NO. 09-1403

In The Supreme Court of the United States

ERICA P. JOHN FUND, INC. F/K/A ARCHDIOCESE OF MILWAUKEE SUPPORTING FUND,

Petitioner,

V.

HALLIBURTON CO. AND DAVID J. LESAR,

Respondents.

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

BRIEF OF DRI—THE VOICE OF THE DEFENSE BAR AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

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March 30, 2011

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES Page

INTEREST OF *AMICUS CURIAE*[1]

Amicus curiae DRI—the Voice of the Defense Bar is an international organization that includes more than 23,000 attorneys involved in the defense of civil litigation. DRI is committed to enhancing the skills, effectiveness, and professionalism of defense attorneys. Because of this commitment, DRI seeks to address issues germane to defense attorneys, to promote the role of the defense lawyer, to improve the civil justice system, and to preserve the civil jury system. DRI has long been a voice in the ongoing effort to make the civil justice system more fair, efficient, and — where national issues are involved — consistent.

To promote these objectives, DRI participates as *amicus curiae* in cases raising issues of importance to its members, their clients, and the judicial system. This is just such a case, because DRI members are frequently involved as counsel in securities-fraud litigation.

In *Oscar Private Equity Investments v. Allegiance Telecom, Inc.*, 487 F.3d 261 (5th Cir. 2007), the Fifth Circuit properly applied the efficient-capital-markets hypothesis to hold that securities-fraud plaintiffs

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[1] Pursuant to Supreme Court Rule 37.6, *amicus curiae* states that no counsel for any party authored this brief in whole or in part and that no entity or person, aside from *amicus curiae*, its members, and its counsel made any monetary contribution towards the preparation and submission of this brief. Pursuant to Supreme Court Rule 37.3(a), *amicus curiae* certifies that counsel of record for both parties have filed letters with the Clerk giving blanket consent to the filing of *amicus* briefs.

seeking class certification based on *Basic*'s presumption of reliance must show that the alleged misrepresentation actually affected the market price of the stock. In contrast, Petitioner's proposed rule would permit class certification even in the face of evidence that the alleged misrepresentation did *not* affect the stock price. The Court should affirm the decision below.

INTRODUCTION AND SUMMARY

Under a traditional Rule 23 analysis, securities-fraud suits would not be subject to class certification because individual issues of reliance would predominate over common issues. But this Court in *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988), approved the use of a rebuttable presumption of reliance to make class certification possible. Many of Petitioner's (and the supporting *amici*'s) arguments misapprehend the nature of that rebuttable presumption, which is a presumption of reliance, not a presumption that the alleged misrepresentations affected the market. And the presumption of reliance is reasonable only if (1) the market is efficient and (2) the misrepresentation actually affected the market price. 485 U.S. at 247-48. If the misrepresentation did not actually move the market, then there is no reasonable basis to presume reliance. *Basic* cannot be read to allow a presumption of reliance based solely on evidence of general market efficiency.

Moreover, Petitioner (and its supporting *amici*) misunderstand the rule articulated in *Oscar* and applied in this case. The Fifth Circuit's rule is the logical result of the reasoning in *Basic* and a straightforward application of Rule 23. If plaintiffs cannot present evidence that the alleged misrepresentation actually affected the stock price, then they cannot invoke *Basic*'s presumption of reliance. And if plaintiffs cannot invoke that presumption, then class-certification is not appropriate. Therefore, the correct standard is the one applied by the Fifth Circuit here and in *Oscar*, not the Seventh Circuit's standard in *Schleicher v. Wendt*, 618 F.3d 679 (7th Cir. 2010).

ARGUMENT

A. A showing of actual market movement is required to invoke *Basic*'s rebuttable presumption of reliance in a defrauded-buyer case.

The Court in *Basic* stated that reliance "provides the requisite causal connection between a defendant's misrepresentation and a plaintiff's injury" in securities-fraud cases. *Basic, Inc. v. Levinson*, 485 U.S. 224, 243 (1988). But if each member of a proposed class had to prove reliance, then individual issues would "overwhelm[]" common issues, and class certification would be improper. *Id.* To overcome this hurdle to class certification, securities-fraud plaintiffs generally try to invoke the rebuttable presumption of reliance based on the efficient-capital-markets hypothesis that the Court first approved in *Basic*. *Id.* at 250.[2] In approving the use of the

[2] The rebuttable presumption of reliance is sometimes referred to as the "fraud-on-the-market presumption." *E.g.*, *Teamsters Local 445 Freight Div. Pension Fund v. Bombardier Inc.*, 546 F.3d 196, 199-200 (2d Cir. 2008); *Binder v. Gillespie*,

rebuttable presumption, the Court relied on a description of the efficient-capital-markets hypothesis from an opinion that Judge Higginbotham authored as a district court judge. *Id.* at 244 (quoting *In re LTV Sec. Litig.*, 88 F.R.D. 134, 143 (N.D. Tex. 1980) (Higginbotham, J.)).

The efficient-capital-markets hypothesis postulates that, in an efficient market, the price of a security will reflect all material, publicly available information. *Basic*, 485 U.S. at 241-42. The hypothesis can therefore support a rebuttable presumption that market participants relied on all material, publicly available information, including the alleged misrepresentations. *Id.* In essence, *Basic*'s rebuttable presumption of reliance is an accommodation that allows securities-fraud plaintiffs to obtain class certification where it would otherwise be impossible.

