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Business Litigation Practice Group

June 24, 2014

Halliburton Ruling: High Court Affirms *Basic v. Levinson* and Confirms Defendants May Rebut Reliance Presumption at Class Certification by Showing Absence of Price Impact

The Supreme Court's June 23, 2014 decision in *Halliburton Co. v. Erica P. John Fund, Inc.* was one of this term's most highly anticipated rulings, involving a request that the Court overrule a landmark precedent from 25 years ago that enabled federal securities claims to be pursued as a class actions, and launched the multi-billion dollar securities class action industry. Although the Court rejected calls to do away with the presumption of reliance adopted in its 1989 *Basic v. Levinson* decision that made it much easier to pursue securities claims as class actions, the Court confirmed in *Halliburton* that Defendants have the opportunity to rebut that presumption before class certification is granted.

Appellant Halliburton Company asked the Court to overrule *Basic*'s legal fiction that permitted courts to *presume* classwide reliance on alleged public material misrepresentations, thereby enabling lawsuits alleging fraud under the federal securities laws to be certified as class actions despite the preponderance of individualized reliance issues that would otherwise render such cases unfit for class treatment. The Court's grant of *certiorari* in November 2013 spawned a torrent of prognostication and debate about the potential end of federal securities class action litigation in this country. Following oral argument this past March, there was even some question whether at least a minority of the Justices might take the opportunity to raise even broader questions concerning the continued viability of an implied private right of action under SEC Rule 10b-5 and Section 10(b) of the Securities Exchange Act of 1934—pursuant to which the vast bulk of federal securities fraud class action lawsuits are brought.[1]

The Supreme Court's Holding

In the end, the Court took a more conservative approach, with a majority of six justices holding that Halliburton had not shown the "special justification" required to overturn *Basic*'s "long-settled precedent." Chief Justice Roberts' opinion for the Court affirmed *Basic*'s ruling that a plaintiff in a securities fraud class action may satisfy the reliance element by invoking a rebuttable presumption of reliance premised on the "fraud on the market theory." That theory posits that "the market price of shares traded on well-developed markets reflects all publicly available information, and, hence any material

For more information, contact:

Michael R. Smith
+1 404 572 4824
mrsmith@kslaw.com

Paul R. Bessette
+1 512 457 2050
pbessette@kslaw.com

Jeffrey S. Bucholtz
+1 202 626 2907
jbucholtz@kslaw.com

Benjamin Lee
+1 404 572 2820
blee@kslaw.com

Andrew Zee
+1 415 318 1222
azee@kslaw.com

King & Spalding
Atlanta
1180 Peachtree Street, NE
Atlanta, Georgia 30309-3521
Tel: +1 404 572 4600
Fax: +1 404 572 5100

Austin
401 Congress Avenue
Suite 3200
Austin, Texas 78701
Tel: +1 512 457 2000
Fax: +1 512 457 2100

Washington, D.C.
1700 Pennsylvania Avenue, NW
Washington, D.C. 20006-4707
Tel: +1 202 737 0500
Fax: +1 202 626 3737

www.kslaw.com

misrepresentations." In order to invoke this rebuttable presumption, a plaintiff need only show that defendants made (i) material misrepresentations (ii) that were publicly known, (iii) that the stock at issue traded on an "efficient" market, and (iv) that the plaintiff bought or sold the stock between the time the misrepresentations were made and the truth was revealed. Moreover, as the Court previously held in *Amgen Inc. v. Connecticut Retirement Plans and Trust Funds*, 568 U. S. --- (2013), plaintiffs need not prove materiality to obtain class certification, because a failure to prove materiality would defeat the claim as to all investors and would not lead to a predominance of individualized issues of proof among the members of the class.

While affirming *Basic*, the *Halliburton* Court vacated and remanded the appealed decision from the Fifth Circuit Court of Appeals, which forbade Halliburton from attempting to rebut the presumption of reliance at the class certification phase by introducing evidence that the alleged misrepresentations in the case did not impact the market price of the company's stock. The Supreme Court observed that price impact, *i.e.*, that a misrepresentation was reflected in the stock price at the time a plaintiff bought or sold, is "*Basic*'s fundamental premise." Without price impact, the fraud on the market theory underlying *Basic*'s presumption collapses. Thus, the Court held that, while *Basic* permits plaintiffs to show price impact *indirectly* at the class certification stage simply by demonstrating market efficiency and that the alleged misrepresentations were public, it would be improper to "artificially limit" defendants from rebutting such an indirect showing with *direct* evidence of an absence of price impact at the class certification stage. Ignoring price impact evidence for purposes of assessing the application of *Basic*'s reliance presumption would be particularly inappropriate, the Court concluded, given that price impact evidence is routinely introduced at class certification (by plaintiffs and defendants) to attempt to show or rebut market efficiency. Thus, the Court held, "Defendants may seek to defeat the *Basic* presumption at [the class certification] stage through direct as well as indirect price impact evidence."[2]

