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Post-Halliburton II Update: Eighth Circuit Denies Class Certification Based on Lack of Price Impact

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Introduction

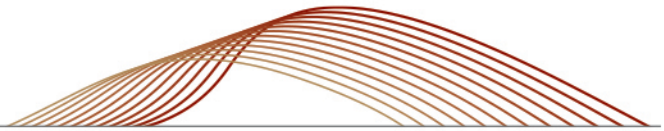
In its 2014 landmark ruling in *Halliburton Co. v. Erica P. John Fund, Inc. ("Halliburton II")*, the U.S. Supreme Court unanimously held that securities fraud defendants may rebut the fraud-on-the-market presumption of reliance before class certification by showing that the alleged misrepresentations did not impact the price of the underlying security.[1] However, in the roughly two years since the *Halliburton II* decision, securities fraud defendants have had limited success rebutting the presumption at the class certification stage.

Last week, in *IBEW Local 98 Pension Fund, et al. v. Best Buy Co., Inc.* ("*Best Buy*"), the Eighth Circuit became the first appellate court since *Halliburton II* to hold that defendants had successfully rebutted the fraud-on-the-market presumption to defeat class certification.[2] A divided three-judge panel found expert evidence demonstrating that the alleged misstatements had no immediate, "front-end" impact on the company's stock price was sufficient to rebut the presumption, and rejected plaintiffs' theory that the alleged misstatements "maintained" the company's inflated stock price.[3] The *Best Buy* decision will be significant authority, both inside and outside the Eighth Circuit, as it confirms that *Halliburton II* provides defendants with a viable weapon to defeat class certification.

Background: The Fraud-On-The-Market Doctrine

In order to bring a securities fraud claim under Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and SEC Rule 10b-5, a plaintiff is required to prove, among other things, that he or she relied upon the alleged misrepresentation when making a decision to buy or sell the security.[4] However, in the context of a securities fraud class action, requiring each member of the purported class to demonstrate individualized reliance would necessarily violate Fed. R. Civ. P. 23(b)(3)'s predominance requirement—*i.e.,* that issues "common to class members predominate over any questions affecting only individual members"—thereby precluding any such class actions.[5]

To address this issue, in *Basic v. Levinson,* the Supreme Court held that securities fraud plaintiffs may invoke a rebuttable presumption of class-wide reliance based on the "fraud-on-the-market" doctrine.[6] The doctrine is founded upon the premise that the price of a security trading in a well-developed market reflects all public information—including material misstatements—about that security;



therefore, investors who buy or sell a security at the price set by the market necessarily rely on the alleged misstatements when making their investment decision.[7]

In order to invoke the *Basic* presumption, plaintiffs must prove four elements: "(1) that the alleged misrepresentations were publicly known, (2) that they were material, (3) that the stock traded in an efficient market, and (4) that the plaintiff traded the stock between the time the representations were made and when the truth was revealed."[8] The presumption, however, is *rebuttable* and can be overcome by "[a]ny showing 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 . . . ."[9] Importantly, in *Halliburton II,* the Supreme Court held that defendants must be afforded the opportunity to challenge the fraud-on-the-market presumption before class certification.[10]

The *Best Buy* Decision

Background

Plaintiff IBEW Local 98 Pension Fund, on behalf of itself and other shareholders of Best Buy Co., Inc. ("Best Buy"), filed suit against Best Buy and three of its executives alleging violations of Section 10(b) of the Exchange Act and SEC Rule 10b-5. Specifically, plaintiffs claimed that, on September 14, 2010, defendants made three fraudulent or recklessly misleading statements—one in a press release and two in a subsequent conference call—that artificially inflated and maintained Best Buy's stock price until its third-quarter earnings were disclosed in December 2010.[11]

