Securities lawyers are awaiting the U.S. Supreme Court's decision in a certification controversy that could have a major impact on the future of class securities-fraud litigation. The justices also are expected to rule on a SLUSA jurisdictional issue arising from R. Alan Stanford's Ponzi scheme and a dispute over the Sarbanes-Oxley Act's whistle-blower anti-retaliation protections. Meanwhile, the high court's 2010 Morrison decision will continue to reverberate in 2014.

Lawyers Awaiting Halliburton Decision; Could Have Big Impact on Class Litigation

By Phyllis Diamond

Jan. 16 -- Heading into 2014, the big story in private securities litigation is the U.S. Supreme Court's highly anticipated ruling in *Halliburton Co. v. Erica P. John Fund Inc.* and what it could mean for the future of class securities fraud litigation.

The controversy, which centers on the viability of the 25-year old fraud-on-the-market doctrine, could sound the death knell for the ability of allegedly defrauded investors to sue on a class basis.

In the words of New York lawyer John Dellaportas, Morgan Lewis & Bockius LLP, a successful fraud-on-the-market challenge “would be like a nuclear bomb dropping in the securities world.” A significant decline in securities fraud class lawsuits also would have a serious impact on attorneys for plaintiffs and defendants alike.

Presumption of Reliance.

In the lawsuit, Halliburton Co., (HAL)which allegedly misled investors about its financial condition, is asking the justices to overturn *Basic Inc. v. Levinson*, a 1988 decision that established the fraud-on-the market presumption of reliance for investors who bought or sold securities in an efficient market.

Regardless of their view on the merits, lawyers contacted by Bloomberg BNA during January agreed that *Halliburton* could be momentous for both issuers and investors. The stakes for investors are enormous, Washington attorney Daniel Sommers, Cohen Milstein Sellers & Toll PLLC, said, He predicted that *Halliburton* “will be the most closely watched and potentially the most significant case impacting private securities litigation in the past quarter century.” The case is scheduled to be argued March 5.

In other action, the justices are slated to rule on two pending cases, a jurisdictional question involving victims of a Ponzi scheme and a whistle-blower retaliation dispute. The year could also see appellate review of district court decisions interpreting the high court's *Morrison* decision.

Halliburton.

In *Halliburton*, plaintiff Archdiocese of Milwaukee Supporting Fund Inc., now Erica P. John Fund Inc., alleged that between June 1999 and December 2001, the energy services company made material misrepresentations

regarding litigation expenses and other matters. On its first Supreme Court trip in 2011, Halliburton failed to persuade the justices that plaintiffs must demonstrate loss causation to obtain class certification .

Undeterred, Halliburton renewed its opposition to class certification; this time, it argued that the class should not be certified because the alleged fraud did not affect the market price of its securities. However, the district court concluded that price-impact evidence had no bearing on whether common issues predominated under Fed.R.Civ.P. 23(b)(3) and the Fifth Circuit affirmed

In a move that came as no surprise to many securities lawyers, in November, the supreme court granted Halliburton's certiorari petition

Over the past few years, the high court has tackled a number of cases involving class certification issues. A little less than a year ago, it concluded in *Amgen Inc. v. Connecticut Retirement Plans and Trust Funds*that to obtain class certification, investors relying on the fraud-on-the-market doctrine were not required to prove that the alleged misrepresentations were material to their investment decision .

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Cohen Milstein Sellers & Toll PLLC

Amgen (AMGN) did not dispute that the market for its securities was efficient; as such, the economic validity of the efficient-market theory was not at issue. However, in the wake of the ruling, a number of lawyers posited that the real significance of *Amgen* lay not in its holding but in the questions it raised regarding the continued viability of the fraud-on-the-market doctrine . In particular, they pointed to four justices' remarks in *Amgen* as an indication that the high court might be contemplating the topic. Generally, a petition for certiorari will be granted if four justices are in favor.

Dark Ages.

Cohen Milstein's Sommers, co-chair of his firm's Securities Fraud and Investor Rights Practice Group, predicted that inasmuch as four justices in *Amgen* "openly questioned" *Basic*, there is little doubt the court will issue a sharply divided opinion in *Halliburton*.

Should the high court overturn or significantly modify its endorsement of the fraud-on-the market presumption, he told Bloomberg BNA, investors will have to demonstrate actual reliance on the alleged misrepresentations. "As a result, the reliance element of a securities fraud claim could become an overwhelming individualized issue preventing certification of an investor class."

