

SUPREME COURT CLARIFIES THAT LOSS CAUSATION IS NOT REQUIRED TO OBTAIN CLASS CERTIFICATION

By Han Nguyen

In a favorable ruling for shareholders, the Supreme Court resolved a split among the circuit courts when it held that securities fraud plaintiffs are not required to prove loss causation to obtain class certification. Prior to this decision, the United States Court of Appeals for the Fifth Circuit stood alone in requiring proof of loss causation at the class certification stage. The Supreme Court's decision in *Erica P. John Fund, Inc. v. Halliburton Co.*, et al. now brings the Fifth Circuit in line with the majority view.

Class certification under Federal Rule of Civil Procedure 23(b)(3) requires a court to determine whether "questions of law or fact common to class members predominate over any questions affecting only individual members." In a securities fraud case, this determination often turns on whether the plaintiffs relied on the company's alleged misrepresentations in trading the stock. Recognizing the impracticality of requiring each individual class member to prove factual reliance, the Supreme Court in 1988 allowed securities fraud plaintiffs to invoke the fraud-on-the-market theory to establish a rebuttable presumption of reliance. This theory presumes that an investor relies on public misstatements whenever he or she trades at the price set by an efficient market.

Last year, the Fifth Circuit ruled that plaintiffs were required to establish loss causation at the class certification stage to "trigger the fraud-on-the-market presumption" of reliance. In *Halliburton*, the Erica P. John Fund (the "EPJ Fund") brought a putative class action against Halli-

burton on behalf of all investors who purchased Halliburton common stock from June 3, 1999 to December 7, 2011. The EPJ Fund alleges that Halliburton intentionally inflated its stock price in violation of §10(b) of the Securities Exchange Act of 1934 and Securities Exchange Commission Rule 10b-5 by making false statements about the scope of its potential liability in asbestos litigation, its expected revenue from its construction business, and the benefits of its merger with another company. The EPJ Fund alleges that investors lost money on their investments when Halliburton made corrective disclosures, thus causing the stock price to decline. The Fifth Circuit affirmed the District Court's denial of class certification for failure to prove loss causation, "i.e., that the corrected truth of the former falsehoods actually caused the stock price to fall and resulted in the losses."

The Supreme Court swiftly rejected the Fifth Circuit's ruling, issuing its opinion just six weeks after oral argument. The Court noted there was no precedent for requiring loss causation as a precondition for invoking the fraud-on-the-market presumption of reliance. The two concepts are unrelated. Loss causation requires plaintiffs to demonstrate that false statements or omissions affected the market price and caused economic loss. The fraud-on-the-market theory presumes that investors rely on a company's false statement or omission because that information will be reflected in the market price. The Supreme

(continued on page 2)

(continued from page 1)

Court noted that loss causation has “no logical connection” to the facts necessary to establish the predicate for the fraud-on-the-market theory. Therefore, loss causation has no place in the class certification analysis.

This decision was not unexpected. The Supreme Court has now eliminated the minority view of the Fifth Circuit and clarified that loss causation is not required to win class certification in securities class action cases. Had the Supreme Court ruled otherwise, investors across the country would have been faced with a daunting challenge in pursuing claims under §10(b) of the Securities Exchange Act and SEC Rule 10b-5. ♦

This document is a basic summary of legal issues. It should not be relied upon as an authoritative statement of the law. You should obtain detailed legal advice before taking legal action.

For more information about Schnader’s Financial Services Litigation Practice Group, or to re-

quest to speak with a member of the group at a particular Schnader office location, please contact:

*Han Nguyen
215-751-2528
hnguyen@schnader.com*

*Theresa E. Loscalzo
Co-Chair, Financial Services Litigation
Practice Group
215-751-2254
tloscalzo@schnader.com*

*Stephen J. Shapiro
Co-Chair, Financial Services Litigation
Practice Group
215-751-2259
sshapiro@schnader.com*

www.schnader.com

©2011 Schnader Harrison Segal & Lewis LLP