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The Impact of the Supreme Court's Recent *Halliburton* Decision on Securities Litigation

On June 23, 2014, the Supreme Court issued its long-awaited decision in *Halliburton Co. v. Erica P. John Fund, Inc.*[1] In *Halliburton*, the Court declined to overrule *Basic v. Levinson*,[2] but rather imposed limitations on the "fraud-on-the-market theory," making it easier for securities class action defendants to defeat class certification.

A. Background

In order to recover damages for violations of Section 10(b) of the Securities Exchange Act of 1934, plaintiffs must prove, among other things, that they relied on misrepresentations or omissions when they purchased or sold a security.

In *Basic*, the Supreme Court adopted the "fraud-on-the-market" theory. Recognizing that requiring each plaintiff to show individualized reliance would effectively negate the ability of plaintiffs to pursue securities class actions, the Court held that in certain circumstances, plaintiffs can satisfy the reliance element by invoking a rebuttable presumption of reliance, rather than requiring each plaintiff to prove direct reliance on an alleged misrepresentation. This presumption – the "fraud-on-the-market" theory – is premised on the economic theory that the market price of securities in well developed markets reflects publicly available information and, therefore, alleged misrepresentations are already accounted for in the price of the security and need not be independently proven for each plaintiff.

Under *Basic*, a plaintiff seeking to invoke the presumption of reliance must show that (a) the alleged misrepresentations were publicly known; (b) the alleged misrepresentations were material; (c) the security traded in an efficient market; and (d) the plaintiff traded the security between the time that the alleged misrepresentation was made and when the truth was revealed. A defendant can rebut the presumption by making a showing that severs the link between the alleged misrepresentation and the price received or paid by the plaintiff or a plaintiff's decision to trade the security at a fair market price.

In *Halliburton*, Erica P. John Fund, Inc. (the "Fund") alleged that, between June 3, 1999, and December 7, 2001, Halliburton made a series of misrepresentations in an attempt to inflate its stock price. The Fund contended that once Halliburton issued corrective disclosures, the stock price dropped and the Fund, along with other investors, lost money. The trial court certified a class, concluding that the Fund was entitled to the presumption of the fraud-on-the-market theory. The trial court declined to allow Halliburton to attempt to rebut this presumption at the class certification stage.

In its decision, the Supreme Court declined to overrule *Basic*.[3] The Court determined, however, that defendants should be permitted to attempt to defeat the *Basic* presumption at the class certification stage, by presenting evidence that the alleged misrepresentation did not affect stock price. In so holding, the Court emphasized that *Basic* provided a presumption, and it was not in dispute that defendants may introduce evidence at the merits stage to defeat the presumption. As price impact is "*Basic*'s fundamental premise," the Court held that defendants should be

[1] No. 13-317; 573 U.S. __; 2014 U.S. Lexis 4305.

[2] 485 U.S. 223 (1988).

[3] In its 2013 decision in *Amgen*, four justices indicated that the economic theories underlying the "fraud-on-the-market" theory have been called into question by recent economic research, and that they might consider overruling *Basic*. *See Amgen Inc. v. Conn. Ret. Plans & Trust Funds*, 133 S. Ct. 1184, 1204 & 1208 n.4 (2013). In its petition for certiorari, Halliburton cited these observations, and asked the Court to overrule *Basic*. In the alternative, Halliburton sought a ruling that defendants seeking to rebut the Basic presumption can present evidence that the alleged misrepresentations did not distort the market price of the stock at the class certification stage. The Court granted certiorari on both questions.

entitled to defeat the presumption at the class certification stage, rather than just at the merits stage.

It also was not in dispute that both plaintiffs and defendants may introduce price impact evidence at the class certification stage, in order to show whether a particular market is efficient. In fact, in *Halliburton*, the Fund submitted an "event study" – a regression analysis that purported to show that the market price of Halliburton's stock tends to respond to publicly reported events.

The Court held that the lower court's ruling – that event studies can be considered by the court at the class certification stage for purposes of determining whether the market is efficient, but cannot be used by defendants to rebut the *Basic* presumption in its entirety – "makes no sense, and can readily lead to bizarre results." Under the lower court's ruling, at the class certification stage, a defendant could introduce an event study that demonstrates both that the market for the security is inefficient and that the alleged misrepresentation had no price impact on the security. In this situation, if the lower court's ruling were to stand, the case could proceed as a class action – even though the fraud-on-the-market theory would be inapplicable – because the evidence failed to show that the misrepresentation had any effect on price. The Court determined that it is logical to permit the trial court to consider event studies – and similar evidence – for both purposes at the class certification stage.

B. Likely Effects of the Decision

Halliburton likely will not "shift the goal posts" of securities class action litigation. As a concurring opinion noted, it is always necessary for defendants to show the absence of price impact at some point in the course of litigation, so *Halliburton* "should impose no heavy toll on securities-fraud plaintiffs with tenable claims."

On the other hand, by explicitly permitting defendants to rebut the fraud-on-the-market theory at the class certification stage, *Halliburton* may allow non-meritorious suits to be disposed of at an earlier stage. In a recent analysis, NERA, an economic consulting firm, determined that 77 percent of motions for class certification that were decided were granted.[4] *Halliburton* will likely reduce this percentage and decrease pressure to settle cases prior to the class certification stage.

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[4] *See* Dr. Renzo Comolli and Svetlana Starykh, "Recent Trends in Securities Class Action Litigation: 2013 Full-Year in Review," at 19, *available at* http://www.nera.com/nera-files/PUB_2013_Year_End_Trends_1.2014.pdf.

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