No. 09-1403

In the Supreme Court of the United States

ERICA P. JOHN FUND, INC.,
Petitioner,
v.
HALLIBURTON, CO., ET AL.,
Respondents.

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

BRIEF OF AARP AND NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC. AS *AMICI CURIAE* IN SUPPORT OF PETITIONER

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INTERESTS OF *AMICI CURIAE*[1]

AARP is a non-partisan, non-profit organization dedicated to representing the needs and interests of people age fifty and older. AARP is greatly concerned about fraudulent, deceptive and unfair business practices, many of which disproportionately harm older people. AARP thus supports laws and public policies designed to protect older people from such business practices and to preserve the legal means for them to seek redress. Among these activities, AARP advocates for improved access to the civil justice system and supports the availability of the full range of enforcement tools, including class actions.

A significant percentage of the investing public in the United States' markets is comprised of members of the age fifty and older population. Older persons are frequent targets of financial fraud because they often have significant assets and they look for investment opportunities that will supplement Social Security and other sources of retirement income. As a result, AARP has elevated the need to combat securities fraud and made this issue a high priority. The Association has regularly commented on legislative and regulatory proposals that address investment fraud, filed *amicus* briefs in

[1] In accordance with this Court's Rule 37.6, no party's counsel wrote this brief in whole or in part and no person other than amici or their counsel made a monetary contribution intended to fund the preparation or submission of the brief. The parties' letters consenting to the filing of this brief have been lodged with the Clerk of the Court.

cases involving the securities laws, and opposed legislative efforts to limit the remedies of defrauded investors.

The North American Securities Administrators Association, Inc. ("NASAA") is the non-profit association of state, provincial, and territorial securities regulators in the United States, Canada, and Mexico. It has sixty-seven (67) members, including the securities regulators in all fifty (50) states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. Formed in 1919, NASAA is the oldest international organization devoted to protecting investors from fraud and abuse in the offer and sale of securities.

NASAA's members are responsible for regulating securities transactions under state law, and their principal activities include registering local securities offerings; licensing the brokers and investment advisers who sell securities or provide investment advice; and initiating enforcement actions to address fraud and other misconduct. They are intimately familiar with the investment offerings and sales abuses confronting their state residents on a daily basis.

NASAA supports all of its members' activities and it appears as amicus curiae in important cases involving securities regulation and investor protection. Recognizing that private actions are an essential complement to governmental enforcement of the securities laws, NASAA and its members also support the rights of investors to seek redress in

court for investment-related fraud and abuse. NASAA and its members have an interest in this appeal because it will profoundly affect the ability of investors to seek redress in cases where unscrupulous companies and individuals seek to cloak their fraudulent acts through perverse uses of the corporate form.

The resolution of this case will have a significant impact on the integrity of the securities markets and the remediation of securities fraud in those markets. This is of particular concern at this time, to both AARP and NASAA, given the entry of many first-time investors into the market and the responsibility for retirement investing that pensioners have had to assume as a result of the shift in the retirement plan paradigm from defined benefit pension plans (under which employers bear the risk of loss) to defined contribution pension plans (under which plan participants bear the risk of loss).

SUMMARY OF ARGUMENT

Securities fraud litigation initiated by private parties under the U.S. Securities and Exchange Commission's Rule 10b-5, 17 C.F.R. § 240.10(b) ("Rule 10b-5"), serves as an essential means of protecting the integrity of the securities markets for investors, maintaining investor confidence in the markets, and making victims whole. The Fifth Circuit's loss causation requirement, however, undermines private securities actions in contravention of *Basic v. Levinson*, 485 U.S. 224 (1988) and Congress' support for such litigation.

Basic serves to aid plaintiffs seeking class certification under Federal Rule of Civil Procedure 23(b)(3) ("Rule 23") by providing them the fraud-on-the-market presumption to demonstrate reliance as a class and satisfy the predominance requirement. The Fifth Circuit's approach contravenes this Court's underlying rationale and establishes a substantial hurdle to certification in many cases by requiring the plaintiff to demonstrate loss causation prior to relying on this presumption. The Circuit mistakenly relies on *Basic*, however, because loss causation focuses on the effects of the defendant's conduct and not on each potential member of the class and is therefore wholly different from reliance.