The Court in *Basic* recognized that the presumption of reliance could be rebutted by "*any showing* that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff or his decision to trade at a fair market price." *Id.* at 248 (emphasis added). The Court cited several examples of evidence that would rebut the presumption, including evidence that the misrepre-

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184 F.3d 1059, 1064 (9th Cir. 1999); *Ockerman v. May Zima & Co.*, 27 F.3d 1151, 1158 (6th Cir. 1994); Petitioner's Br. at 23. But this phrase is a misnomer, because it suggests that the presumption at issue relates to the impact of the alleged misrepresentations on the market. A better short-hand reference is "presumption of reliance" because it more accurately describes what has to be presumed in order to make the requisite causal connection.

sentation did not affect the market price, evidence that the truth entered the market and dissipated the effect of the misrepresentation, and evidence that plaintiffs acted without relying on the integrity of the market. *Id.* at 248-49.

The plaintiffs in *Basic* were allegedly defrauded sellers of stock. *Id.* at 227-28. Since the market was efficient, under the efficient-capital-markets hypothesis, it could be presumed that the proposed class members sold their shares at a price that was based at least in part on the denials that merger discussions were taking place. *Id.* at 247. This presumption provided the causal link between the alleged misrepresentations and the plaintiffs' injuries. As articulated by the Court's earlier decision in *Affiliated Ute Citizens v. United States*, an allegedly defrauded seller's injury is the difference between the price received and the "fair value of what … would have been received had there been no fraudulent conduct …." 406 U.S. 128, 155 (1972). Therefore, the presumption that the plaintiffs sold their stock based on the defendants' misrepresentations links those misrepresentations to the injury. And the presumption could be rebutted by any showing that severed the link between the misrepresentation and that injury.

Here, and in *Oscar*, the plaintiffs were allegedly defrauded buyers, not sellers. *Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*, 597 F.3d 330, 334 (5th Cir. 2010); *Oscar Private Equity Invs. v. Allegiance Telecom, Inc.*, 487 F.3d 261, 263 (5th Cir. 2007). Under the Private Securities Litigation Reform Act (PSLRA) and *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336

(2005), an allegedly defrauded buyer's injury is different than an allegedly defrauded seller's. Merely purchasing the stock at an inflated price is not sufficient to show injury. In cases involving allegedly defrauded buyers, there is a separation between the time the investor acts and the time the relevant economic loss is measured. While the Court did not purport to comprehensively address proximate cause or loss causation in *Dura*, the Court specifically held that an "'artificially inflated purchase price' is not itself a relevant economic loss." 544 U.S. at 346. The rationale for the Court's ruling was that at best "the higher purchase price will *sometimes* play a role in bringing about a future loss." *Id.* at 343. Instead, the relevant economic loss cannot be measured until at least after the "truth" is revealed to the market. *Id.*

In other words, in cases involving allegedly defrauded buyers, the presumption of reliance is that the class members purchased stock in reliance on the integrity of the market, but the market price was inflated by the misstatements. To complete the required causal connection between the alleged misstatements and the plaintiffs' injuries, the class members must have then continued to rely on the integrity of the market while holding the stock. They then suffer a loss when the truth enters the market and the market price declines.

Therefore, in cases of allegedly defrauded buyers, the required causal connection between the misrepresentation and a plaintiff's injury must extend beyond a plaintiff's decision to purchase the stock. It must also encompass the plaintiff's participation in the market through the time that the plaintiff suffers an economic loss as defined in *Dura*. As a result, the efficient-market hypothesis can support the presumption of reliance only if: (1) the market is continuously efficient from the time of the purchase at the inflated price until the relevant economic loss is sustained; and (2) there is a market loss at the time the truth is revealed.

The first point is obvious. Normally in an efficient market, there will be both a statistically significant stock price increase in response to a material misstatement and a statistically significant stock price decrease when the market learns the truth. For the requisite causal connection to exist, the misstatement must continue to affect the efficient market's price for the stock until the sale or other disposition occurs and the plaintiff sustains an economic loss.

The second point is less obvious. In an efficient market, proof that revelation of the truth actually caused a stock price decrease establishes that the prior misstatement still is material and has caused a market loss. But it also establishes (or confirms) that the misstatement artificially inflated (or propped up) the stock price in the first place. If, however, there is no adverse market reaction to the revelation of the truth, then the causal connection has been broken, because there is no basis to presume that the misstatement caused any actual economic loss to the proposed class members. Under those circumstances, applying the presumption would directly contradict the efficient-capital-markets hypothesis on which it is based.

B. The Fifth Circuit cases applying the presumption of reliance are consistent with *Basic*, the PSLRA, and *Dura*.

1. In *Nathenson*, the Fifth Circuit correctly held that the presumption of reliance is not applicable unless the alleged misrepresentations actually affected the stock price.

In *Nathenson v. Zonagen, Inc.*, a case involving allegedly defrauded buyers that predates *Dura*, the Fifth Circuit addressed the need to show that the alleged misrepresentation affected the market price. 267 F.3d 400 (5th Cir. 2001). There, the defendants asserted that the presumption of reliance based on the efficient-capital-markets hypothesis was improper because the alleged misrepresentations did not cause the stock price to increase. *Id.* at 413. The district court agreed, reasoning that because the alleged misrepresentations did not impact the stock price, they were immaterial and plaintiffs did not rely on them. *Id.* at 414. This reasoning was based, in part, on the Third Circuit's opinion in *In re Burlington Coat Factory Securities Litigation*, 114 F.3d 1410 (3d Cir. 1997) (Alito, J.).

The Fifth Circuit generally agreed with the Third Circuit's reasoning about the importance of impact on the stock price. 267 F.3d at 414-15. But the Fifth Circuit concluded that the reasoning applied more appropriately to reliance than to materiality. *Id.* at 415. The Fifth Circuit reasoned that "[i]f the market price was not actually affected by the statement, reliance on the market price does not *of itself* become reliance on the statement." *Id.* at 419 (emphasis in original). Therefore, if "the information in question did not affect the price of the stock then the district court may properly deny fraud-on-the-market based recovery." *Id.* at 415.

