



Split 8th Circuit Rejects Class Certification in 10b-5 Case

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1. Legal Framework for Class Certification in a Rule 10b-5 Class Action

To be certified, a proposed class must show that “questions of law or fact common to class members predominate over any questions affecting only individual members.” Fed. R. Civ. P. 23(b)(3). This predominance inquiry can be difficult for plaintiffs in a Rule 10b-5 fraud case, because one of the elements the plaintiffs must prove is reliance upon the misrepresentation or omission. *Amgen, Inc. v. Conn. Ret. Plans & Tr. Funds*, 133 S. Ct. 1184, 1192 (2013).

Rather than requiring every individual investor to prove how they would have acted if the misrepresentation was not made, the U.S. Supreme Court has set forth a rebuttable presumption of reliance in Rule 10b-5 cases where the plaintiffs trade on an impersonal market. The theory is that “the market price of shares traded on well-developed markets reflects all publicly available information,” and “an investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price.” *Basic, Inc. v. Levinson* 485 U.S. 224, 246-47 (1988).

For this presumption to apply, Plaintiffs must demonstrate:

- “(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 misrepresentations were made and when the truth was revealed.”

Halliburton Co. v. Erica P. John Fund, Inc. (Halliburton II), 134 S. Ct. 2398, 2408 (2014).

However, plaintiffs in a Rule 10b-5 case are not required to prove materiality at the class certification stage. *Amgen, Inc.*, 133 S. Ct. at 1197.

A Rule 10b-5 defendant can rebut the *Basic* presumption by showing an absence of price impact, that is, 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.” *Erica P. John Fund, Inc. v. Halliburton Co. (Halliburton I)*, 131 S.Ct. 2179, 2408 (2011).

Recently, the Supreme Court reaffirmed the presumption in *Basic*, holding that “Defendants must be afforded an opportunity before class certification to defeat the [*Basic*] presumption through evidence that an alleged misrepresentation did not actually affect the market price of the stock.” *Halliburton II*, 134 S. Ct. at 2417. The Court held that this evidence could be either direct or indirect evidence of price impact. *Id.* If a defendant rebuts the presumption, “a Rule 10b-5 suit cannot proceed as a class action,” because individual questions of reliance will predominate over common questions of law and fact. *Id.* at 2416.

2. Alleged Misstatements by Best Buy Officers in *IBEW Local 98 Pension Fund v. Best Buy Co., Inc.* Litigation

At 8 a.m. on September 14, 2010, Best Buy issued a press release summarizing its financial performance for the second quarter of its fiscal year. Best Buy announced that it was increasing its full-year earnings per share (EPS) guidance by 10 cents to \$3.55-3.70. Best Buy’s common stock (BBY), which had closed on September 13 at \$34.65, opened at 9:30 a.m. on September 14 at \$37.25.

At 10 a.m. on the same day, CEO Brian J. Dunn and CFO Jim Muehlbauer of Best Buy held a conference call with stock analysts. On the conference call, Muehlbauer asserted that “we are pleased that our earnings are essentially in line with our original expectations for the year,” and “we are on track to deliver and exceed our annual EPS guidance.” BBY closed on September 14 at \$36.73.

After three months of BBY’s price increases, Best Buy released a statement on December 14 at 8 a.m. reporting a decline in third quarter sales and announcing that it had reduced the FY 2011 EPS guidance to \$3.20-\$3.40. In a conference call after the market opened that day, Dunn

and Muehlbauer discussed the “lower than expected” third-quarter sales. BBY’s price, which had closed at \$41.70 on December 13, closed at \$35.52 on December 14.

3. The *IBEW Local 98 Pension Fund v. Best Buy Co, Inc.* Lawsuit and Class

Certification Motion

Plaintiffs sued Best Buy and three of its executives (“Defendants”), alleging they violated SEC Rule 10b-5 by making fraudulent or recklessly misleading public statements in both the September 14 press release and the ensuing conference call. In ruling on Defendants’ motion to dismiss, the district court distinguished between the press conference and the conference call on the basis that only the latter was “not forward-looking and . . . a statement of present condition.” Accordingly, the district court dismissed the claim based on the press release, but upheld the claim based on the conference call statements.

Relying on the *Basic* presumption to establish reliance, Plaintiffs moved for certification of a class consisting of all purchasers of Best Buy stock between September 14 and December 14, 2010. The district court certified the class, concluding that common questions predominate because Defendants failed to rebut the *Basic* presumption by establishing that the challenged statements did not impact the price of BBY. The district court held that “[e]ven though the stock price may have been inflated prior to the [conference call], the alleged misrepresentations could have further inflated the price, prolonged the inflation of the price, or slowed the rate of fall.” The district court also held that “price impact can be shown by a decrease in price following a revelation of the fraud” and that Defendants failed to “show that Best Buy’s stock price did not decrease when the truth was revealed.”

4. The 8th Circuit Reverses Class Certification

Defendants appealed this decision to the 8th Circuit. On appeal, Defendants did not contest that the alleged conference call misrepresentations were publicly made that Best Buy’s stock traded in an efficient public market or the class definition. Instead, they argued that the district court had failed to correctly assess the evidence of price impact under the framework established by *Basic* and *Halliburton II*.

The 8th Circuit ruled 2-1 in favor of Defendants, reversing the district court’s class certification order. Writing for the majority, Judge Loken held that the district court misapplied the price impact analysis mandated by *Halliburton II*. Judge Loken held that defendants had presented strong evidence that the conference call could not be linked to an increase in price on the

front end, because Plaintiffs' expert had not adequately parsed the effect of these statements from the earlier press release. Furthermore, the majority was not convinced by Plaintiffs' theory that the price decrease on December 14 provided evidence of a price impact, because the allegedly "inflated price" was established by the nonfraudulent press release. To the majority, the statements on the conference call added nothing substantively different to the statements in the press release that were disclosed two hours before the call. The majority ruled that, since the district court had failed to conduct a "rigorous analysis" that closely examined the expert testimony, it had abused its discretion.

In dissent, Judge Murphy argued that Defendants had not rebutted the presumption of reliance, because they had not produced evidence showing that the alleged misrepresentations had not counteracted a price decline that would otherwise have occurred. She criticized the majority opinion for ignoring the theory that the conference call prevented the stock price from declining, thus departing from other circuits that recognize price maintenance theories as cognizable under the Securities Exchange Act.

5. Significance

Best Buy is a friendly application of the *Halliburton II* price impact analysis. To defeat class certification, Defendants can look to other events that took place very close to the time of the alleged misrepresentation to explain any increase in price of the stock. Under this standard, Plaintiffs will have difficulty certifying a class if the increase in price of a stock can be attributed to nonfraudulent events.

Especially when it comes to expert testimony, Plaintiffs must present unequivocal evidence of price impact at the class certification stage or risk having the *Basic* presumption rebutted. Plaintiffs will have to be careful to differentiate between different "events" when analyzing the effects of the alleged misrepresentations.

Furthermore, it is not clear that a "price maintenance theory" will be recognized in the 8th Circuit. Even where such a theory is recognized, Plaintiffs should do more than simply point to a drop in stock price after a misrepresentation is corrected. Plaintiffs should present evidence that the price would have declined had it not been for the misrepresentation.

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