

# Client Alert

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## Eighth Circuit Denies Class Certification in Securities Fraud Suit, Finding the “Fraud-on-the-Market” Presumption of Reliance Did Not Apply Under *Halliburton II*

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On April 12, 2016, the U.S. Court of Appeals for the Eighth Circuit issued a significant decision denying class certification in a federal securities fraud action, holding that the defendants had rebutted the fraud-on-the-market presumption of class-wide reliance. *IBEW Local 98 Pension Fund, et al. v. Best Buy Co., Inc.*,<sup>1</sup> is the first federal appellate court decision denying class certification in a federal securities case under the Supreme Court’s *Halliburton II* decision and provides useful guidance for defendants seeking to defeat class certification in federal securities class actions by rebutting the fraud-on-the-market presumption.

### 1. BACKGROUND: RELIANCE, FRAUD-ON-THE-MARKET, AND “PRICE IMPACT”

Investors pursuing claims for securities fraud under Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 must prove that they relied on an alleged misrepresentation in connection with the purchase or sale of a security. In theory, the requirement to prove that each individual investor actually relied on an allegedly fraudulent statement about a company when deciding whether to invest in the company’s securities would present individual questions potentially precluding certification of any Section 10(b) claims as class actions. Under decades-old Supreme Court precedent, however, if a company’s stock traded in an efficient market, shareholder plaintiffs are entitled to a presumption of reliance, on the theory that investors rely on the integrity of a stock’s market price and, in an efficient market, any public misstatement about the company is reflected in the market price, resulting in a “fraud on the market.”<sup>2</sup>

In its 2014 decision in *Halliburton II*, the Supreme Court affirmed the continued validity of the “fraud-on-the-market” presumption of reliance, despite challenges to its theoretical underpinnings. The Court explained, however, that a defendant in a securities fraud action should have the opportunity at the class certification stage to rebut the presumption by showing the absence of “price impact.” In other words, a defendant may rebut the presumption by showing that an alleged misstatement did not affect the stock’s market price and, thus, investors could not prove reliance on the alleged misstatement by showing that the misstatement was reflected in the

<sup>1</sup> No. 14-3178 (8th Cir. April 12, 2016).

<sup>2</sup> See *Basic, Inc. v. Levinson*, 485 U.S. 224, 245 (1988) (“the market price of shares traded on well-developed markets reflects all publicly available information, and, hence, any material misrepresentations”).

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market price.<sup>3</sup> As the Court explained, “if a defendant could show that the alleged misrepresentation did not, for whatever reason, actually affect the market price, . . . then the presumption of reliance would not apply.”<sup>4</sup>

In *Best Buy*, the Eighth Circuit, applying *Halliburton II*, held that Best Buy had successfully rebutted the fraud-on-the-market presumption by showing a lack of price impact, and reversed the trial court’s decision certifying the class.

## 2. THE *BEST BUY* DECISION

The *Best Buy* case involved allegations that Best Buy’s forward-looking guidance released in connection with its second quarter 2011 earnings announcements was fraudulent. Best Buy made the challenged statements both in a press release issued before the market opened on September 14, 2010, and in a conference call with stock analysts later that day. The trial court had previously held, however, that the statements in the company’s press release were protected by the securities laws’ safe harbor for “forward looking” statements.<sup>5</sup> As a result, the only alleged misstatements still at issue in the case were those made during the analyst conference call later that same day.

The plaintiffs moved for class certification, relying on the fraud-on-the-market presumption of class-wide reliance. To support their motion, the plaintiffs submitted an expert report showing that Best Buy’s stock traded in an efficient market and that the company’s share price increased in reaction to the allegedly misleading statements on September 14. The plaintiffs’ expert study did not differentiate between the effect of the statements in the press release and the later statements on the analyst conference call, however. In opposition to class certification, the defendants submitted an expert report finding that the price increase on September 14 occurred entirely in the hours after the company issued its press release but **before** the analyst conference call. Thus, the defendants argued, the plaintiffs could not demonstrate price impact with respect to the statements on the conference call, which were the only statements that were actionable under federal securities law. Nonetheless, the district court applied the fraud-on-the-market presumption and certified the class, finding that, even though the stock price may have been inflated before the analyst conference call, “the alleged misrepresentation could have further inflated the price, prolonged the inflation of the price, or slowed the rate of fall.”

The Eighth Circuit reversed. As the court noted, under *Halliburton II*, a defendant may rebut the fraud-on-the-market presumption with “evidence that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff, or his decision to trade at a fair market price.”<sup>6</sup> Based on both experts’ reports, the court concluded that the defendants had severed the link between the alleged misstatements in the conference call and the market price by showing that any increase in the market price that day was caused by the earlier statements in the company’s press release, which were “virtually the same” as the alleged misstatements during the conference call. And, because the court found that the plaintiffs could not prove class-wide reliance on

<sup>3</sup> *Halliburton Co., et al. v. Erica P. John Fund, Inc.*, 134 S. Ct. 2398, 2415 (2014) (“*Halliburton II*”).

<sup>4</sup> *Halliburton II*, 134 S. Ct. at 2408.

<sup>5</sup> The Private Securities Litigation Reform Act provides a safe harbor from liability for forward-looking statements that are identified as such and accompanied by meaningful cautionary language. 15 U.S.C. § 78u-5(c).

<sup>6</sup> *Best Buy*, at \*8 (quotation marks omitted).

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the alleged misstatements in the conference call based on the fraud-on-the-market presumption, the court concluded that the plaintiffs “failed to satisfy the predominance requirement of Rule 23(b)(3), and the district court abused its discretion by certifying the class.”<sup>7</sup>

The Eighth Circuit’s decision in *Best Buy* was tied to the particular facts of that case. In *Best Buy*, where the company had made two virtually identical statements, only one of which was legally actionable, the plaintiffs could not demonstrate that the statements underlying their claims affected the stock price. Nonetheless, as the first post-*Halliburton II* appellate decision denying class certification, the decision provides important guidance for defendants seeking to defeat class certification by rebutting the fraud-on-the-market presumption of reliance. Securities fraud cases frequently involve multiple related statements by the defendants, only some of which may be actionable. Applying *Best Buy*, to invoke the fraud-on-the-market presumption plaintiffs must show that the specific statements underlying their claims—and not other, related statements—affected the market price. And defendants may defeat class certification by demonstrating the absence of a link between the specific statements at issue in the case and the market price.

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<sup>7</sup> *Id.* at \*12-13. The dissent argued that the majority missapplied *Haliburton II*. According to the dissent, a showing that the alleged misrepresentation did not increase the stock price will only sever the link between the alleged misrepresentation and the market price where the plaintiff alleges that the misrepresentation fraudulently increased the stock price. In *Best Buy*, however, the plaintiffs relied on a “price maintenance” theory, arguing that the alleged misstatements in the conference call “confirmed” the prior misstatements in the press release and maintained Best Buy’s stock price at its allegedly inflated level. To rebut the presumption under the “price maintenance” theory, the dissent would have required Best Buy to “produc[e] evidence showing that the alleged misrepresentations had not counteracted a price decline that would otherwise have occurred.” *Id.* at \*14.