Moreover, the Fifth Circuit's holding undermines private securities litigation by adding loss causation as a prerequisite for class certification when it is not part of the plain language of Rule 23. Further, Congress in its lawmaking has recognized the interests that must be balanced in facilitating private securities litigation and plainly addressed these interests through the Private Securities Litigation Reform Act of 2005 ("PSLRA"), 15 U.S.C. 78u-4 (2006), and the Securities Litigation Uniform Standards Act ("SLUSA"), 15 U.S.C. § 78a (2006). The Fifth Circuit's loss causation requirement tampers with the balance struck in these statutes and implements a hurdle that Congress chose not to enact.

Therefore, as a result of the importance of Rule 10b-5 and the unavailability of alternative remedies under state law, the Fifth Circuit's

requirement that a plaintiff demonstrate loss causation by a preponderance of the evidence at the certification stage will have a deleterious result on private securities litigation, leaving investors unprotected.

ARGUMENT

The Fifth Circuit's requirement that the named plaintiff prove loss causation by a preponderance of the evidence prior to class certification creates an insurmountable hurdle that will close the door to the private securities actions that Congress embraced under Section 10(b) of the Securities and Exchange Act of 1934 and the U.S. Securities and Exchange Commission ("Commission") implemented through Rule 10b-5.

I. RULE 10b-5 PROVIDES PLAINTIFFS THE OPPORTUNITY TO BRING PRIVATE SECURITIES LITIGATION.

Congress' intention to provide individual investors private rights of action in securities frauds claims is manifest throughout the federal securities law. Section 10(b) of the Securities and Exchange Act of 1934 makes it unlawful to violate the rules promulgated by the Commission. *See* 15 U.S.C. § 78j(b). In turn, Rule 10b-5 provides that it is unlawful, during the sale or purchase of a security, for an issuer to "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

light of the circumstances under which they were made, not misleading." *See* 17 C.F.R. § 240.10b-5(b).

In order to prove a violation of Rule 10b-5, a party must demonstrate (1) the presence of a material misrepresentation or omission; (2) the defendant's scienter; (3) a connection between the misrepresentation or omission and the transaction involving the security; (4) a plaintiff's reliance on the misrepresentation or omission; (5) a plaintiff's economic loss; and (6) a causal connection between the misrepresentation or omission and the plaintiff's loss. *See Dura Pharms., Inc. v. Broudo* (*Dura*), 544 U.S. 336, 341 (2005). Because Rule 10b-5 does not specify these elements, *see* 17 C.F.R. 240.10b-5(b), this Court has taken the initiative for detailing the requirements of proving a violation of Rule 10b-5, *see* Matthew L. Fry, *Pleading and Proving Loss Causation in Fraud-on-the-Market-Based Securities Suits Post*-Dura Pharmaceuticals, 36 Sec. Reg. L.J. 31, 33 (2008).

Rule 10b-5 creates a private right of action. *See Dura*, 544 U.S. at 341, 345 (recognizing the importance of the private right of action in securities cases and explaining their role in maintaining public confidence and deterring fraud). This private right of action is often pursued by a class certified pursuant to Federal Rule of Civil Procedure 23 ("Rule 23"). Successful certification of a class under Rule 23 requires the named plaintiff to show numerosity, commonality, and adequacy of representation. Further, the named plaintiff must demonstrate that her claim falls within Rule 23(b).

The named plaintiff in this case seeks to demonstrate that its suit falls within Rule 23(b)(3), Pet. Mot. For Class Certification 8-9 (Sept. 17, 2007), which provides for class certification when "the questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy," Fed. R. Civ. P. 23(b)(3).

This Court embraced the importance of certified classes pursuing private causes of action under Rule 10b-5 and made such classes more feasible through its holding in *Basic*, 485 U.S. at 241. Because reliance, unlike any of the other factors in a Rule 10b-5 claim, is specific to each member of the class, this Court aided the ability of plaintiffs to demonstrate a common question of fact under Rule 23(b) by allowing them to establish a presumption of reliance, rather than having them demonstrate reliance for each member of the proposed class. *See id.* To establish this presumption, the plaintiff must demonstrate (1) the alleged misrepresentations were made publicly by the defendant; (2) the shares at issue were traded in an efficient market; and (3) the trading of shares took place in the time between when the misrepresentations were made and the truth was revealed. *See Basic*, 485 U.S. at 241-42.