Significantly, the Fifth Circuit further recognized that a fraudulent misstatement might not always cause an increase in the stock price:

> For example, if the market believes the company will earn $1.00 per share and this belief is reflected in the share price, then the share price may well not change when the company reports that it has indeed earned $1.00 per share even though the report is false in that the company has actually lost money (presumably, when that loss is disclosed the share price will fall).

Id. at 419. Because there were no such allegations in *Nathenson*, the Fifth Circuit did not explore the issue further. *Id.* ("[N]o such special circumstance is alleged or even hinted at here.").

2. In *Greenberg*, the Fifth Circuit explained how a securities-fraud plaintiff can invoke the presumption by showing that the efficient market reacted when the truth became public.

Three years later, the Fifth Circuit did address the "special circumstance" identified in *Nathenson*. Seeking to apply the presumption of reliance, the plaintiffs in *Greenberg v. Crossroads Systems, Inc.* attempted to show that the alleged misrepresentations fraudulently inflated the stock price by relying on a decrease in the stock price when the alleged truth was revealed. 364 F.3d 657, 660 (5th Cir. 2004). The Fifth Circuit observed that impact on stock price "ordinarily" has been shown by an increase in price after the misrepresentation was made. *Id.* at 665. The court also observed that impact also can be shown inferentially by a decrease in the stock price when the alleged truth was revealed. *Id.* But the inference of impact does not attach to all negative information.

Instead, such an inference is warranted only where the misrepresentation "was related to the statement causing the decrease." *Id.* Otherwise, "the invocation of the presumption of reliance would be based solely on speculation." *Id.* In sum, the court held that

> in order to show that a stock's price was actually affected through evidence of a significant price decrease following the revelation of the alleged "truth" of earlier false statements, plaintiffs must demonstrate: (1) that the negative "truthful" information causing the decrease in price is related to an allegedly false, non-confirmatory positive statement made earlier and (2) that it is more probable than not that it was this negative statement, and not other unrelated negative statements, that caused a significant amount of the decline.

Id. at 666.

This reasoning is consistent with the efficient-market hypothesis and with *Basic*'s recognition that the fraud-on-the-market theory can apply only when the alleged misrepresentation affected the stock price. When plaintiffs choose to rely on inference rather than on direct evidence of such impact, the inference should be reasonable. And if the negative information is not related to the alleged prior misrepresentation, then there can be no reasonable inference that the misrepresentation affected the stock price.

3. In *Unger*, the Fifth Circuit held that securities-fraud plaintiffs seeking class certification must produce evidence of their entitlement to the presumption of reliance.

One year after *Greenberg*, the Fifth Circuit addressed the evidentiary burden on plaintiffs seeking class certification. *Unger v. Amedisys, Inc.*, 401 F.3d 316, 321 (5th Cir. 2005). The court first noted this Court's direction that "[c]lass certification hearings should not be mini-trials on the merits of the class or individual claims." *Id.* at 321 (citing *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156, 177-78 (1974)). But the Fifth Circuit also observed that "[t]he plain text of Rule 23 requires the court to 'find,' not merely assume, the facts favoring class certification." *Id.* (quoting Fed. R. Civ. P. 23(b)(3)). The court also collected cases from other circuits that applied "rigorous, though preliminary, standards of proof to the market efficiency determination." *Id.* at 322 (citing cases from the Third, Fourth, Seventh, and Ninth Circuits). Therefore, the court concluded that

> When a court considers class certification based on the fraud on the market theory, it must engage in thorough analysis, weigh the relevant factors, require both parties to justify their allegations, and base its ruling on admissible evidence. Questions of market efficiency cannot be treated differently from other preliminary certification issues. Courts cannot make an informed decision based on bare allegations, one-sided affidavits, and unexplained Internet printouts.

Id. at 325.

4. In *Oscar*, the Fifth Circuit correctly applied *Basic*, *Nathenson, Greenberg*, and *Unger* to determine that proof of market effect is required at the class-certification stage to invoke the presumption of reliance.

In *Oscar Private Equity Investments v. Allegiance Telecom, Inc.*, the Fifth Circuit considered the presumption of reliance in a class action involving allegedly defrauded buyers in an opinion by Judge Higginbotham. 487 F.3d 261 (5th Cir. 2007) (Higginbotham, J.). At the class-certification hearing, the plaintiffs made no attempt to establish a connection between the alleged misrepresentations and their injury. *Id.* at 271. Instead, they argued that the defendants had no right to contest the applicability of the rebuttable presumption of reliance at the class certification stage. *Id.* at 269. The district court agreed, and certified the proposed class. *Id.* at 262.

The Fifth Circuit granted permission to appeal, and rejected that argument. *Id.* at 266. The court first noted that subtle changes to Rule 23 recognized the importance of a rigorous analysis of the requirements for class certification. *Id.* at 267. Indeed, as the court observed, the notes to the 2003 amendments advise that "[a] court that is not satisfied that the requirements of Rule 23 have been met should refuse certification until they have been met." *Id.* (citing Fed. R. Civ. P. 23 Advisory Committee Notes to the 2003 Amendments). The court also noted that the adoption of the PSLRA was a "less-subtle" recognition by Congress that "a district court's certification order often bestows upon plaintiffs extraordinary leverage, and its bite should dictate the process that precedes it." *Id.*

Following the principles embodied in the amendments to Rule 23 and the PSLRA, the Fifth Circuit concluded that application of the efficient-capital-markets hypothesis *must* be addressed at the class-certification stage. *Id.* at 268. The court also concluded that because the district court has to "find" facts to support class certification, plaintiffs must prove the facts supporting entitlement to the presumption of reliance by a preponderance of the evidence. *Id.*

The Fifth Circuit then applied *Greenberg*'s holding that the presumption of reliance can be invoked only with proof of market impact. *Id.* at 266. And a decrease in stock price following the release of the negative news can show market impact only if the negative news is related to the prior alleged misrepresentation. Otherwise, under the efficient-capital-markets hypothesis, there is no basis to presume that the misstatement affected the stock price.[3]

