be able to establish that element of their claims on the merits. See *Schleicher*, 618 F.3d at 685.

Respondents rely in part (Br. in Opp. 23) on this Court's suggestion in *Basic* that a plaintiff who invokes the fraud-on-the-market presumption "must allege and prove" five enumerated elements, including "that the [defendant's] misrepresentations would induce a reasonable, relying investor to misjudge the value of the shares." 485 U.S. at 248 n.27. The Court in that passage was describing the analysis of the Sixth Circuit in the decision it was reviewing, and the Sixth Circuit's discussion of that element is illuminating. The Sixth Circuit explained that the plaintiff in that case had clearly satisfied four of the five requirements for invoking the fraud-on-the-market presumption and that "[t]he only real question then is element (4)—whether the plaintiffs can prove that a reasonable investor who was aware of the defendant's statements would have undervalued the stock." *Levinson* v. *Basic Inc.*, 786 F.2d 741, 750 (1986), vacated by 485 U.S. 224 (1988). The court then stated:

> The plaintiffs claim that the misrepresentations were intended to and did deflate the price of Basic's stock. This allegation satisfies element (4) for pleading purposes and should not be dismissed as a matter of law. If the plaintiffs are able to prove this and the other elements, it will be quite logical to presume that some investors relied on the misrepresentations resulting in a deflation of stock price and that members of the class relied upon the supposed integrity of the market price when selling their shares. The mere

> fact that the proof could be difficult does not preclude the opportunity to make the presentation *at trial*.

Id. at 750-751 (citation omitted; emphasis added).

The court of appeals in *Basic* thus clearly contemplated that any disputes concerning the actual effect on stock prices of the defendant's alleged misrepresentations would be resolved *at trial*. Respondent's contention that the district court must decide that factual issue as part of its threshold class-certification determination is inconsistent with the Sixth Circuit's analysis. And nothing in this Court's opinion in *Basic* suggests that the Court intended to impose more demanding class-certification requirements than those described by the court of appeals in *Basic*. See note 3, *infra*.

2. This Court's subsequent decision in *Dura Pharmaceuticals, Inc.* v. *Broudo*, *supra*, highlights the fact that reliance and loss causation are distinct elements of a securities-fraud claim. In *Dura*, the Court held that a plaintiff does not adequately allege loss causation simply by alleging that he purchased stock at an inflated price due to a defendant's misrepresentation or omission. *Id.* at 342-346. The Court explained that an investor who buys stock at a price that is inflated due to the defendant's misstatement suffers no immediate loss because "the inflated purchase payment is offset by ownership of a share that *at that instant* possesses equivalent value." *Id.* at 342. While acknowledging the existence of a "logical link between the inflated share purchase price and any later economic loss," the Court characterized that connection as "not invariably strong" because the purchaser's subsequent sale of the shares at a lower price "may reflect, not the earlier misrepresentation, but changed economic circumstances, changed investor ex-

pectations, [or] new industry-specific or firm-specific facts, conditions, or other events." *Id.* at 343. Thus, even if *Basic* were properly read to require an inquiry into market distortion as part of the class-certification decision, there would be no warrant for extending that inquiry to the distinct issue of loss causation.

3. The *Basic* Court held that courts may rely on a rebuttable presumption of reliance supported by the fraud-on-the-market theory. 485 U.S. at 250. The Court explained that the prerequisites for invoking the presumption are satisfied if the alleged misrepresentations were made publicly, the stock was traded in an efficient market, and the plaintiffs traded between the time of the alleged misrepresentations and the time the defendant made corrective statements. *Id.* at 241-242, 247. Even when those prerequisites have been satisfied, a defendant may rebut the presumption through "[a]ny showing that severs the link between the alleged misrepresentation and * * * the price received (or paid) by the plaintiff." *Id.* at 248. Under *Basic*, however, the *defendant* bears the burden of rebutting the presumption of reliance. See *id.* at 248-249; *In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474, 483 (2d Cir. 2008) (*Salomon*) (explaining that, "[u]nder *Basic*, * * * the burden of showing that there was no price impact is properly placed on defendants at the rebuttal stage"). Thus, even if an inquiry into actual market distortion were part of the class-certification inquiry, and even if market distortion and loss causation could properly be equated, there would be no warrant for the Fifth Circuit's requirement that the named plaintiff must prove loss causation at the class-certification stage.

D. The Circuits Are In Conflict Over The Question Presented, And This Case Is A Suitable Vehicle To Resolve That Disagreement

1. In its recent decision in *Schleicher*, the Seventh Circuit expressly rejected the Fifth Circuit's requirement that loss causation be proven at the class-certification stage. 618 F.3d at 685-687 (Easterbrook, J.). The court stated that, "unlike the fifth circuit, [the Seventh Cicuit] do[es] not understand *Basic* to license each court of appeals to set up its own criteria for certification of securities class actions or to 'tighten' Rule 23's requirements." *Id.* at 686. Instead, the court explained, whether a securities-fraud class should be certified depends solely on the requirements of Rule 23, and a court may review the merits only as necessary to make "decisions essential" under that Rule. *Id.* at 681, 685. In the court's view, any "potential for class certification to create pressure for settlement" is to be addressed by Congress, not the federal courts. *Id.* at 686.