This presumption does not apply to the other factors for a Rule 10b-5 violation. Unlike the issue of whether a particular plaintiff relied on the

defendant's misstatement or omission, in the context of the other elements of a Rule 10b-5 claim the plaintiff's reliance is irrelevant because the elements of a Rule 10b-5 inquiry revolve around the defendant's conduct and its effect on the market. Nevertheless, despite the inapplicability of *Basic*'s presumption as to the other elements of a Rule 10b-5 claim, the Fifth Circuit and the Respondent seek to apply this Court's analysis to the loss causation factor. *See Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.* ("*AMSF*"), 597 F.3d 330, 335 (5th Cir. 2010); Joint Brief of the Appellees Halliburton Company and David J. Lesar at 18, *AMSF*, 597 F.3d 330 (5th Cir. 2010). This use of the *Basic* holding not only reverses this Court's attempt to facilitate more efficient class certification in the Rule 10b-5 context, but also builds a restrictive wall around class certification. Significantly, rather than walling off class certification, as is the result of the Fifth Circuit's approach, *Basic* represents the importance this Court places on facilitating class certifications, which allow plaintiffs the opportunity to prove their Rule 10b-5 claim on its merits.

II. PRIVATE SECURITIES LITIGATION SERVES A CRUCIAL ROLE IN THE ENFORCEMENT OF THE SECURITIES LAWS, MAINTAINING INVESTOR CONFIDENCE, AND MAKING VICTIMS WHOLE.

Securities fraud litigation initiated by private parties is an essential means of enforcing the securities laws and protecting the integrity of the securities markets for investors and maintaining investor confidence in the markets. The limited

resources of the Commission are selectively employed and are seldom directed at making securities fraud victims whole. *See* Brief of the United States as Amicus Curiae Supporting Respondents at 1, *Merck & Co., Inc. v. Reynolds*, 130 S. Ct. 1784 (2010) (recognizing the importance of private securities litigation as a supplement to the Commission's criminal and civil enforcement actions); Brief for the Securities and Exchange Commission as Amicus Curiae in Support of Partial Affirmance at 6, *Herman & MacLean v. Huddleston*, 459 U.S. 375 (1983).

Consequently, the answer to the questions presented in this case will have immediate and potentially serious repercussions for the civil enforcement of securities law violations in this country, especially as they relate to Rule 10b-5. As financial crimes abound and alternative forums for aggrieved investors remain limited, it is especially important that the federal courts interpret federal law in a way that, to the extent possible, affords meaningful remedies to victims of securities fraud. This Court's reversal of the Fifth Circuit's holding will help accomplish this objective by fulfilling the standards articulated in Rule 10b-5 and providing plaintiffs a source of relief not otherwise available under state law.

A. This Court and Congress Have Emphasized the Importance of Private Securities Litigation in Deterring and Redressing Securities Fraud.

The Court has long recognized the vital importance of legitimate private securities litigation to the federal enforcement regime for securities fraud. *See, e.g.*, *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350 (1991); *Pinter v. Dahl*, 486 U.S. 622 (1988); *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 310 (1985) (observing that "implied private actions are a most effective weapon in the enforcement of the securities laws"); *J.I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964). *See also Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 730 (1975) (stating that "private enforcement" of Rule 10b-5 is "a necessary supplement to Commission action"). In these and other decisions, the Court has recognized a strong Congressional policy of favoring private actions as a means of achieving the fundamental goals of our securities laws: fraud deterrence, victim compensation, and the promotion of investor confidence.