Applying *Unger*, the Fifth Circuit also held that the plaintiffs had a burden to establish their entitlement to the rebuttable presumption of reliance. *Id.* at 268-69. The court found that the class proponent had the burden to show market effect under *Greenberg*. *Id.* at 265. The court, however, acknowledged that often the class opponent affirmatively seeks to sever a link in the causal chain by pointing out a lack of price movement in response to a misrepresentation or by producing evidence that the alleged "corrective" disclosure was one of multiple pieces of negative news. *Id.* In either case, the presumption is rebutted "on arrival." *Id.*

The court also observed that because of the nature of the evidence related to this issue, the placement of the burden of proof makes little practical difference. *Id.* Because the focus of the inquiry is the market's reaction to information, the evidence needed for the inquiry is all publicly available. *Id.* at 271. Econometric analysis, such as

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[3] *Dura* recognized that, in a defrauded-buyer case, injury cannot be proven by evidence of price inflation alone. *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 346 (2005). Although *Oscar* did not address this issue, it could be argued that evidence of price inflation alone is similarly insufficient to support a presumption of reliance. If, as the Court observed in *Basic*, reliance provides the causal link between the misrepresentation and the plaintiff's injury, then only evidence of a decrease when the "truth" is revealed can support a presumption of that link consistent with the efficient-market hypothesis.

an event study, can isolate the factors affecting the stock price. *Id.* Frequently, defendants point to an event study as evidence to sever the link between the alleged misrepresentation and the stock price. *Id.* at 265 n.22. And in response, plaintiffs then point to their own event study to refute the defendants' contentions. *Id.*

At that point, the trial court will have to decide which expert to believe, and the placement of the burden of proof makes little or no difference. If the defendant has an initial burden to rebut, then the court must decide whether to credit the defendant's expert over the plaintiff's expert. And if the plaintiff has a burden to prove market impact, then the court must decide whether to credit the plaintiff's expert over the defendant's expert. But in either case, the analysis is the same, and the placement of the burden is immaterial.

Moreover, where, as here, the parties dispute whether the negative news is even related to the prior alleged misrepresentations, the burden of proof is even less important. The relatedness requirement is important because it is relatedness that allows the court to infer from the decrease in stock price that the alleged misrepresentation affected the stock price. *Greenberg v. Crossroads Sys., Inc.*, 364 F.3d 657, 663 (5th Cir. 2004). Where the parties dispute relatedness, the court simply needs to compare the negative news to the prior alleged misrepresentation and decide whether the negative news let the market know that the prior alleged misrepresentations were false. The burden of proof makes no difference in that determination.

The Fifth Circuit also observed that virtually no discovery is needed to produce evidence of actual market impact. The efficient-market hypothesis focuses on what information was made publicly available and how the market reacted to that information. Internal company documents are irrelevant to this determination unless they were made public. *E.g.*, *Alaska Elec. Pension Fund v. Flowserve Corp.*, 572 F.3d 221, 230 (5th Cir. 2009) ("[U]ndisclosed information cannot drive down the market price of a stock."). Therefore, because all of the relevant information must be public, discovery is not necessary.

5. Summary

Oscar is the unremarkable logical result of the Fifth Circuit's application of the efficient-capital-markets hypothesis to a case involving allegedly defrauded buyers. In *Nathenson*, the Fifth Circuit observed that a decrease in stock price when the "truth" is revealed also could prove market impact. In *Greenberg*, the court recognized that the presumption of reliance can be reasonable only if corrective information that causes the subsequent price decline actually relates back to the prior misrepresentation. In *Unger*, the court recognized that the presumption of reliance cannot be applied unless the plaintiffs produce admissible evidence to support it. And in *Oscar*, the court correctly recognized that proof of market impact is necessary at class-certification to invoke the presumption of reliance. Since entitlement to the presumption is an essential prerequisite under Rule 23, the Fifth Circuit properly requires plaintiffs to prove entitlement by a preponderance of the evidence at the class-certification stage.

C. Petitioner's attacks on *Oscar* miss the mark.

When *Oscar* is considered in light of its jurisprudential underpinnings, Petitioner's arguments that *Oscar* was incorrectly decided cannot withstand scrutiny. As discussed more fully below, *Oscar* does not conflict with *Basic* or *Eisen*. Nor did the Fifth Circuit engage in improper judicial legislation. *Oscar* is consistent with both the Court's jurisprudence and Congress's expressed intent regarding securities-fraud suits.

1. Petitioner and the Petitioner's *amici* misunderstand the term "loss causation" as used in *Oscar*.

As the Seventh Circuit has noted: "'Loss causation' is an exotic name – perhaps an unhappy one … for the standard rule of tort law that the plaintiff must allege and prove that, but-for the defendant's wrongdoing, the plaintiff would not have incurred the harm of which he complains." *Bastian v. Petren Res. Corp.*, 892 F.2d 680, 685 (7th Cir. 1990) (Posner, J.). In *Oscar*, the Fifth Circuit used "loss causation" as a short-hand phrase in a specific context — to describe its requirement that a class proponent seeking to invoke the presumption of reliance in a defrauded-buyer case must prove that the misstatement affected the market price. In *Oscar*, the plaintiffs had failed to offer any proof that any portion of the stock price decrease following the 4Q01 release would not have occurred but-for the prior positive regarding line count. 487 F.3d at 271. In using this phrase, the Fifth Circuit was not using "loss causation" in the same sense as the Court used the term in *Dura*.