"Because investor losses--even those of large institutional investors--are typically too small to justify the cost of bringing an individual securities fraud case," Sommers related, "many investors could be left without any meaningful remedy under the antifraud provisions of the federal securities laws."

"If the fraud on the market presumption is jettisoned in its entirety, investors will be left to explore vastly inferior methods for demonstrating reliance, including framing cases as 'omissions' cases rather than cases of affirmative misrepresentations," Sommers continued. "Such an outcome would bring investors back to the pre-*Basic* 'dark

ages' of private securities litigation."

Modest Outcome.

Not all lawyers agreed with Sommers' bleak prognosis. According to Denver lawyer Michael MacPhail, Faegre Baker Daniels LLP, "the most modest and perhaps most likely outcome" is that the court will conclude that defendants may rebut the presumption at the class certification stage by showing that the stock price did not move significantly in the wake of corrective disclosures.

However, MacPhail suggested, the court also could issue a broader ruling--i.e., that plaintiffs must show at the class certification stage that the market was efficient as to the specific disclosures in issue. "Market efficiency as to specific disclosures would be a very difficult showing for plaintiffs to make," MacPhail commented.

Of course, he added, the high court could "simply do away with the fraud-on-the-market presumption, but this is the least likely outcome."

Plaintiffs lawyer Darren Robbins, Robbins Geller Rudman & Dowd LLP, San Diego, also predicted that the justices are unlikely to invalidate the theory. He said the "notion that the court will disregard decades of jurisprudence" that has served as a mechanism to consolidate litigation into a single proceeding and lessened the burden on both courts and litigants "is, I think, somewhat fanciful."

However, Robbins added, there are "powerful forces that have a coordinated strategy" to eliminate any potential for litigation exposure, regardless of the merits. He called *Halliburton* "simply a vehicle by very powerful corporate interests who regularly sit around and try to concoct legal strategies to eviscerate the protections of our financial markets. It seems somewhat shortsighted."

San Francisco lawyer Mark Fickes, a former Securities and Exchange Commission enforcement lawyer, currently of counsel at Cannata, Ching & O'Toole LLP, had a more succinct analysis. "If the theory stands, I think we're going to continue to see securities class litigation." On the other hand, "it's going to be tough for a lot of plaintiffs" if the theory is invalidated.

Asked to predict how the justices will rule, he said the court "has not always been favorable to class actions. So I think it's at least within the realm of possibility that they strike down the fraud-on-the-market theory."

Meanwhile, two other securities cases--a Securities Litigation Uniform Standards Act dispute arising from R. Allen Stanford's $8 billion Ponzi scheme, and a dispute over the scope of Sarbanes-Oxley Act whistle-blower anti-retaliation protections--are awaiting high court resolution.

SLUSA.

In the SLUSA case, lawyers, insurance brokers, and other third parties that allegedly aided Stanford's scam are appealing a decision by the U.S. Court of Appeals for the Fifth Circuit that allowed Stanford investors to bring state court class actions to recover their losses (*Chadbourne & Parke LLP v. Troice*; *Willis of Colo. Inc. v. Troice*; *Proskauer Rose LLP v. Troice*). SLUSA provides generally for federal preemption--removal, followed by dismissal--of state law class actions alleging "misrepresentations in connection with the purchase or sale of a covered security." On a question of first impression, the Fifth Circuit concluded that the alleged fraud was only tangentially related to the purchase or sale of covered securities for SLUSA preemption purposes.

According to Jonathan Youngwood, Simpson Thacher & Bartlett LLP, New York, both *Troice* and *Halliburton* could lead to an increase in state-law class lawsuits, depending on how the high court rules.

If the justices invalidate the fraud-on-the-market theory in *Halliburton*, Youngwood reasoned, "securities fraud plaintiffs may be eager to find potential avenues for recovery other than bringing class actions in federal court under [1934 Securities Exchange Act] Section 10(b) and Rule 10b-5." Similarly, he suggested, if the high court narrowly construes SLUSA's "in connection with" requirement" in *Troice*, "plaintiffs may increasingly attempt to rely on state law to bring class actions they might otherwise have brought" under those provisions.

Troice was argued Oct. 7, the first day of the high court's 2013-2014 term

SOX §806.

In the whistle-blower case, *Lawson v. FMR LLC*, the plaintiffs were employees of private companies that provided contractual advising or management services to the Fidelity family of funds. One plaintiff claimed he was fired in retaliation for raising concerns about inaccuracies in a draft revised registration statement for certain Fidelity funds. The other plaintiff claimed she was constructively discharged for questioning her employer's mutual-fund accounting practices.

