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SUPREME COURT: ERICA P. JOHN FUND V. HALLIBURTON

In this issue … we look at a case before the U.S. Supreme Court that has direct implications for federal securities class action lawsuits.

INTRODUCTION

In recent years the U.S. Supreme court has heard a number of cases that impact securities class action lawsuits (*Dura, Dabit, Stoneridge, Tellabs*). Currently before the court is another: *Erica P. John Fund, Inc., FKA Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co, et al.* At issue in the case are the requirements that plaintiffs must meet in order to obtain "class certification" from the courts: Should courts consider the merits of a securities litigation case when ruling on class certification?

BACKGROUND

The original or underlying lawsuit filed by the Archdiocese of Milwaukee ("plaintiffs") sought class certification for an alleged securities fraud by Halliburton. This motion for class certification was denied by the district court, a decision that was upheld by the Fifth Circuit Court of Appeals in a February 2010 ruling.

The rejection of class certification was largely based upon what was felt to be the failure of the plaintiffs to show that statements made by Halliburton – which corrected earlier public statements – caused a drop in the Halliburton stock price. By not being able to show a direct causation, the courts held that the plaintiffs were ineligible to qualify for class certification.

The plaintiffs petitioned the U.S. Supreme Court for their case to be heard. To support their petition the plaintiffs pointed to a conflict between the Fifth Circuit's position and those of other Circuits, notably the Second Circuit: "The Fifth Circuit holding has been squarely rejected by the Second Circuit and by district courts in seven other circuits."

When there are disagreements between the federal circuits, the Supreme Court is the ultimate arbiter. To help decide whether it should accept the case, the court invited the U.S. Solicitor General's office for its comment. The resulting brief filed by the U.S. Solicitor General endorsing a Supreme Court review increased the likelihood that the case would be heard. Oral arguments were set for April 25, 2011.

[For context, the federal courts offer an interactive map of the federal court system.]

AMICUS CURIAE FILINGS

Once the case had been accepted, supporters of the opposing parties began to make themselves known by filing briefs of "*amicus curiae*" or a friend of the court. Among those standing behind the plaintiffs were various shareholder and investor advocates, while supporters of Halliburton included the Chamber of Commerce and representatives from the Securities Industry and Financial Markets Association. It was a line up of "friends" reminiscent of the *Stoneridge* case in 2007.

ORAL ARGUMENTS

As usually happens at Supreme Court hearings, the oral arguments in the case often invoked fine points of precedent, supplemented in this instance by frequent reference to the Federal Rule of Civil Procedure which directs class action certification (Rule 23). Nonetheless, it is possible to sift through the arcane legal discussions to get a practical understanding of the dispute.

The plaintiffs maintain that the Fifth Circuit overstepped its authority when it refused to certify the putative class action on the grounds that there was no evidence that a stock price drop was caused by the corrective statements made by Halliburton. According to the plaintiffs, all that the Fifth Circuit should concern itself with at the class certification stage was the legitimacy of the class, not the merits of the class's case:

Ms. Nicole A. Saharsky, Assistant to the Solicitor General, for the plaintiffs:

> *The question the court is supposed to be asking at … the class certification stage is not "Can these people win on the merits?" And that's a question the Fifth Circuit was asking. The question it's supposed to ask is "Can this group of people proceed together?"*

After an exchange with Justice Scalia who momentarily nonplussed everyone by suggesting the current class certification process is "a crazy way to run a railroad" and that it should really operate in reverse, Ms. Saharsky reiterated her point:

> *The problem in this case is that the Fifth Circuit took it upon itself to tighten the Rule 23 requirements. It was not satisfied with the rules as they exist, and it took the class-certification stage and turned it into a merits-inquiry stage.*

In responding, counsel for Halliburton emphasized that the misrepresentation and its effect on the stock price were bound together:

> *It makes no sense for district courts to be certifying class actions based upon … indirect or circumstantial proof while ignoring the direct proof of the absence of price impact.*

Justice Ginsburg suggested to Halliburton's counsel that if the merits of the case were wrapped up in the class certification process, then there would be nothing left to talk about:

> *Your argument seems to say, "To get a class certified, you have to virtually prove your case on the merits." You … leave almost nothing over … if you've won the class action certification on your basis what else is left on the merits? You win on the merits if you win certification.*

Counsel for Halliburton disagreed.

> *It's not a finding on the merits. A determination at the class certification stage is simply one of whether the Rule 23 (b) predominance requirement is met and whether the class can appropriately proceed as a class.*

Discussion moved to the realities of the discovery process and the significant economic impact on the defendant that might follow class certification. As Halliburton's counsel commented:

> *The sheer grant of class certification, which aggregates … tens of thousands of these claims together in one big case, … puts huge settlement pressure on the defendant.*

In his final response, counsel for the plaintiffs summed up his side's position:

> *I would urge the court that when you have pleadings, summary judgments, and trial tests for merit questions, then you don't need another merits test … at the class certification stage.*

SUMMARY

Suppose a group of children decide to form a baseball team and join a league. They gather together a sufficient number of team members, they complete the necessary forms, they pay their fees and they get their uniforms. They comply with what they believe is every league requirement. But the league rejects their application and refuses to allow them to play in the league. “We have seen you practice,” says the league. “You can’t throw, you can’t catch and you can’t hit, so you cannot join the league.”

“But that’s not fair,” says the team. “How successful we are will be determined when we start playing other teams. It’s not for you to make a decision on whether we can participate based on our abilities.” “Yes, we can,” says the league. “We have a larger responsibility to ensure that the league operates in a way that maintains its standing and reputation. Your team’s lack of ability is a relevant and unavoidable issue; we also have a duty to the other teams to make sure their time and money is not wasted. We are not saying you cannot play at all, just not in this league.” Who is right?

The ramifications of this case could be significant. A finding for the plaintiffs may help maintain the relatively benign path for future plaintiffs seeking class action certification; a finding for Halliburton could result in new impediments, with fewer successful class action petitions for securities fraud cases. The court is expected to release its decision in the next few months. ❖

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