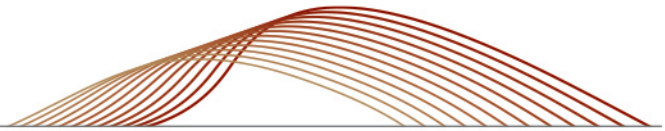
The press release, issued at 8:00 am on September 14, informed investors that Best Buy was increasing its full-year earnings per share (EPS) guidance by ten cents to $3.55 – $3.70. After this announcement, Best Buy's stock price rose to $37.25 when the market opened at 9:30 am that morning—an increase of 7.5% over the previous day's closing price.[12] At 10:00 am that morning, Best Buy's CEO and CFO conducted a conference call with analysts. During the call, the CFO stated that "we are pleased that our earnings [for the first half of fiscal 2011] are essentially in line with our original expectations" and "we are on track to deliver and exceed our annual EPS guidance." Later that day, Best Buy's stock closed at $36.73.[13]

On December 14, 2010, Best Buy announced that third quarter sales were "lower than expected" and reduced its 2011 EPS guidance to $3.20 – $3.40. After this announcement, Best Buy's stock—which had increased since September 14—closed at $35.52 or 14.8% lower than its previous closing price.[14]

Procedural History

The United States District Court for the District of Minnesota dismissed plaintiffs' claims, with prejudice, finding the alleged misrepresentations made in the September 14 press release and on the conference call were forward-looking statements protected by the safe harbor provision of the Private Securities Litigation Report Act ("PSLRA"). After granting plaintiffs' leave to file an amended complaint, the district again dismissed plaintiffs' claims relating to the press release, but permitted claims relating to the conference call to proceed.[15]

Plaintiffs moved to certify the class, and relied upon *Basic*'s fraud-on-the-market presumption to prove the reliance element of their 10b-5 claims and satisfy Rule 23's predominance requirement.[16] In support, plaintiffs submitted the expert report of Bjorn I. Steinholt, who concluded that Best Buy's stock price increased in reaction to the three statements made by defendants on September 14.[17] In response, defendants submitted an event study by their own expert, Kenneth Lehn, demonstrating that the price increase occurred after the press release, but before the conference call. Lehn concluded



that the "on track" and "in line" conference call statements had no "discernible impact on Best Buy's stock price."[18] On reply, plaintiffs' expert agreed that the conference call statements did not cause an increase in the stock price. Nevertheless, Mr. Steinholt opined that the decline of Best Buy's stock after the December 14 corrective disclosure demonstrated that the conference call statements "fraudulently maintained" the company's stock price.[19]

The district court, which stayed its decision on class certification until the resolution of *Halliburton II*, granted plaintiff's motion for class certification finding that defendants failed to adequately rebut the presumption of reliance. The court explained that, "[e]ven though the stock price may have been inflated prior to the earnings phone conference . . . the alleged misrepresentations could have further inflated the price, prolonged the inflation of the price, or slowed the rate of fall." The court further held that "price impact can be shown by a decrease in price following a revelation of the fraud" and defendants did not offer "evidence to show that Best Buy's stock price did not decrease when the truth was revealed" on December 14.[20]

Eighth Circuit Decision

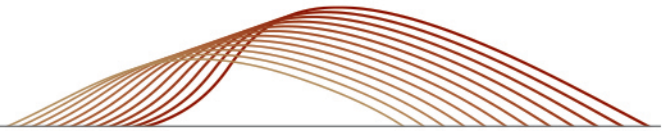
The Eighth Circuit reversed the decision of the district court, finding that defendants sufficiently rebutted the *Basic* presumption and, since plaintiffs presented no contrary evidence, plaintiffs failed to satisfy the predominance requirement of Rule 23(b)(3).[21]

In a 2-1 decision, Judge James B. Loken, writing for the majority, found that the district court ignored "strong evidence" demonstrating a lack of price impact—the opinion of plaintiffs' own expert.[22] Specifically, Mr. Steinholt opined that the "economic substance" of the non-fraudulent press release and the alleged misrepresentations in the conference call was "virtually the same." Moreover, his event study showed (and defendants' expert agreed) that, while the EPS guidance disclosed in the 8:00 am press release had an immediate impact on Best Buy's stock price, the confirming statements made in the conference call later that morning had "no additional price impact." The Court held that this "overwhelming evidence" of no "front-end" price impact "severed any link between the alleged conference calls misrepresentations and the stock price at which plaintiffs purchased" and, therefore, was sufficient to rebut the *Basic* presumption.[23]