The district court turned back a dismissal motion, but the U.S. Court of Appeals for the First Circuit reversed In a divided opinion, it concluded that only employees of public companies are covered by SOX Section 806. The case was argued Nov. 12

"If the court decides that private company employees have SOX whistle-blower protection, you're going to see an uptake in employment litigation," Fickes predicted. Also, private companies will have to be mindful of their employment policies for whistle-blowers. "I could see a lot of people bringing claims against former employees if they're in that whistle-blower posture," Fickes said.

Troice.

While attorneys Bloomberg BNA spoke with agreed that *Halliburton* could have a dramatic impact on securities class actions, they said *Troice*, which also concerns class litigation, could be consequential as well.

MacPhail pointed out that the Ninth and Fifth Circuits have interpreted SLUSA narrowly to preempt only fraud claims that are more than "tangentially related" to covered security transactions. In contrast, the Second, Sixth, and Eleventh Circuits have applied SLUSA more broadly.

In MacPhail's view, the justices' questioning during oral argument suggests that the court "is likely to adopt the narrower interpretation, allowing some state class actions involving covered securities to proceed."

However, he said, if the high court adopts the broader tests of the Second, Sixth and Eleventh circuits, most state-law securities class actions would be precluded. "In any event, the Court's decision should result in greater consistency among SLUSA preclusion decisions going forward," MacPhail predicted.

San Francisco lawyer Thad Davis, Gibson Dunn & Crutcher LLP, was similarly inconclusive, saying the court "could adopt either a very narrow or a very broad interpretation of the 'in connection with' requirement." Alternatively, he suggested, the court "could simply decide the case on the unique facts at issue."

Meanwhile, Davis posited, "[a] less noted potential result of the *Troice* decision is that however the Court chooses to get there, its holding will impact not only the types of cases that fall under SLUSA, but also the elements of a 10b-5 claim."

In the 10b-5 context, he noted, issuers and other defendants generally favor a narrow construction of the requirement. In the SLUSA context, however, defendants--"who may be facing state law claims precisely because they are not 'traditional' 10b-5 defendants"--"typically argue for a broad construction."

However, Davis noted, the "in connection with language" is the same in both SLUSA and Rule 10b-5. As such, he predicted, any decision in *Troice* will also be applied to interpreting the elements in future Rule 10b-5 cases.

Impact of Morrison.

Meanwhile, the impact of the Supreme Court's decision in *Morrison v. National Australia Bank Ltd.*, 561 U.S. __, (2010), will continue to be felt in 2014 and beyond.

In *Morrison*, the justices took a relatively narrow view of the federal securities laws' extraterritorial reach, concluding that Section 10(b) applies only to securities listed on a U.S. exchange or to securities transactions that take place in the U.S.

Given the increasingly global nature of securities transactions, it is all but certain that the decision will give rise to interpretive questions for years to come. One such issue, according to Georgetown University law professor Donald Langevoort, is how the courts will interpret the Dodd-Frank Wall Street Reform and Consumer Protection Act's "save" for SEC enforcement actions--"largely because cases currently in litigation tend to be based on facts that arose before Dodd-Frank was enacted."

However, Langevoort said, "[t]hat is in the process of changing, and there are many practitioners convinced that Congress did not do enough to restore the Commission's pre-*Morrison* authority."

Dodd-Frank Section 929P(b)41 amended the jurisdictional provisions of the securities laws to provide that the federal district courts have jurisdiction over SEC or U.S. actions alleging a securities fraud violation involving U.S. conduct "that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors."

The statute also provides for jurisdiction over overseas conduct "that has a foreseeable substantial effect within the United States." Although the new law can be read as restoring the pre-*Morrison* conduct-and-effects test, its impact is uncertain, inasmuch as *Morrison* addressed not jurisdiction but the scope of Section 10(b). In May, a senior SEC official told a legal gathering that the dismissal of SEC allegations over an alleged international boiler-room scheme raised a good question as to the adequacy of the congressional fix to restore the agency's extraterritorial enforcement authority).

Similarly, Deloitte's Shanghai affiliate told the U.S. District Court for the District of Columbia in March that the commission was attempting to "'leapfrog'" over *Morrison* by subpoenaing its U.S. counsel to obtain the work papers of a China-based issuer . Although a ruling in the agency's favor could have set precedent for SEC subpoena actions involving foreign auditors and issuers, the parties later resolved their differences.

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Faegre Baker Daniels LLP

In August, the Second Circuit concluded, in *United States v. Vilar* that *Morrison* applies to criminal as well as civil cases In addition, the federal district courts decided a number of *Morrison* issues in 2013, any of which could provide a vehicle for appellate review.