As a deterrent, private securities actions are essential to inspiring compliance with securities laws. As the Commission has explained, "given the limited enforcement resources of the Commission, the private right of action is vital to effective enforcement of Section 10(b)." See Brief for the Securities and Exchange Commission as Amicus

Curiae in Support of Partial Affirmance, *supra*, at 6. Former SEC Chairman David Ruder noted in 1989 that in earlier years less than ten percent of cases involving securities or commodities had been brought by the government. *See* David S. Ruder, *The Development of Legal Doctrine through Amicus Participation: The SEC Experience*, 1989 Wis. L. Rev. 1167, 1168.

William R. McLucas, former Director of the Commission's Enforcement Division, has argued that the private right of action under §10(b) and Rule 10b-5 is necessary to supplement federal enforcement of securities laws, based on "the continued growth in the size and complexity of our securities market, and the absolute certainty that persons seeking to perpetuate financial fraud will always be among us." *Private Litigation of the Federal Securities Laws: Hearings Before the Subcomm. on Securities of the Senate Comm. on Banking Housing & Urban Affairs*, 103d Cong., 1st Sess. 113 (June 17, 1993) [hereinafter *Hearings*] (testimony of William R. McLucas). Government agencies are generally strangers to the transactions that give rise to allegations of fraud. Private participants in allegedly fraudulent transactions thus have an informational advantage over government agencies and have stronger incentives to prosecute certain alleged frauds because they stand to profit from any recovery.

Statistics show that "private enforcement . . . dwarf[s] public enforcement," and thus private litigants are much more successful in terms of

recovery than the Commission. John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 Colum. L. Rev. 1534, 1542-43 tbls. 2 & 3 (2006). In fact, "even in major scandals where the [Commission] has brought its own action, the damages paid in securities class actions are usually (but not always) a multiple of those paid to the [Commission]." *Id.* Private actions are also able to reach a much broader range of perpetrated frauds. The Congressional mandate and funding for the Commission only allows it to prosecute the most flagrant abuses of securities laws. The Commission "does not have the resources to investigate every instance in which a public company's disclosure is questionable," an issue that would "continue to be the case even if the Commission's resources were substantially increased." *Berner v. Lazzaro*, 730 F.2d 1319, 1322-23 (9th Cir. 1984). *See also* H.R. Rep. No. 355, 98th Cong., 1st Sess., at 6 (1983) ("In recent years, the securities markets have grown dramatically in size and complexity, while Commission enforcement resources have declined."). Nowhere have the limits of the Commission's abilities to stop and prevent fraud been more apparent than the case of Bernard Madoff, who managed to operate a Ponzi scheme for nearly half a century in spite of continuous oversight from the Commission. Further, probing violations in the mutual fund industry has not been a top priority for the Commission. Marcia Vickers, Commentary, *How Eliot Spitzer Makes the SEC Look Stodgy*, Businessweek (Sept. 15, 2003), *available at* http://www.business week.com/magazine/content /03_37/b384 9047.htm ("The real failure has been on

the enforcement side. The SEC has done nothing to show that it really means business.").

Private enforcement actions are also an essential tool in compensating victims. Private actions afford victims of fraud the best and often only hope of recovering their losses, something for which government enforcement actions are ill equipped. As the Commission has explained,

> When the Commission files an enforcement action, its principal objectives are to enjoin the wrongdoer from future violations of the law, to deprive violators of their profit by seeking orders of disgorgement, and generally to deter other violations by seeking civil money penalties. Although the Commission usually makes disgorged funds available for the compensation of injured investors, the amount of investor losses often exceeds the wrongdoer's ill-gotten gains. Private actions, by contrast, enable defrauded investors to seek compensatory damages and thereby recover the full amount of their losses.

Hearings, *supra*, at 113.

Thus, while the Commission may seek monetary relief, its remedies are designed primarily to deter violations by making them unprofitable, rather than to make investors whole. And with good reason: the

damages in major securities fraud cases can and often do run into the billions of dollars. *See, e.g.*, *Regents of the Univ. of California v. Credit Suisse First Bos.*, 482 F.3d 372, 379 (2007); *In re Global Crossing*, 225 F.R.D. 436, 460 (2004); *see also* Coffee, *supra*, at 1555 (cataloguing settlement amounts in major securities fraud cases).

