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Roadmap for Litigating Price Impact at Class Certification Stage

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On July 25—13 months after the U.S. Supreme Court's landmark opinion in *Halliburton v. Erica P. John Fund (Halliburton II)*, 134 S. Ct. 2398 (2014)—the U.S. District Court for the Northern District of Texas, on remand, issued its much-anticipated revised decision on the motion of lead plaintiff Erica P. John Fund Inc. for class certification in this 14-year-old securities fraud case. In *Halliburton II*, the Supreme Court held that, contrary to the opinions of the district court and the U.S. Court of Appeals for the Fifth Circuit below, at the class certification stage, a defendant may rebut the fraud-on-the-market presumption of reliance permitted under *Basic v. Levinson*, 485 U.S. 224 (1988), by demonstrating that an alleged misrepresentation had no impact on the corporate defendant's stock price.

After considering the parties' supplemental expert reports and legal briefs and holding an evidentiary hearing on the price impact issue, U.S. District Judge Barbara M.G. Lynn of the Northern District of Texas held that Halliburton Co. had successfully rebutted the presumption of reliance with respect to five out of six alleged corrective disclosures but that it had failed to show the sixth disclosure did not have an impact on the company's stock price. Accordingly, the district court in *Erica P. John Fund v. Halliburton*, No. 3:02-cv-1152, 2015 U.S. Dist. LEXIS 97464, at *95-96 (N.D. Tex. July 25, 2015), granted the fund's motion for class certification as to the sixth disclosure: Halliburton's Dec. 7, 2001, announcement that a Baltimore jury had returned a $30 million verdict in an asbestos lawsuit against one of its subsidiaries. The court's detailed opinion provides parties and district courts in other securities fraud cases with useful guidance for litigating the price impact issue at the class certification stage.

Demonstrating Lack of Price Impact: Background

To bring a securities fraud lawsuit under Section 10(b) of the Securities Exchange Act of 1934 and the U.S. Securities and Exchange Commission Rule 10b-5, an investor plaintiff must prove, among other things, that he or she individually relied on the alleged misrepresentation. If courts strictly applied this requirement in the class action context, then common questions would not "predominate" for purposes of satisfying Federal Rule of Civil Procedure Rule 23(b)(3). Instead, each investor would have to testify that he or she was aware of the alleged misrepresentation and made an investment decision based on that representation.

In *Basic*, the Supreme Court addressed this issue by holding that prospective investor classes could use a proxy for individual reliance by establishing a rebuttable presumption of classwide reliance via the fraud-on-the-market theory. Under this theory, as long as a company's stock trades in an efficient market, all public information about that stock is viewed as being incorporated in the stock's price—including the alleged misrepresentation. Thus, a court may presume that all members of the putative class indirectly relied on the alleged misrepresentation through reliance on the stock's market price, so long as plaintiffs can prove an efficient market.

In *Halliburton II*, Halliburton asked the court to allow a corporate defendant to rebut the *Basic* presumption and prevent class certification by introducing evidence that the alleged misrepresentations did not impact the market price of its stock. The court agreed with Halliburton that, if a plaintiff establishes the *Basic* presumption, then the defendant "should at least be allowed to defeat the presumption at the class certification stage through evidence that the misrepresentation did not in fact affect the stock price."

Because securities fraud claims typically focus on a price change at the time of an alleged corrective disclosure rather than a price change at the time of the alleged misrepresentation itself, the district court decision on remand examines the parties' expert evidence as to the price impact, or lack of price impact, of six alleged corrective disclosures.

As the district court's opinion explains: "If a particular disclosure causes the stock price to decline at the time of disclosure, then the misrepresentation must have made the price higher than it would have otherwise been without the misrepresentation. Measuring price change at the time of the corrective disclosure, rather than at the time of the corresponding misrepresentation, allows for the fact that many alleged misrepresentations conceal a truth. Thus, the misrepresentation will not have changed the share price at the time it was made."

To show the absence of a price impact, courts generally require the defendant demonstrate, through the testimony of an economic expert and the use of an "event study," that the stock price movement after an alleged misrepresentation or corrective disclosure was not statistically significant under a 95 percent confidence standard. "An event study is generally comprised of two parts: (1) a calculation of the market-adjusted price change in the issuer's share price at the time the corrective disclosure became public; and (2) a determination of whether the corrective disclosure is among the [Halliburton-related] news that affected the price on the date the disclosure became public," the opinion said.