In reaching its decision, the Court rejected two alternative theories offered by plaintiffs: (i) the conference call statements effected a "gradual increase" in the stock price between September and December of 2011, and (ii) Best Buy's stock decline, after the alleged corrective disclosure on December 14, was evidence that the conference call statements "maintain[ed] an inflated stock price." As to the first theory, the Court found that such a "gradual increase" was contrary to the very premise upon which the *Basic* presumption is founded, *i.e.,* that an efficient market will "rapidly reflect" all publicly available information. As to plaintiffs' second theory, the Eighth Circuit found that it "provided no evidence that refuted defendants' overwhelming evidence of no price impact."[24]

The Best Buy Dissent

In her dissent, Judge Diane E. Murphy argued that the majority misapplied *Halliburton II*'s price impact analysis, and class certification should have been affirmed under plaintiffs' "price maintenance theory."[25] Under plaintiffs' theory, the statements made in the conference call disclosed "confirmatory information" that maintained Best Buy's stock at a constant price and counteracted expected price declines.[26] Therefore, in Judge Murphy's view, defendants could have rebutted the presumption of reliance through evidence demonstrating the alleged misrepresentations had not counteracted a price



decline and, since no such evidence was offered, the fraud-on-the-market presumption was not rebutted.[27]

Ramifications

The *Best Buy* decision demonstrates that, in practice, the *Halliburton II* decision provides defendants with a meaningful avenue to defeat the fraud-on-the-market presumption. To date, the Eighth Circuit is the only federal appellate court to hold that the *Basic* presumption was adequately rebutted to defeat class certification. As a result, *Best Buy* will be an important authority, both within the Eighth Circuit and in other jurisdictions, as issues of reliance continue to be a battleground at the class certification stage.

Moreover, within the Eighth Circuit, the *Best Buy* decision may effectively limit plaintiffs' ability to pursue securities fraud claims based on a "price maintenance" theory. Although such theories have been recognized by certain courts in other jurisdictions, after *Best Buy*, strong evidence demonstrating lack of an immediate, "front-end" price impact may be enough to rebut the *Basic* presumption in the Eighth Circuit. The *Best Buy* decision also suggests that the presumption cannot be grounded on mere speculation about the effects of the alleged misstatements—*i.e.,* arguments that the misstatements "could have" further inflated the price, prolonged inflation or slowed the rate of price decline will likely be insufficient absent strong correlating evidence. It is, however, important to emphasize that the Eighth Circuit's decision ultimately turned on plaintiffs' expert's agreement with defendant's expert that there was a lack of price impact from the conference call.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings New York lawyers:

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1 134 S. Ct. 2398, 2414-17 (2014).

2 *Best Buy*, No. 14-3178 (8th Cir. Apr. 12, 2016), at 2.

3 *Id.* at 12-13.

4 15 U.S.C § 78j(b); SEC Rule 10b-5, codified at 17 C.F.R. § 240.10b-5.

5 *Basic, Inc. v. Levinson*, 485 U.S. 224, 242 (1988); *see also Amgen Inc. v. Conn. Ret. Plans & Trust Funds*, 133 S. Ct. 1184, 1193 (2013).

6 *Basic*, 485 U.S. at 241-49; *see also Halliburton II*, 134 S. Ct. at 2408.

7 *Id.* at 241-45.

8 *Halliburton II*, 134 S. Ct. at 2408; *Basic,* 485 U.S. at 248-50.

9 *Halliburton II*, 134 S. Ct. at 2408 (quoting *Basic,* 485 U.S. at 248).

10 *Halliburton II*, 134 S. Ct. at 2417.

[11] *Id.* at 2.
[12] *Id.* at 3.
[13] *Id.*
[14] *Id.*
[15] *Id.* at 4.
[16] *Id.* at 2, 6.
[17] *Id.* at 6.
[18] *Id.* at 7.
[19] *Id.*
[20] *Id.* at 10.
[21] *Id.* at 12-13.
[22] *Id.* at 11.
[23] *Id.* at 12.
[24] *Id.*
[25] *Id.* at 13-14.
[26] *Id.* at 14.
[27] *Id.*