In *Dura*, "loss causation" clearly refers to the plaintiffs' obligation to prove that the misrepresentation ultimately caused an actual economic loss, not just a "paper loss" when the truth became known to the market. The specific issue there was whether an allegation that the price of the security was inflated on the date of purchase was sufficient to allege that the defendant's fraud caused an economic loss to the plaintiffs. 544 U.S. at 338. The Court noted that the PSLRA "expressly imposes on plaintiffs 'the burden of proving' that the defendant's misrepresentations 'caused the loss for which the plaintiff seeks to recover.'" *Id.* at 345-46 (quoting 15 U.S.C. § 78u-4(b)(4)). The Court also observed that courts refer to this requirement as "loss causation." *Id.* at 338.

The Court concluded in *Dura* that "[n]ormally, in cases such as this one (*i.e.*, fraud-on-the-market cases), an inflated purchase price will not itself constitute or proximately cause the relevant economic loss." *Id.* at 342. Although an inflated purchase price may be a necessary condition of economic loss, it is not sufficient by itself. *Id.* at 343. Therefore, the Court required that plaintiffs plead and prove that the defendant's fraudulent conduct proximately caused "the plaintiff's economic loss." *Id.* at 346. And this showing is what the Court refers to as "loss causation" in *Dura*.

Under the same reasoning, the deflation in price that, under the efficient-market hypothesis, will occur if the misstatement has any continuing effect when the market learns the truth will not itself constitute or proximately cause the relevant economic loss. Such a market loss may be necessary for an actual economic loss, but it is not sufficient by itself. At least for a defrauded buyer who continues to hold the security, the actual economic loss will be sustained some time later than the paper loss from the market decline.

Thus, the showing of actual economic loss described as "loss causation" in *Dura* is separate and distinct from the showing of a market loss described as "loss causation" in *Oscar*. In fact, the court in *Oscar* specifically noted "Our approach is unaffected by the Supreme Court's recent and very narrow decision in *Dura Pharms.*, 125 S. Ct. at 1627." *Id.* at 265.

Despite this distinction, Petitioner has seized on the Fifth Circuit's use of the term "loss causation" to set up a straw man. Many of Petitioner's arguments are premised on the idea that the Fifth Circuit requires proof of loss causation as that term is used in *Dura*. For example:

- "In *Oscar,* the Fifth Circuit held that securities fraud plaintiffs must prove loss causation, *i.e.*, that a defendant's alleged misrepresentations are the proximate cause of their economic loss, at class certification, to invoke the fraud-on-the-market presumption." (Petitioner's Br. at 23.)
- "Loss causation, by contrast, concerns

> whether a subsequent corrective disclosure caused plaintiffs' loss." (*Id.* at 45.)

In addition, Petitioner's repeated argument that *Oscar* imposes an additional burden at the class-certification stage is based on the assertion that "loss causation" in *Oscar* means the same thing as "loss causation" in *Dura.* (*See* Petitioner's Br. at 5, 24, 27, 32, 38, 47.) But, as discussed above, *Oscar* ties its requirement for proof of "market-loss causation" to the issue of whether any presumption of reliance can continue to supply the necessary causal link between the earlier misstatement and any actual economic loss sustained after the truth enters the market. Therefore, the Court should disregard Petitioner's arguments based on this misunderstanding of the sense in which the Fifth Circuit is using the term "loss causation" in *Oscar.*[4]

2. *Oscar* does not conflict with *Basic*.

As detailed in Part B above, *Oscar* is the logical result of the Court's decision in *Basic*, and the application of its principles in subsequent Fifth Circuit cases. Most of Petitioner's arguments about ways that *Oscar* allegedly conflicts with *Basic*

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[4] Petitioner and some *amici* appear to suggest that the Fifth Circuit is unaware of the distinction between reliance (or transaction causation) and loss causation. Any such suggestion is ludicrous. Judge Patrick Higginbotham authored the *Oscar* opinion. He has written extensively on securities issues in prior opinions, and in scholarly publications. In its discussion of the efficient-market hypothesis, the Court in *Basic* quoted Judge Higginbotham's 1980 opinion in *In re LTV Securities Litigation*, 88 F.R.D. 134 (N.D. Tex. 1980). 485 U.S. at 244.

collapse when they are analyzed with the proper understanding of "loss causation" as *Oscar* uses that term. *Oscar* simply ensures that the actual market events through the time the truth enters the market are consistent with the efficient-market hypothesis that underlies the presumption of reliance. If they are not, then there is no basis for continuing to presume that an allegedly defrauded buyer is relying on a tainted market. Petitioner's arguments that *Oscar* is inconsistent with *Basic* fail for at least three reasons.

First, Petitioner appears to misunderstand the nature of the presumption in *Basic*. Petitioner claims that the Fifth Circuit's rule subverts the fraud-on-the-market theory by "requiring the plaintiffs to prove, as a pre-condition to application of the presumption, the very facts that are to be presumed under *Basic*." (Petitioner's Br. at 33 (quoting the dissent in *Oscar*).) The presumption in *Basic* is not that the misrepresentation affected the market price. Rather, *if* the misrepresentation affected the efficient market's price, then it is presumed that plaintiffs relied on the misrepresentation in participating in the market. *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 159 (2008); *Basic*, 485 U.S. at 247-48. Conversely, if the misrepresentation did not affect the efficient market's price, then there is no basis to use the presumption of reliance to make a causal connection between the misrepresentation and the plaintiff's injury. Therefore, *Oscar* simply requires that plaintiffs show that the presumption is warranted by showing that the alleged misrepresentation affected the market price of the securities at issue.

Second, Petitioner's argument that there is no justification for requiring proof of market impact ignores an essential element of the fraud-on-the-market theory. Petitioner claims that the presumption of reliance can be invoked simply by showing general market efficiency. (Petitioner's Br. at 40-41.) But the efficient-market hypothesis underlying the presumption of reliance predicts that the alleged misrepresentation will cause a market decline when the truth enters the market if it continues to affect the defrauded buyer's stock. The fact that a decline attributable to the misstatement does not occur eliminates the justification for applying the presumption. *Stoneridge*, 552 U.S. at 159; *Basic*, 485 U.S. at 248.