For example, in March, the U.S. District Court for the Southern District of New York concluded in connection with a motion for class certification that the fact that a securities transaction is cleared in the U.S. does not in and of itself mean that the transaction meets *Morrison* parameters . At around the same time, the Southern District cited *Morrison*in dismissing a Russian woman's claims that she was defrauded by a New York-based financial services organization, in violation of Commodity Exchange Act Sections 4o and 22 (*Loginovskaya v. Batratchenko*, .

In October, the same court dismissed anti-retaliation claims by a Taiwan man who complained of a Foreign Corrupt Practices Act kickback scam at Siemens AG's China subsidiary . Citing *Morrison*, it found no indication that Congress intended the Dodd-Frank Act's anti-retaliation provision to apply extraterritorially.

Adverse Impact.

While the parameters of *Morrison* continue to unfold, Sommers said the decision already is having "a significant adverse impact on U.S. investors."

First, Sommers related, U.S. investors have been disadvantaged in cases where issuers have dual listed securities with ordinary shares traded overseas and American Depositary Receipts traded in the U.S.

"In those cases," he said, "U.S. investors have found themselves with a federal securities law remedy for purchases in the U.S. but without such a remedy for purchases of ordinary shares, even though the underlying conduct is identical and even if substantial conduct took place in the U.S."

Sommers noted that in some cases, investors are attempting to use state law, non-class remedies in the U.S. "It is still too early to tell whether these efforts will be successful for investors," he said. In any event, such remedies "will not be useful to investors with losses too small to justify individual litigation."

In addition, Sommers posited, *Morrison* "has forced U.S. investors to closely monitor their non-U.S. investments and to wade into the highly complex world of pursuing non-U.S. litigation."

Loss causation is "a serious weapon in the securities defendant's arsenal," Thad Davis, Gibson Dunn & Crutcher LLP, said.

"I expect this trend to continue over the next few years and that we will see substantial, sophisticated U.S. investors become increasingly active in pursuing their rights in non-U.S. forums despite the generally less friendly substantive and procedural laws in many non-U.S. jurisdictions."

Circuit Split.

It remains to be seen what, if any, *Morrison* issues will work their way up through the appeals courts and/or result in high court resolution. However, Gibson Dunn's Davis identified a recent appeals court decision that, in his view, could be a candidate for Supreme Court review.

In *Indiana State District Council of Laborers and Hod Carriers Pension and Welfare Fund v. Omnicare*, 719 F.3d 498 (6th Cir. 2013), the U.S. Court of Appeals for the Sixth Circuit revived an investor suit alleging that Omnicare Inc. (OCR)and its officials violated 1933 Securities Act Section 11 by stating in securities registration documents that the concern's billing practices complied with state and federal requirements, when it actually was involved in hidden kickback arrangements with manufacturers and other misconduct .

The pro-plaintiff ruling in the long-running action set up a split with the Second and Ninth Circuits on whether a plaintiff is required to plead that the defendant knew its disclosures were false to state a Section 11 claim. On Oct. 4, defendant Omnicare filed a certiorari petition.

“As plaintiffs are frequently relying on Section 11 claims, this case is of significant interest and the circuit split may also lend support to a petition grant,” Davis said.

Loss Causation.

In terms of emerging issues, he commented there were several loss-causation cases during 2013 “that will serve as useful tools for defendants.” Specifically, he pointed to:

- *Meyer v. Greene*, in which the Eleventh Circuit affirmed the dismissal of a would-be class securities fraud action against a Florida-based real-estate development company .
- *IBEW Local 90 Pension Fund v. Deutsche Bank AG*, in which the U.S. District Court for the Southern District of New York denied a motion for class certification over the plaintiffs' failure to meet Rule 23(b) typicality requirements.
- *Lighthouse Financial Group v. Royal Bank of Scotland*, in which the Southern District refused to allow the plaintiffs to amend their complaint in part because of their failure adequately to allege loss causation; and
- *Central States, Southeast and Southwest Areas Pension Fund v. Federal Home Loan Mortgage Corp.*, in which the Second Circuit affirmed that the plaintiff failed to demonstrate losses that were directly attributable to the alleged misstatements, rather than the bursting of the housing bubble that occurred during the same period.

“These cases cover a broad range of deficiencies that may arise in a plaintiff's case and which can be resolved as early as the class certification or motion to dismiss stage,” Davis noted. “Cumulatively, these cases give renewed importance to the loss causation prong, making it a serious weapon in the securities defendant's arsenal.”

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