Accordingly, the primary means of compensating injured investors remains the private action. Finally, and especially important in our current financial downturn, private securities litigation performs a significant role in maintaining investor confidence by enforcing the mandatory disclosure system. As this Court recently noted, "The magnitude of the federal interest in protecting the integrity and efficient operation of the market for nationally traded securities cannot be overstated." *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 78 (2006). Investor confidence in the integrity of the securities markets is crucial to helping businesses raise the capital they need to expand and keep the lights on. *See Basic*, 485 U.S. at 235 n.12 (1988). If investors are prevented from holding corporate actors accountable for their frauds, investors will be far less willing to participate in our securities markets. *See Hearings*, *supra*, at 145.

B. Rule 10b-5 Represents the Petitioner's Only Source of Redress Because of Federal Limitations on Securities Fraud Claims Based on State Law.

The need to insure that investors have meaningful remedies in federal court is all the more important when state law does not provide an alternative remedy. This is especially true for securities fraud cases in light of the fact that "federal law, not state law has long been the principal vehicle for asserting class-action securities fraud claims." *Dabit*, 547 U.S. at 88. Furthermore, this Court has observed that the disadvantages posed by a restrictive interpretation of federal securities law can be "attenuated" where adequate remedies are available under state law. *See Blue Chip Stamps*, 421 U.S. at 738 n.9 (weighing fact that class action in state court was an alternative remedy); *see also Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 478 (1977) (state cause of action under corporate law was a factor in determining whether to recognize federal cause of action); *J.I. Case Co.*, 377 U.S. at 434-35 (1964) (noting that if federal jurisdiction is limited and state affords no relief, then the "whole purpose" of the statutory provision might be frustrated). Conversely, where state law does not offer a significant alternative forum for plaintiffs' claims, there is a correspondingly greater justification—and need—for the federal courts to afford relief.

In this case, state law offers limited recourse for investors in the Petitioner's position, as Congress

has expressly limited the use of class action suits seeking recovery for securities fraud under state law. In 1998, Congress enacted SLUSA to address the concern that "securities class action lawsuits [had] shifted from Federal to state courts" as a means of circumventing the Reform Act. *See* 15 U.S.C. § 78a (findings set forth in Pub. L. 105-353, § 2, Nov. 3, 1998). With certain exceptions, SLUSA provides that no class action based upon state law may be maintained in any state court on behalf of more than 50 class members. *See id.* § 77p(b). Moreover, state courts generally have not recognized the doctrine of fraud-on-the-market in cases seeking relief under state common law—a doctrine central to Petitioner's case—further limiting the state courts as an alternative forum for investors aggrieved by misconduct of the sort alleged in this case. *See, e.g.*, *Peil v. Speiser*, 806 F.2d 1154, 1163 (3rd Cir. 1986) (noting that no states have adopted fraud on the market theory); *Kaufman v. i-Stat Corp.*, 754 A.2d 1188, 1193-94 (N.J. 2000); *Mirkin v. Wasserman*, 858 P.2d 568, 584 (Cal. 1993).

Precisely because of the massive corporate frauds that have surfaced in recent years, some courts have recognized the need to re-evaluate barriers to civil actions alleging securities fraud. The California Supreme Court, for example, has cited the troubling increase in corporate fraud as a reason to recalibrate the balance between the interests of investors and the interests of corporations, in favor of providing greater judicial recourse to victims of fraud. The court explained that

When Congress enacted the Private Securities Litigation Reform Act of 1995 and the Uniform Standards Act of 1998, it was almost entirely concerned with preventing non-meritorious suits. But events since 1998 have changed the perspective. The last few years have seen repeated reports of false financial statements and accounting fraud, demonstrating that many charges of corporate fraud were neither speculative nor attempts to extort settlement money, but were based on actual misconduct. To open the newspaper today is to receive a daily dose of scandal, from Adelphia to Enron and beyond. Sadly, each of us knows that these newly publicized instances of accounting-related securities fraud are no longer out of the ordinary, save perhaps in scale alone. The victims of the reported frauds, moreover, are often persons who were induced to hold corporate stock by rosy but false financial reports, while others who knew the true state of affairs exercised stock options and sold at inflated prices. Eliminating barriers that deny redress to actual victims of fraud now assumes an importance equal

> to that of deterring non-meritorious suits.

