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Eighth Circuit Interprets *Halliburton II*, Holding That Defendants Successfully Rebutted Fraud-on-the-Market Presumption of Reliance by Showing that the Alleged Misstatements Did Not Cause a Stock-Price Increase

On April 12, 2016, in *IBEW Local 98 Pension Fund* v. *Best Buy Co., Inc.*,[1] the Eighth Circuit interpreted and applied the Supreme Court's decision in *Halliburton Co.* v. *Erica P. John Fund, Inc.* ("*Halliburton II*"),[2] which held that defendants have the right to rebut the fraud-on-the-market presumption of reliance created by *Basic, Inc.* v. *Levinson*,[3] prior to the certification of a class, by showing a lack of "price impact." The Eighth Circuit held that the *Best Buy* defendants successfully rebutted the presumption with a "front-end" showing of a lack of price impact—*i.e.*, that the alleged misstatements did not cause a statistically significant stock-price increase when made.

The Eighth Circuit's decision is the first appellate decision, since *Halliburton II*, to find that a defendant has successfully rebutted the fraud-on-the-market presumption at the class certification stage. Significantly, and over a dissent, the Eighth Circuit rejected plaintiffs' argument that defendants' showing failed to refute plaintiffs' "price maintenance" theory. The Eighth Circuit's decision interprets *Halliburton II* to provide defendants with a meaningful opportunity to challenge class certification. What the *Halliburton II* rebuttal requires defendants to show remains a contested issue, including in similar cases already pending before other circuits.

Background

At 8:00 am on September 14, 2010, Best Buy Co., Inc. ("Best Buy") issued a press release, before the stock market opened, that announced that Best Buy was increasing its full-year earnings per share ("EPS") guidance for FY 2011 by ten cents to $3.55-$3.70. At 10:00 am that same day, Best Buy's CEO and CFO held a conference call with analysts. On the call, the CFO stated that "our earnings are essentially in line with our original expectations for the year" and that "we are on track to deliver and exceed our annual

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1 No. 14-3178 (8th Cir. Apr. 12, 2016). Paul, Weiss, Rifkind, Wharton & Garrison LLP represented the Securities Industry and Financial Markets Association as an amicus curiae in support of defendants-appellants before the Eighth Circuit.

2 134 S. Ct. 2398 (2014).

3 485 U.S. 224 (1988).

EPS guidance." Best Buy's common stock, which had closed the previous day at $34.65, opened at $37.25 (up 7.5%) and closed at $36.73 that day.

On December 14, 2010, Best Buy announced "lower than expected" third quarter sales and reduced its EPS guidance to $3.20-$3.40. The stock closed at $35.52 that day, down 14.8% from $41.70 the previous day.

Plaintiffs filed a putative class action against Best Buy and certain of its executives in February 2011 in the District of Minnesota, alleging that Best Buy's September 14, 2010, statements were false and misleading. The district court dismissed the Amended Complaint with prejudice, finding that all of the alleged misstatements were protected by the Private Securities Litigation Reform Act of 1995's ("PSLRA") "safe harbor" for forward-looking statements, 15 U.S.C. § 78u-5(c). The district court then granted plaintiffs leave to file a First Amended Class Action Complaint. On defendants' renewed motion, the district court again dismissed the claims related to the EPS guidance in the press release, but this time sustained the claims related to the "on track" and "in line" statements on the conference call.

Plaintiffs moved for class certification, relying upon *Basic*'s fraud-on-the-market presumption. In support of that motion, plaintiffs submitted an expert report from Bjorn Steinholt, who performed an "event study" and concluded that Best Buy experienced a statistically significant stock-price increase on September 14, 2010. In opposing class certification, defendants attempted to rebut the presumption. Defendants' expert, Kenneth Lehn, found that the stock-price increase occurred between 8:00 am and 10:00 am, after the press release but before the conference call, and that there was no statistically significant stock-price increase after the conference call. In response, Mr. Steinholt agreed with Dr. Lehn that the conference call did not cause a stock-price increase, but suggested, in light of the stock-price drop on December 14, 2010, that the statements on the conference call could have "maintained" the inflation introduced into the stock price by the (inactionable) press release.

After awaiting the Supreme Court's decision in *Halliburton II*, the district court certified the class. The district court found that defendants had failed to rebut the presumption because: "Even 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 the fall." The district court further held that "price impact can be shown by a decrease in price following a revelation of the fraud," and thus that defendants were required to prove that Best Buy's stock price did not decrease on December 14, 2010, in order to rebut the presumption.

Eighth Circuit Decision

After granting defendants permission to take an interlocutory appeal pursuant to Rule 23(f), the Eighth Circuit reversed the class certification order in a 2-1 decision. Judge James B. Loken, joined by Judge

Steven M. Colloton, held that defendants had successfully rebutted the *Basic* presumption, thereby precluding the requisite finding of predominance under Rule 23(b)(3).