As the court observed in *Oscar*, the fraud-on-the-market theory rests on the "semi-strong efficient-market hypothesis." 487 F.3d at 269. The semi-strong efficient-market hypothesis posits that "the collective action of a sufficient number of market participants buying or selling stock causes a very rapid, if not virtually instantaneous, adjustment in price." Daniel R. Fischel, *Use of Modern Finance Theory in Securities Fraud Cases Involving Actively Traded Securities*, 38 Bus. Law. 1, 10 (1982-83).

If the release of the alleged "truth" does not cause a stock price decline, there are three possible explanations. First, the prior alleged misrepresentation may not have been material. *Oscar*, 487 F.3d at 269. Second, it may be that the market is not efficient as to that information, even though the other relevant indicia support a finding that the market is generally efficient. *Id*. Third, it may be that the market is "strong-form efficient" as to that information. *Id.* When a market is strong-form efficient, the price reflects not only public information but also insider information. *Id.*

Each of these three scenarios is inconsistent with the justification for applying a presumption of reliance. If the information was immaterial, then no one could have relied on it. *Basic*, 485 U.S. at 248 n.27 (noting that one requirement of the fraud-on-the-market theory is the existence of a public, material misrepresentation). If the market is not efficient as to the information at issue, then there is no basis to presume that buyers and sellers were relying on that information when participating in the market. Finally, if the market is strong-form efficient, then there is no basis to presume that market participants were relying on *public* information. Therefore, by requiring plaintiffs to prove a market impact, *Oscar* simply ensures that any presumption of reliance applied is consistent with the efficient-capital-markets hypothesis.

Third, Petitioner claims that *Basic* holds that the presumption can be rebutted only at the time of trial. (Petitioner's Br. at 24.) In support of this assertion, Petitioner relies on footnote 29 in *Basic*. (*Id.*) But footnote 29 suggests only that the time of trial is one possible time at which the presumption can be rebutted. *Basic*, 485 U.S. at 249 n.29. The Court noted that the district court retains the ability to amend the certification order as may be appropriate. *Id.* (citing Fed. R. Civ. P. 23(c)(1) and (c)(4)). But nothing in Rule 23 requires that such amendments can only be made at the time of trial. Fed. R. Civ. P. 23(c)(1)(C). Rather, they can be made at any time that a party presents evidence to support them. *Id.* ("An order that grants or denies class certification may be altered or amended before final judgment."). Therefore, *Oscar* is not inconsistent with *Basic* in holding that the presumption can be rebutted at the class-certification stage if the evidence does not support the application of the presumption of reliance.

3. *Oscar* does not conflict with *Eisen*.

Petitioner also argues that *Oscar* conflicts with the Court's decision in *Eisen v. Carlisle & Jacquelin*, in which the Court held that Rule 23 does not permit a preliminary inquiry into the merits of the plaintiffs' claims. 417 U.S. 156, 177 (1974). Petitioner concedes, as it must, that *Eisen* has been interpreted to mean that merits inquiry is not foreclosed if it is necessary to determine whether the requirements of Rule 23 have been met. (Petitioner's Br. at 47 (citing *In re Initial Pub. Sec. Offerings Litig.*, 471 F.3d 24, 41 (2d Cir. 2006)).) Therefore, Petitioner's argument that *Oscar* conflicts with *Eisen* is premised on the assumption that there is no relationship between the causal connection the presumption of reliance is being used to make and *Oscar*'s requirement of showing a market impact.

That assumption is faulty because *Oscar*'s requirement of a market loss is part of the fraud-on-the-market analysis, which, in turn, is part of the Rule 23 analysis. There is no dispute that entitlement to the presumption of reliance based on the efficient-market hypothesis is a critical part of the Rule 23 analysis. The presumption of reliance allows plaintiffs to meet the predominance requirement for class certification. *See* Fed. R. Civ. P. 23(b)(3). In the absence of the presumption of reliance, there would have be an individual inquiry to establish each proposed class member's reliance and class certification would be improper. *Basic*, 485 U.S. at 242.

As discussed in detail above, *Oscar*'s rule is inextricably related to the justification for the presumption that the allegedly defrauded buyers relied on the price set by an efficient, but tainted market. If there is no market movement attributable to the misstatement, there is no basis for applying the presumption to a set of events that are inconsistent with it. And without the presumption of reliance, the requirements of Rule 23 cannot be met. Therefore, *Oscar* does not conflict with *Eisen. See also Unger*, 401 F.3d at 325.

Petitioner also argues that because determination of whether the alleged misstatement caused all or part of a later market loss is a common issue, it should not be considered at the class-certification stage. But as shown above, the requirements of Rule 23 cannot be satisfied without the presumption of reliance. Therefore, even if market loss is a common issue, it still must be considered and decided at the class-certification stage in order to determine whether the presumption of reliance can be used to satisfy Rule 23's predominance requirement. Otherwise class certification is improper.

Petitioner also claims that plaintiffs cannot make the showing required by *Oscar* without merits discovery. (Petitioner's Br. at 52-56.) This is factually incorrect. As *Oscar* explicitly demonstrated, proof that the alleged misrepresentation affected the market price will require only publicly available information. *Oscar*, 487 F.3d at 267. Petitioner claims that merits discovery would have permitted it to "look behind" the public disclosures. (Petitioner's Br. at 53.) But the market-loss inquiry is concerned only with the efficient market's reaction to what was known to the efficient market. *Oscar*, 487 F.3d at 267. Under the efficient-market hypothesis, internal company information, or other information not known to the efficient market, could not have impacted how the market reacted to the revelation of the truth. *E.g.*, *Alaska Elec. Pension Fund v. Flowserve Corp.*, 572 F.3d 221, 230 (5th Cir. 2009) ("[U]ndisclosed information cannot drive down the market price of a stock."). There is no basis for Petitioner's claim that this type of merits discovery would be relevant to the but-for inquiry on "market-loss causation."