See Small v. Fritz Companies, Inc., 65 P. 3d 1255, 1263-64 (Cal. 2003) (internal citations and quotation marks omitted).

III. THE FIFTH CIRCUIT'S REQUIREMENT OF PROVING LOSS CAUSATION CUTS AGAINST THIS COURT'S PRECEDENT, CONGRESS' ENACTMENT OF SECURITIES FRAUD REMEDIAL PROVISIONS UNDER SECTION 10(B), AND THE SEC'S REGULATORY AUTHORITY EXPRESSED IN RULE 10b-5.

The Fifth Circuit's requirement that plaintiffs demonstrate loss causation by a preponderance of the evidence prior to class certification mistakenly relies on this Court's precedent in *Basic* and undermines Court precedent, Congressional enactment, and regulatory rulemaking.

A. The Fifth Circuit's Loss Causation Requirement Contravenes this Court's Holding in *Basic*.

By requiring the plaintiff to prove loss causation when demonstrating the common issues of law and fact under Rule 23(b)(3), the Fifth Circuit's holding erects a substantial hurdle in contravention of this Court's recognition of the importance of private securities fraud causes of action. *See AMSF*, 597 F.3d at 344. The Circuit does not explicitly require loss causation as a condition for Rule 23

certification. Instead, the holding below cloaks the proof hurdle as a prerequisite to relying on *Basic*'s fraud on the market presumption. *See Oscar Private Equity Invs. v. Allegiance Telecom, Inc.*, 487 F.3d 261, 265 (5th Cir. 2007) (holding that "we require plaintiffs to establish loss causation in order to trigger the fraud-on-the-market presumption.").

Because a plaintiff seeking to use *Basic*'s reliance presumption must first demonstrate loss causation, the Circuit's requirement directly contravenes this Court's underlying rationale in *Basic*, which aimed to aid rather than hinder plaintiffs seeking to certify a class in Rule 10b-5 actions. *Basic* provides the fraud-on-the-market presumption as a result of the difficulty of proving reliance for each individual class member. Loss causation, however, does not share this characteristic. Specifically, because loss causation focuses on the defendant and not the plaintiffs, it is different from the reliance factor and consequently is necessarily irrelevant to Rule 23 considerations. Unlike reliance, loss causation is necessarily common to all plaintiffs because it focuses merely on whether the defendant's conduct caused a change in the market. The number or type of plaintiff is irrelevant in this consideration. Therefore, while the presence of loss causation may be important in the context of a motion to dismiss, a motion for summary judgment, or a trial, such a consideration is irrelevant when the court evaluates whether plaintiffs share common issues of law or fact under Rule 23(b)(3). Thus, without legal or logical warrant, the Circuit's holding requires plaintiffs to

undertake a merits inquiry not related to class certification prior to having access to full discovery.

Despite the irrelevance of loss causation in determining the existence of common issues of fact, the Fifth Circuit reaffirmed this considerable burden in this case without providing any additional rationale except for reliance on the Circuit's previous holding in *Oscar*. No other circuit has adopted the Fifth Circuit's approach. For instance, the Second Circuit implicitly rejects the requirement that plaintiffs demonstrate loss causation at the certification stage. *See In re Salomon Analyst Metromedia Litigation*, 544 F.3d 474, 483 (2d Cir. 2008). More recently, a unanimous panel of the Seventh Circuit dismissed the loss causation requirement at the certification stage explaining that the Fifth Circuit's requirement "represents a go-it-alone strategy" that "would make certification impossible in many securities suits." *See Schleicher v. Wendt*, 618 F.3d 679, 686-87 (7th Cir. 2010). Writing for the court, Judge Easterbrook recognized that requiring plaintiffs to establish loss causation at the certification stage would cause the circuit to essentially "jettison the fraud-on-the-market exception" established by this Court under *Basic*. *See id.* at 683.