Preliminary Legal Issues

Before assessing the parties' price impact evidence, the district court answered two threshold legal questions that the Supreme Court's decision in *Halliburton II* did not directly address.

First, the court held that Halliburton, not the fund, bore both the burden of production and the burden of persuasion to show lack of price impact. The court rejected Halliburton's reliance on Federal Rule of Evidence 301, which provides, in pertinent part, that "the party against whom a presumption is directed has the burden of producing evidence to rebut the presumption" and that the burden of persuasion "remains on the party who had it originally." According to the court, "a literal application of Rule 301 to the fraud-on-the-market presumption in a class certification hearing would allow defendants to preclude class certification by merely putting on a reputable expert that can opine with 95 percent confidence that a corrective disclosure had no effect on price." As the court explained, "The fund would then be forced to move forward and prove reliance without the aid of the presumption, which would doom the class on predominance grounds." The court concluded "the Supreme Court would not have modified the fraud-on-the-market presumption so substantially without explicitly saying so."

Second, the district court held that, based on the Supreme Court's decisions in *Erica P. John Fund v. Halliburton (Halliburton I)*, 131 S. Ct. 2179, 2185-86 (2011) (holding that a plaintiff need not prove loss causation at class certification stage), and *Amgen v. Connecticut Retirement Plans and Trust Funds*, 133 S. Ct. 1184 (2013) (holding that a plaintiff need not prove materiality at class certification stage), "class certification is not the proper procedural stage for the court to determine, as a matter of law, whether the relevant disclosures were corrective."

"To hold otherwise would require the court to pass judgment on the merits of the allegations after the dismissal stage and before summary judgment—in effect, giving a third bite at the apple to Halliburton. While it may be true that a finding that a particular disclosure was not corrective as a matter of law would 'sever the link between the alleged misrepresentation and ... the price received (or paid) by the plaintiff,' the court is unable to unravel such a finding from the materiality inquiry," the court said, quoting *Halliburton II*. Accordingly, the court's opinion assumes "that the asserted misrepresentations were, in fact, misrepresentations," and "that the asserted corrective disclosures were corrective of the alleged misrepresentations."

Standards for Price Impact Evidence

The district court adopted several standards for assessing price impact evidence. First, the court recognized that evidence of price impact or lack of price impact should be shown to a 95 percent confidence level.

Second, the court applied a multiple-comparison adjustment in order to reduce the potential for finding false positives among the substantial number (35) of comparisons being tested for statistical significance. As the court explained, "According to [Halliburton's expert witness], the multiple-comparison issue arises when a large number of price reactions are tested for statistical significance, because the more price reactions tested, the greater the odds are of finding statistical significance simply due to chance."

Third, the court applied a one-day window, instead of a two-day window, to measure price impact. “In this case, the use of a two-day window is inappropriate to measure price impact in an efficient market,” the court said.

In addition to applying these general standards for assessing price impact, the court adopted case-specific aspects of each party’s proposed expert methodology. For example, the court’s price impact analysis included not only the S&P 500 Energy Index and the Fortune E&C Index proposed by Halliburton, but also the fund’s so-called “Analyst Index”—a “peer index” composed of companies identified by securities analysts as being Halliburton’s peers—to control for the company’s specific industry. And although the court applied a multiple-comparison adjustment as urged by Halliburton’s expert, it selected the so-called Holm-Bonferroni version advocated by the fund’s expert so as to reduce any false negatives that might occur from the multiple-comparison analysis. After meticulously assessing the price impact of each of the six alleged misrepresentations, the court held that, with respect to five of them, Halliburton met its burden of proving that there was no impact on its stock price in response to the alleged corrective disclosures. Because the *Basic* presumption of reliance did not apply to these five alleged misrepresentations, the court could not certify a class of investors who allegedly “relied” on them.

As for the sixth alleged corrective disclosure, the court held that Halliburton did not meet its burden of showing lack of price impact. On that same day, after the announcement, the company’s stock price dropped by approximately 40 percent, a decline that was statistically significant under both Halliburton’s and the fund’s price impact models. Because the court applied a one-day window to measure price impact, it refused to consider the rebound in the company’s stock price on the next trading day, as urged by Halliburton’s expert. The 14-day time period for the parties to file a petition for permission to appeal the court’s decision under Federal Rule of Civil Procedure 23(f) has expired. Accordingly, the court’s guidelines for litigating price impact at the class certification stage remain intact for parties and district courts to follow or modify in other securities fraud cases.