Petitioner stretches *Oscar* beyond its breaking point to argue that the Fifth Circuit requires proof of scienter at the class-certification stage. (Petitioner's Br. at 53-54.) Nothing in *Oscar* requires proof that the defendants were aware of the falsity of the alleged prior misrepresentations. Again, the focus is on the market's reaction to the negative news, and whether but-for the alleged prior positive misrepresentations, that negative reaction would have occurred. Whether the prior statements were made with scienter has nothing to do with *Oscar*'s requirement to show that the alleged misrepresentation caused a market loss.

In sum, *Oscar*'s "market-impact" causation requirement is directly tied to the justifications underlying the presumption that defrauded buyers were relying upon the price set by an efficient, but tainted market. If there is no market movement attributable to the alleged misstatement, there is no justification for presuming that but-for their misguided reliance on the integrity of the efficient market, the defrauded buyers would not have sustained an actual economic loss. Since absence of market movement when the truth enters the efficient market is directly contrary to the efficient-market hypothesis, *Oscar*'s requirement is consistent with *Basic*, *Dura*, and Rule 23.

4. ***Oscar* is not impermissible judicial legislation.**

Petitioner concludes its brief by arguing that the Fifth Circuit invaded Congress's prerogative to "calibrate" class-certification Rules. (Petitioner's Br. at 57-67.) But this argument is infected by the same misunderstandings and faulty assumptions that doom Petitioner's other arguments. Petitioner's arguments are premised on its assertion that the rule in *Oscar* is not consistent with Rule 23. As shown above, *Oscar* is simply an application of the principles underlying the presumption of reliance as they apply to claims by allegedly defrauded buyers. Because *Oscar* is consistent with Rule 23, Petitioner's claims of improper "amendment" or "recalibration" are unfounded.

Petitioner's specific arguments fail for additional reasons, as well. Petitioner first claims that the Fifth Circuit improperly injected policy considerations into its analysis. (Petitioner's Br. at 57.) But, as discussed more fully above, the policy considerations that the Fifth Circuit identified are those reflected in Congressional actions regarding Rule 23 and the PSLRA. (*See* page 14, above.) The Fifth Circuit was simply acknowledging and furthering the policies identified by Congress.

Petitioner next claims that *Oscar* improperly recalibrated the requirements for a securities-fraud case to be certified as a class action because that may only be done by Congress. (Petitioner's Br. at 60.) This argument ignores the fact that it was the courts, not Congress, that approved the presumption of reliance based on the fraud-on-the-market theory. As discussed above, the judicially created presumption of reliance allows cases to proceed as class actions that otherwise would not satisfy the requirements of Rule 23. (*See* pages 3-4, above.) And because the rule in *Oscar* is consistent with this Court's class-action jurisprudence, there is nothing improper about the development of class-action law in the Fifth Circuit.

Petitioner also attempts to invoke plaintiffs' right to a jury trial under the Seventh Amendment. (Petitioner's Br. at 62.) But this right is not implicated because, as shown above, the rule in *Oscar* is simply part of the Rule 23 analysis. And there is no right to a jury trial on whether the requirements of Rule 23 have been satisfied. Fed. R. Civ. P. 23(b)(3) (providing that class certification is appropriate if "the court finds" that the requirements are met). And the standard of proof is immaterial to this analysis because all of the requirements of Rule 23 must be established by a preponderance of the evidence. *See In re Hydrogen Peroxide Antitrust Litig.,* 552 F.3d 305, 320 (3d Cir. 2008); *Teamsters Local 445 Freight Div. Pension Fund v. Bombardier Inc.,* 546 F.3d 196, 202 (2d Cir. 2008); *Oscar,* 487 F.3d at 267-269.

Petitioner's final argument is simply a complaint that the standard in *Oscar* is difficult to satisfy. (Petitioner's Br. at 66-67.) As shown above, *Oscar* simply requires plaintiffs to show that the presumption should be applied. The fact that this showing may be difficult in some cases is no reason for the Court to further lower a bar already lowered by allowing use of the presumption of reliance to satisfy the predominance requirement in Rule 23. Without any valid policy justification, Petitioner, in effect, seeks the recognition of a completely new presumption — a conclusive presumption of market impact through the class certification stage. This would facilitate precisely the type of litigation abuse that was an unintended result of *Basic* and that the PSLRA sought to eradicate.

D. The Seventh Circuit's simplistic approach in *Schleicher* fails to rigorously analyze whether the presumption of reliance makes the necessary causal link between the misstatements at issue and the economic loss claimed.

Petitioner repeatedly points to the Seventh Circuit's recent opinion in *Schleicher v. Wendt*, 618 F.3d 679 (7th Cir. 2010), as a contrast to *Oscar* on the proper approach to certification of a class of allegedly defrauded buyers. (Petitioner's Br. at 29, 31, 41, 44, 61, 67.) *Schleicher* expressly disavows the Fifth Circuit's approach in *Oscar*, and holds that a class proponent need show only general market efficiency at the time of purchase to invoke the presumption of reliance. *See* 618 F.3d at 684 ("Conseco was a large, well-followed firm, whose stock traded actively in a liquid market. It comfortably meets *Basic*'s requirements.") Under the Seventh Circuit's approach, any consideration of whether the alleged misrepresentation actually produced movement in the generally efficient market is a merits inquiry *prohibited* at the class certification stage. *See* 618 F.3d at 686-87 ("The chance, even the certainty, that a class will lose on the merits does not prevent its certification.").[5]