In addition to contravening the underlying rationale in *Basic*, the Fifth Circuit's requirement that the plaintiff establish loss causation at the certification stage creates an impermissible hurdle in two concrete ways. First, the named plaintiff must demonstrate loss causation prior to having the

benefit of discovery – a substantial burden, to be sure! Second, in addition to requiring that the plaintiff demonstrate loss causation at a very early stage in the litigation, the plaintiff makes her proof by a preponderance of the evidence. In sum, under the Circuit's loss causation requirement, the named plaintiff must prove by a preponderance of the evidence that the defendant's misrepresentation or omission caused her loss, and consequently the losses of everyone in the class, without the benefit of full discovery. It may be fairly observed that the burdens imposed by the Fifth Circuit's scheme amount to no less than the plaintiff having to make her entire case on the merits at the class certification stage. *See Schleicher*, 618 F.3d at 686-87 (explaining that requiring loss causation at the class certification stage "gets the cart before the horse" and "make[s] certification impossible in many securities suits").

The court below implicitly concedes the difficulty with the proof burden its analysis imposes and explains that the "showing of loss causation is a 'rigorous process' and requires both expert testimony and analytical research or an event study." *See AMSF*, 597 F.3d at 341. Further, the evidence on which the plaintiff must rely in satisfying this burden is becoming considerably more difficult to acquire. Previously, the Fifth Circuit accepted proof of causation based on "public data and public records." *See Oscar Private Equity Invs.*, 487 F.3d at 267. In the present case, however, the Circuit increases the difficulty of proving causation by requiring the plaintiffs to rely on evidence specific to

the defendant. *See AMSF*, 597 F.3d at 338. In particular, rather than relying on third-party analysis of the defendant's conduct in the market to demonstrate causation, the court held that the plaintiffs must focus on the scienter of the defendant and "prove 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 or predictions were designed to defraud." *See AMSF*, 597 F.3d at 338. The rigor of the showing required of the plaintiff at the class certification stage is unique in the circuits, and it is unsupported by applicable law.

This substantial burden of proof results in the trial of Rule10b-5 claims on the merits before discovery is substantially completed or even underway. For instance, in the present case, the plaintiff sought certification at approximately six months into discovery proceedings. *See* Brief of Petitioner at 14, *Erica P. John Fund v. Halliburton Co.*, No. 09-1403 (2010). Further, although the plaintiff in this case had the benefit of some discovery, lower courts in the Fifth Circuit have already begun to refuse the requests of plaintiffs to allow more discovery before having to prove loss causation by a preponderance of the evidence. *See, e.g.*, *In re TETRA Technologies, Inc. Securities Litigation*, No. 4:08-cv-0965, 2010 U.S. Dist. LEXIS 33012, at *9 (S.D. Tex. Apr. 5, 2010) (finding that the plaintiffs are not "entitled by law to additional merits discovery prior to submitting their expert report and seeking class certification"). This result

directly contravenes this Court's rationale in *Basic* and imposes severe restrictions on class certification under Rule 10b-5.

B. The Fifth Circuit's Loss Causation Requirement Undermines the Congressional Initiative Expressed In Section 10(b) and the SEC's Regulatory and Enforcement Follow-Up in Rule 10b-5.

This Court, Congress and the SEC embrace the importance of private securities litigation. *See* 15 USCS § 78u-4 (detailing the requirements for a private right of action under the Securities and Exchange Act of 1934); *Dura*, 544 U.S. at 341 (describing the private right of action available under the Securities and Exchange Act of 1934); 17 C.F.R. 240.10b-5. Through Rule 23 Congress and this Court determined the elements for class certification. In enacting the PSLRA and SLUSA Congress provided additional requirements for private securities litigation. These requirements, however, represent the full extent of the hurdles that plaintiffs must overcome in order to certify a class under Section 10(b) and the related Rule 10b-5 and Rule 23. As such, the Fifth Circuit exceeded its judicial power in setting a higher bar. It is beyond argument that additional restrictive measures, such as the need to prove loss causation during class certification under Rule 10b-5, directly contravene Congress' intent by creating requirements that Congress itself omitted from its enactments. The Fifth Circuit's erection of these additional hurdles

beyond the terms of Rule 23 and the PSLRA is unsustainable under the law.

