



## Fifth Circuit Requirement that Securities Plaintiffs Prove Loss Causation at Class Certification Stage Overruled

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In a unanimous decision in *Erica P. John Fund, Inc. v. Halliburton Co.*, No. 09-1403 (Decided June 6, 2011), the Supreme Court held that plaintiffs in securities class actions do not need to prove loss causation in order to obtain class certification.

The plaintiff filed a securities class action alleging Halliburton made false statements regarding: its potential liability in asbestos claims, revenue from construction contracts, and the benefits of its merger with another company. After surviving a motion to dismiss, the plaintiff sought to certify the class pursuant to Rule 23 of the Federal Rules of Civil Procedure.

The district court found that the plaintiff had met the standards for class certification under Rule 23(b)(3), but that the class could not be certified because the plaintiff “failed to establish loss causation with respect to any’ of its claims.” The court explicitly stated that, but for the “stringent loss causation requirement,” the class would have been certified. The Fifth Circuit affirmed.

The Supreme Court granted certiorari, noting that there was a split among the circuits with regard to whether loss causation must be proven to certify a class. The opinion, authored by Chief Justice John Roberts, began by noting the elements which must be proven in a securities fraud claim based on violations of Section 10(b) of the Exchange Act: (1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance; (5) economic loss; and (6) loss causation.

Turning to the reliance element, the Court explained that under the “fraud-on-the-market” theory, “the market price of shares traded on a well-developed market reflects all publicly available information, and, hence, any material misrepresentations.” Thus, when an investor buys or sells at the market price there is a rebuttable presumption of reliance under the fraud-on-the-market theory.

Under the Fifth Circuit’s jurisprudence, a plaintiff must “establish a causal link between the alleged falsehoods and its losses in order to invoke the fraud-on-the-market presumption.” Thus, a plaintiff in the Fifth Circuit had to establish loss causation in order to trigger the fraud-on-the-market presumption of reliance. In *Halliburton*, proving loss causation at the class certification stage would mean proving that the decline in Halliburton’s stock was “because of the correction to a prior misleading statement” and “that the subsequent loss could not otherwise be explained by some



additional factors revealed then to the market.” The Supreme Court found that such a requirement was illogical, stating:

The fact that a subsequent loss may have been caused by factors other than the revelation of a misrepresentation has nothing to do with whether an investor relied on the misrepresentation in the first place, either directly or presumptively through the fraud-on-the-market theory. Loss causation has no logical connection to the facts necessary to establish the efficient market predicate to the fraud-on-the-market theory.

Therefore, the Supreme Court concluded that the Fifth Circuit had erred by requiring the plaintiff to prove loss causation, but explicitly declined to address other questions about the presumption of reliance or how and when the presumption may be rebutted.

Halliburton argued that the Fifth Circuit did not require the plaintiff to prove loss causation, but was using the term “loss causation” as shorthand for the plaintiff’s obligation to prove “‘price impact’—that is, whether the alleged misrepresentations affected the market price in the first place.” The Court viewed Halliburton’s argument as a “wishful interpretation” and noted that, regardless of what Halliburton believes the Fifth Circuit *meant* to say, “what it said was loss causation.” While counsel for Halliburton maintains that the decision is very narrow and will not prevent Halliburton from defeating class certification on remand, the plaintiffs’ bar maintains that *Halliburton* is a victory for securities plaintiffs in the Fifth Circuit.

Prior to this decision, plaintiffs in the Fifth Circuit were required to prove that the decline in the price of shares was due to a correction of an earlier misleading statement and that the loss could not be explained by other factors revealed in the market at the time. Although there will continue to be nuances with regard to the application of the fraud-on-the-market theory among the circuits, the Fifth was the only circuit court that required plaintiffs to prove loss causation at the class certification state. Thus, the decision in *Halliburton* brings the Fifth Circuit in line with the other circuits and will likely result in more cases being initiated within the Fifth Circuit.

*Halliburton* marks the second Supreme Court victory for securities class action plaintiffs this term. Earlier this year the Supreme Court handed down a favorable ruling on materiality in *Matrixx Initiatives v. Siracusano*, 563 U.S. \_\_\_ (2011).

Our attorneys have extensive experience in handling securities class actions and derivative suits on behalf of individuals and companies.

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