As discussed above, absent actual impact on the stock price, the presumption of reliance cannot supply the requisite but-for causal connection between the alleged misrepresentation and the actual economic loss. *Schleicher* acknowledges that "[w]hen an unduly optimistic false statement causes a stock's price to rise, the price will fall again when the truth comes to light." 618 F.3d at 683. But the opinion

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[5] *Schleicher* also rejects the approaches of the First and Second Circuits that have required a showing of market impact at the class certification stage in analyzing the materiality element of a 10b-5 claim. 618 F.3d at 687. Curiously, *Schleicher* references the Third Circuit's decision in *In re Burlington Coat Factory Securities Litigation*, 114 F.3d 1410, 1419 n.8 (3d Cir. 1997) (Alito, J.) as support for its position on materiality. In *Oran v. Stafford*, 226 F.3d 275, 282 (3d Cir. 2000), the Third Circuit found that the *Burlington Coat* requirement for a showing of market movement applied in the class-action context.

ignores the converse. If the price does not fall when the truth comes to light, then the effect, if any, that the unduly optimistic false statement had on the market price has been dissipated. The buyer is continuing to rely on the market to set the price, but the market is no longer tainted by the misrepresentation. Thus, the presumption of reliance no longer makes the requisite causal link for the proposed class members. The class proponent then cannot show entitlement to the presumption, or the presumption has been rebutted. By ignoring this essential element, *Schleicher* conflicts with *Basic* and *Stoneridge*. *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 159 (2008); *Basic*, 485 U.S. at 248.

Schleicher also makes the bald statement that "person-specific issues" that determine "how much a given investor lost (or gained) as a result of the fraud" are issues that "can be resolved mechanically" by a computer. 618 F.3d at 681. This is clearly incorrect. As discussed above, *Dura* does not define a precise measure of damages for a defrauded buyer's 10b-5 claim, but the decision does make clear that the "relevant economic loss" is not the amount of inflation at the time of purchase or the "paper loss" in response the revelation of the truth. *Dura*, 544 U.S. at 343-44. The original purchase prices and quantities for proposed class members presumably are susceptible of mechanical calculation by a computer. But given the myriad of factors affecting price, and the myriad of factors involved in the individual decisions to sell, a mechanical calculation of the continuing effect, if any, of the fraudulent statement on the stock price for shares held by proposed class member after the truth becomes known is simply not possible.

Many of *Schleicher*'s criticisms are the same as those raised by Petitioner, and they are addressed above. But three additional criticisms warrant specific mention here. *Schleicher* suggests that *Oscar* would make it too difficult to certify class actions in cases where it is "impossible" to disentangle the effects of fraudulent statements from the effects of other statements. *Schleicher*, 618 F.3d at 686. But this argument ignores the very nature of the efficient-capital-markets hypothesis. If the effects of the statements cannot be disentangled, then either plaintiffs have not shown entitlement to the presumption or defendants have rebutted it. In either case, the presumption that the class of buyers relied on the market does not make the required but-for connection between the alleged misrepresentation and the economic loss claimed. Under those circumstances, individual issues of reliance predominate and the class cannot be certified.

Schleicher also suggests that *Oscar* does not adequately account for the "truth-on-the-market" theory, in which the truth comes out and affects the stock price before any formal announcement is made. *Id.* at 687. That is simply a misreading of *Oscar*. There the plaintiffs affirmatively asserted that the market learned the truth through the company's 4Q01 release. The opinion specifically recognizes and accounts for the possibility that the truth may become known in other ways. *Oscar,* 487 F.3d at 269-70.

Finally, *Schleicher* claims that a plaintiff's failure to satisfy the requirements of *Oscar* results in the plaintiff losing on the merits. 618 F.3d at 687. But *Oscar* makes clear that the only impact of failing to obtain the presumption of reliance at the class-certification stage is that the class will not be certified. 487 F.3d at 271. The lead plaintiffs (and other plaintiffs) are still free to pursue their individual claims. Institutional investors like Petitioner still have a substantial economic incentive to do so.

In sum, *Schleicher* oversimplifies and mischaracterizes the issues in an attempt to dispose of *Oscar*. *Schleicher*'s simplistic approach would require certification of a class where, under the efficient-capital-markets hypothesis, the market effects, if any, of the alleged misstatement have been dissipated. *Basic* did not adopt the efficient-market hypothesis. Instead, the Court found it had sufficient empirical support to be used as the basis for a presumption that investors relied upon an alleged misstatement because an efficient market would have factored it into the security's price. But where the actual events are inconsistent with the events the efficient-market hypothesis predicts, there is no basis for using the presumption to make the requisite but-for causal connection. *Basic* stated that "any showing" could make the presumption inappropriate. *Oscar* and the other Fifth Circuit cases are consistent with *Basic*. It is *Schleicher* that is inconsistent.

CONCLUSION

The Fifth Circuit's rule, as outlined in *Oscar* and in this case, is the logical result of the Court's decision in *Basic*. There, the Court approved the use of a rebuttable presumption of reliance based on the efficient-capital-markets hypothesis. This presumption can allow class certification of securities-fraud suits even though proof of reliance is usually an individualized inquiry. But if the alleged misrepresentation did not actually affect the market price, then there is no reasonable basis to presume reliance. Therefore, the Court recognized that the presumption is rebutted by "any showing" that severs the causal link.

Petitioner seeks to further lower the bar to class certification. First, Petitioner seeks to apply the rebuttable presumption of reliance based simply on evidence of market efficiency. This approach ignores the importance of actual market impact. Second, Petitioner asks this Court to hold that the rebuttable presumption is *not* rebuttable at the class-certification stage. Even if the preponderance of the admissible evidence shows that the alleged misrepresentations had no impact on the market price, Petitioner's proposed rule would require the class to be certified. The Court should affirm the decision below.

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March 30, 2011

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