In a separate opinion concurring in the judgment only, Justice Thomas, joined by Justices Scalia and Alito, would have overruled *Basic*, arguing that *Basic* rests on assumptions that were "highly contestable" 25 years ago and have been eroded further by subsequent developments.[3] The concurrence challenged *Basic*'s assumption that well-developed markets "uniformly incorporate information into market prices with high speed" and argued that, even when information is promptly incorporated, that often does not necessarily mean that the market price accurately reflects a stock's value. Justice Thomas also blasted *Basic*'s assumption that investors buy and sell in reliance on the "integrity" of market prices, pointing out that many investors trade for the opposite reason, believing that stock prices are over- or under-valued, or for reasons wholly unrelated to price, such as concerns over taxes, liquidity, or portfolio balancing.

Implications of the Decision

Despite prior speculation that *Halliburton* could portend the demise of securities class action litigation, the Court's decision affirmed the fundamental ruling of *Basic*, and likely will not prompt a substantial reduction in securities class action filings. However, the rule announced in *Halliburton* will give defendants an important opportunity to end litigation at the class certification stage and avoid much of the expense and discovery necessary to prevail at the summary judgment or trial. In many cases, having this potential silver bullet in hand should provide defendants with greater leverage to settle marginal cases that nonetheless survived a motion to dismiss.

The *Halliburton* ruling also promises to give birth to a substantial corpus of new authorities interpreting and applying the Court's directive. A recent study of securities class actions filed and resolved between January 2000 and December 2013 showed that 73% of the cases were resolved before a motion for class certification was even filed and that motions for class certification were actually decided in only 15% of the cases studied.[4] Following *Halliburton*, we expect that more defendants will litigate cases through a decision on class certification. Yet, as is frequently the case in this area of the law, application of the newly announced doctrinal rule can be expected to spawn a host of new questions, which courts addressing class certification motions following *Halliburton* will find difficult to answer. For instance, in assessing price impact, to what extent must courts distinguish price movements caused by the alleged fraud from those

resulting from confounding factors (*e.g.*, other news disclosed more or less simultaneously with an alleged misstatement or correction thereof; general market volatility; *etc*.)? If confounding factors must be ruled out as the causes of the price movements at issue, what precise means of proof and what degree of certainty are required to show that a price move was caused by fraud and not a confounding factor? How, if at all, should over- or under-reactions by the market (reflected by reversals in price movements or other means) be considered, and what time windows can be considered in assessing whether an over- or under-reaction occurred?

These and other questions with which lower courts applying *Halliburton* will have to grapple are complex, and their resolutions are not likely to be susceptible to decision by reference to a simple set of rules. Instead, they will be highly fact-dependent and substantially influenced by expert judgments and analyses made in the contexts of particular cases. The outcome may be that Supreme Court ultimately will be called upon to resolve many of these further questions as well.

Conclusion

While disappointing to those who held out hope that the Supreme Court would overrule *Basic* and effectively bring an end to securities class action claims in this country, the *Halliburton* case marks an important victory for securities class action defendants and all those potentially subject to such claims. The Supreme Court's ruling that defendants may rebut the application of *Basic* at the class certification stage by demonstrating an absence of price impact gives defendants an additional and important opportunity to defeat claims without incurring the staggering expense of completing full merits discovery, litigating summary judgment, and perhaps taking a case all the way to trial.

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[1] *See, e.g., Fate of Securities Class Actions in Question Following Argument Before High Court in* Halliburton Co. v. Erica P. John Fund, Inc., FINANCIAL FRAUD LAW REPORT, Vol. 6, No. 4 (April 2014).

[2] The Court's holding resolved a split between the Second and Third Circuits on the one hand, which previously held that defendants could rebut the Basic presumption of reliance and defeat class certification by showing the absence of price impact and, on the other hand, the Fifth and Seventh Circuits, which had both held that price impact was a merits question that could not be considered at class certification. *Compare In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474, 484 (2d Cir, 2008) and *In re DVI, Inc. Sec. Litig.*, 639 F.3d 623, 638 (3d Cir. 2011), *with Schleicher v. Wendt*, 618 F.3d 679, 685 (7th Cir. 2010) and *Erica P. John Fund, Inc. v. Halliburton Co.*, 718 F.3d 423, 434 (5th Cir. 2013).

[3] Justices Ginsburg, Breyer, and Sotomayor joined in a separate concurrence, stating that they approved of the judgment because it "should impose no heavy toll on securities-fraud plaintiffs with tenable claims."

[4] Renzo Comolli and Svetlana Starykh, National Economic Research Associates, Inc., *Recent Trends in Securities Class Action Litigation: 2013 Full-Year Review* at 19 (Jan. 21, 2014), available at http://www.nera.com/nera-files/PUB_2013_Year_End_Trends_1.2014.pdf.