First, a named plaintiff seeking to certify a class must satisfy the requirements of Rule 23. Rule 23 has never stood as an insurmountable bar for plaintiffs by requiring a trial on the merits before discovery is complete and the courts venture out of their proper bounds in erecting such a hurdle. *See Amchem Prods. v. Windsor*, 521 U.S. 591, 620 (1997) (explaining in the context of Rule 23 that "[c]ourts are not free to amend a rule outside the process Congress ordered."). The Fifth Circuit's loss causation requirement, however, contravenes the generally understood and previously accepted operative plan of Rule 23 by requiring a series of "mini-trials on the merits of cases at the class certification stage." *Oscar*, 487 F.3d at 272 (Dennis, J., dissenting). Rather than permitting the erection of hurdles not previously recognized, this Court should focus on the plain language of Rule 23 and consider whether the plaintiffs satisfied the requirements of the Rule as interpreted by *Basic*. *See Eisen v. Carlisle & Jacquelin*, 417 U.S. 156, 177-78 (1974).

Second, Congress struck a balance between the various interests in private securities litigation through the PSLRA and SLUSA. In order to address abuses that arose in such actions, Congress changed the pleading standards for scienter and misrepresentation, but remained silent with regard to the loss causation requirement. *See* Fry, *supra*, at 33; *see also Schleicher*, 618 F.3d at 686 (explaining

that Congress already addressed private securities reform by "requir[ing] more at the pleading stage and to ensur[ing] that litigation occurs in federal court). Despite the heightened pleading requirements, this Court recognized the balance that Congress struck and explained that "[n]othing in the PSLRA . . . casts doubt on the conclusion 'that private securities litigation is an indispensable tool with which defrauded investors can recover their losses'-a matter crucial to the integrity of domestic capital markets." *See Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 321 n.4 (2007) (*quoting Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit,* 547 U.S. 71, 81 (2006) (internal quotation marks omitted)).

As such, at the height of reform of private securities litigation, Congress continued to recognize the importance of private securities actions and declined to change the pleading standard for loss causation much less suggest that plaintiffs prove it by a preponderance of the evidence during class certification proceedings. Further, Congress recognized that the heightened pleading standards it created in the PLSRA unintentionally undercut private securities litigation and responded by enacting the SLUSA to help facilitate easier class certification. Nevertheless, the Fifth Circuit seeks to add the loss causation element to reform actions under Section 10(b) and the related Rule 10b-5 in a way that Congress and the Commission did not envision.

Lastly, adding the loss causation requirement cuts against the Securities Act of 1934, as well as the PSLRA and SLUSA, by creating a loophole for dishonesty. In particular, issuers will be able to hide behind a smoke screen of unrelated information to shroud the effect of releasing the details about a prior misstatement or omission. *See* Tad E. Thompson, Recent Development, *Messin' with Texas: How The Fifth Circuit's Decision in* Oscar Private Equity *Misinterprets The Fraud-on-the-Market Theory*, 86 N.C. L. Rev. 1086, 1095-96 (2008); *see also Schleicher v. Wendt*, 618 F.3d 679, 686 (7th Cir. 2010) (explaining that the Fifth Circuit's approach "would make certification impossible in many securities suits, because when true and false statements are made together it is often impossible to disentangle the effects with any confidence"). So long as any misstatement or omission is made in conjunction with unrelated, but accurate, information, plaintiffs will experience significant difficulty in demonstrating loss causation. This loophole becomes especially apparent when it arises early in discovery and the plaintiff must prove causation by a preponderance of the evidence. In such a situation, the plaintiff will not have the necessary information to differentiate between statements of the issuer that caused loss and those deviously designed to cloud the situation. *See* Thompson, *supra*, at 1095-96. This loophole cuts directly against the Securities Act of 1934, by means of which Congress intended to encourage issuers to provide open, full, and honest information in the sale and purchase of securities. *See* H.R. Rep. No. 73-1383, at 11 (1934) (explaining that the Act was

meant to promote fair and honest markets by encouraging full disclosure).

CONCLUSION

For all of the foregoing reasons, *amici* respectfully submit that the decision of the Fifth Circuit should be reversed.

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Respectfully submitted,

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