The Seventh Circuit also rejected the view that a plaintiff in a private securities class action must show loss causation to rely on the fraud-on-the-market presumption of reliance. The court explained that, under *Basic*, courts may presume that "the price of a well-followed and frequently traded stock reflects the public information about a company." *Schleicher*, 618 F.3d at 682. To invoke the presumption of reliance, the Seventh Circuit explained, the plaintiff must simply show that the "company's stock trades in a large and efficient market." *Ibid.* The court stated that the separate question of loss causation need not be addressed at the class-certification stage because the determination whether and when the stock price was affected by fraud "can be made on a class-wide basis, because it affects investors in com-

mon." *Id.* at 687. To require proof of loss causation before a class is certified, the court stated, would "put the cart before the horse." *Ibid.* Characterizing the Fifth Circuit's approach as "a go-it-alone strategy," and noting that it "has not been adopted by any other circuit," the Seventh Circuit expressly "disappove[d]" that approach. *Ibid.*

2. The Second Circuit has taken an intermediate approach, allowing some consideration of the merits of a securities-fraud action at the class-certification stage (like the Fifth Circuit) but declining to consider loss causation at that stage (like the Seventh Circuit). In *Salomon*, the Second Circuit held that "plaintiffs do not bear the burden of showing an impact on price" from misrepresentations because the "point of *Basic* is that an effect on market price is presumed based on the materiality of the information and a well-developed market's ability to readily incorporate that information into the price of securities." 544 F.3d at 483. Although the court in *Salomon* did not expressly address the Fifth Circuit's approach, or expressly disavow consideration of loss causation at the class-certification stage, it stated that the prerequisites set out in *Basic* are "all that is needed to warrant the presumption" of reliance and that plaintiffs need not show at class certification that the alleged misrepresentations "moved the market." *Id.* at 481-482. The Second Circuit thus does not require plaintiffs to prove price distortion, let alone loss causation, at the class-certification stage.

The Second Circuit does, however, permit greater consideration of the merits at the class-certification stage than does the Seventh Circuit. Rather than limit a court's certification analysis to whether the stock traded in an efficient market and the alleged misrepre-

sentations were made publicly, the court in *Salomon* stated that a court considering a class-certification request may "take and weigh evidence on whether the presumption can be rebutted." 544 F.3d at 484. In particular, the court stated that class certification is inappropriate if the defendant can demonstrate "that the market price was not affected by the alleged misstatements." *Id.* at 485.[2]

The Second Circuit reached that conclusion because it read *Basic* to hold "that a successful rebuttal *defeats* certification by defeating the Rule 23(b)(3) predominance requirement." *Salomon*, 544 F.3d at 485.[3] In

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[2] Respondents contend (Br. in Opp. 8-9) that by allowing defendants to rebut the fraud-on-the-market presumption of reliance, the Second Circuit allows consideration of loss causation at the class-certification stage. That contention confuses reliance with loss causation. When the Second Circuit stated that defendants could rebut the presumption of reliance by showing that "the misrepresentation in fact did not lead to a distortion of price," 544 F.3d at 483-484, the court was addressing price distortion caused by a misstatement, not the cause of a plaintiff's later loss.

[3] As support for that proposition, the court in *Salomon* cited footnote 29 of this Court's opinion in *Basic*. See 544 F.3d at 485. In that footnote, this Court acknowledged a potential "incongruity between the assumption that Basic shares are traded on a well-developed, efficient, and information-hungry market, and the allegation that such a market could remain misinformed, and its valuation of Basic shares depressed, for 14 months, on the basis of the three public statements." 485 U.S. at 249 n.29. The Court stated that "[p]roof of that sort is a matter for trial, throughout which the District Court retains the authority to amend the certification order as appropriate." *Ibid.* That analysis suggests that, if the evidence ultimately demonstrates that the distortive effect of a defendant's misstatements was cured as of a particular date, a class-certification order may be amended to exclude class members who purchased or sold shares after that date. Footnote 29 of the Court's opinion in *Basic* does not suggest, however, that a district court should make factual determinations regarding price distortion as part of its

Schleicher, by contrast, the Seventh Circuit rejected the defendants' contention that, "before certifying a class, a court must determine whether false statements materially affected the price." 618 F.3d at 685. The court explained that "[f]alsehood and materiality affect investors alike," and that "[i]t is possible to certify a class under Rule 23(b)(3) even though all statements turn out to have only trivial effects on stock prices. Certification is appropriate, but the class will lose on the merits." *Ibid.*

3. The question presented warrants this Court's consideration. This Court has characterized private securities-fraud actions as "an essential supplement to criminal prosecutions and civil enforcement actions," *Tellabs, Inc.*, 551 U.S. at 313, and has recognized that they "deter[] fraud" and "maintain public confidence in the marketplace," *Dura*, 544 U.S. at 345. These cases commonly proceed as class actions, and the lower courts regularly consider the prerequisites for class certification. See Pet. 15-17 (citing cases). And the impact of the Fifth Circuit's loss-causation rule is significant. As the Seventh Circuit observed in *Schleicher*, the Fifth Circuit's approach "make[s] certification impossible in many securities suits." 618 F.3d at 687.

This case provides an appropriate vehicle to resolve the existing circuit conflict. All agree that the question whether petitioner must prove loss causation to obtain class certification is dispositive in this case. The district court determined that the Rule 23 requirements for class certification had been met, and the court stated

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initial class-certification inquiry. To the contrary, the Court's statement that "[p]roof of that sort is a matter for trial," *ibid.*, strongly indicates that such an inquiry is inappropriate at a threshold stage of the litigation. See pp. 14-16, *supra*.

that it would have certified the class but for Fifth Circuit precedents requiring proof of loss causation at this stage of the suit. Pet. App. 4a. And the lower courts' extensive analyses of loss causation on the merits (*id.* at 11a-54a, 123a-136a) provide a vivid example of the effect of requiring plaintiffs to prove loss causation at the class-certification stage. Accordingly, this Court's review is warranted.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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