The Eighth Circuit noted that plaintiffs' and defendants' experts were in agreement that, while the 8:00 am press release caused an immediate stock-price increase, the 10:00 am conference call caused no additional stock-price increase. In the words of plaintiffs' expert, Mr. Steinholt, the "economic substance" of the inactionable press release and the alleged misstatements on the conference call was "virtually the same." The Eighth Circuit held that: "This overwhelming evidence of no 'front-end' price impact rebutted the *Basic* presumption." In other words, defendants' showing "severed any link" between the alleged misstatements on the conference call and the stock price at which plaintiffs purchased.

The Eighth Circuit rejected plaintiffs' arguments that (i) the conference call statements caused a "gradual" stock-price increase between September and December 2010, and (ii) that the December 14, 2010, "corrective disclosure" suggested that the conference call statements "maintain[ed] an inflated stock price." As to the former, the Eighth Circuit noted that this argument was contrary to the efficient market hypothesis, which predicts that an efficient market will "rapidly" reflect publicly available information. As to the latter, the Eighth Circuit held that this "theory provided no evidence that refuted defendants' overwhelming evidence of no price impact."

Judge Diana E. Murphy dissented, arguing that defendants had not rebutted plaintiffs' "price maintenance" theory. Under that theory, "confirmatory information" can fraudulently maintain a constant stock price by "counteract[ing] expected price declines," "fraudulently prevent[ing]" a stock price "from declining." Judge Murphy argued that, to rebut the *Basic* presumption, defendants were obliged to produce "evidence showing that the alleged misrepresentations had not counteracted a price decline that would otherwise have occurred."

Analysis

Best Buy is significant because it is the first appellate decision, since *Halliburton II*, to find that a defendant has successfully rebutted the fraud-on-the-market presumption of reliance at the class certification stage. That theory has been a primary enabler of class action securities litigation under Section 10(b) of the Securities Exchange Act of 1934. As a practical matter, the impact of *Halliburton II* will depend upon what lower courts require to disprove price impact. That issue remains hotly contested. Indeed, the Second and Fifth Circuits have already granted Rule 23(f) petitions raising issues concerning the *Halliburton II* rebuttal.[4]

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4 *See In re Goldman Sachs Grp., Inc. Sec. Litig.*, No. 16-250 (2d Cir.); *Erica P. John Fund, Inc.* v. *Halliburton Co.*, No. 15-11096 (5th Cir.).

In particular, *Best Buy* is significant because it holds that a defendant's "front-end" showing is alone sufficient, at least on these facts, and that a defendant does not also have to make a "back-end" showing (*i.e.*, whether the stock-price decline at the time of the alleged "corrective disclosure" is evidence of prior stock-price inflation). Plaintiffs, naturally, would prefer that defendants be required to disprove price impact *both* at the front end *and* at the back end. Moreover, because "bad news" generally causes a stock-price drop, whether or not the news "corrects" a prior misstatement, a back-end showing will generally be more difficult.

Relatedly, although *Best Buy* does not explicitly reject "price maintenance" as a cognizable theory, it holds that the mere "theory" of price maintenance, without supporting evidence, is insufficient to overcome a defendant's compelling "front-end" rebuttal. The dissent, on the other hand, would have required defendants to prove that the stock price would not have declined but for the alleged misstatements. It remains unclear what sort of price maintenance showing a plaintiff could make to rebut a defendant's rebuttal; or (under the dissent's view) what showing a defendant could make to rebut the suggestion of price maintenance. Notably, in a decision issued the same day, the Second Circuit left open the issue of whether "inflation-maintenance" is a legally sustainable theory at all.[5] The *In re Goldman Sachs Group, Inc. Securities Litigation* case pending in the Second Circuit also raises an issue of the interaction of the price maintenance theory with the *Halliburton II* rebuttal.[6]

Crucially, *Best Buy* rejects the sort of speculation that the district court engaged in when it opined that the alleged misrepresentations "could have" caused stock-price inflation over a two month period or prevented the stock price from declining. At least on the facts of that case, there was no reason to believe that the stock-price increase caused by the optimistic EPS guidance at 8:00 am would have been reversed but for the "on track" and "in line" statements two hours later. *Best Buy* is clear that, in the face of a meaningful *Halliburton II* rebuttal, securities class actions will not be certified based on such speculation alone.

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5 *See In re Pfizer Inc. Sec. Litig.*, No. 14-2853, slip op. at 31, 46-47 & n.9 (2d Cir. Apr. 12, 2016).

6 *See In re Goldman Sachs Grp., Inc. Sec. Litig.*, 2015 WL 5613150, at *6 (S.D.N.Y. Sept. 24, 2015), *appeal pending*, No. 16-250 (2d Cir.).

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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