EXPERT HELPS PROVE "EFFICIENT MARKET" IN SECURITIES FRAUD LITIGATION

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The "fraud-on-the-market" presumption that allows plaintiffs in securities fraud litigation to establish class-wide reliance on alleged fraudulent misrepresentations, was recently the subject of major publicity as a result of the Supreme Court's pending decision in *Haliburton.* Would the Supreme Court dismantle this longstanding pillar of securities class actions and potentially put the plaintiffs' securities bar out of business? As it turns out, the outcome was less dramatic with the Supreme Court preserving the fraud-on-the-market presumption, but holding that a securities fraud defendant can defeat the presumption at the class certification stage with evidence that the alleged misrepresentations did not in fact affect the price of the relevant stock. *Haliburton v. Erica P. John Fund, Inc.,* 134 S.Ct. 2398, 2414 (2014).

While the plaintiffs' securities bar undoubtedly breathed a collective sigh of relief, establishing the fraud-on-the-market presumption at the class certification stage is certainly no cakewalk, but instead requires carefully prepared expert testimony. More specifically, securities plaintiffs will typically seek class certification pursuant to Federal Rule 23(b)(3), which provides that a class action is maintainable only if "questions of law or fact common to class members predominate over any questions affecting only individual members." To defeat compliance with Rule 23(b)(3), defendants frequently assert that individualized questions about whether members of the proposed class actually relied on the alleged misrepresentations when purchasing the relevant stock will predominate over class-wide questions of reliance. Plaintiffs always respond that the "fraud-on-the-market" presumption applies, and thus actual reliance is not relevant. To establish this, plaintiffs must show that, among other things, the relevant stock traded on an efficient market. This is where the expert comes in, as illustrated in the recent decision of *McIntire v. China MediaExpress Holdings, Inc.*, 2014 WL 4049896 (S.D.N.Y. Aug. 15, 2014).

McIntire involved a company, China MediaExpress Holdings ("CCME") that turned out to be a fraud. The plaintiffs bought the stock when things were looking good, but then the company's auditor resigned after finding signs of fraud originally alleged in reports published by short sellers. The stock tanked. The plaintiffs sued both the company and its auditor, which had issued an audit report during the class period certifying CCME's financials, and stating that they complied with generally accepted accounting principles ("GAAP"). After CCME defaulted, the auditor remained as the sole defendant.

To establish market efficiency for CCME's stock, Plaintiff's expert, Cynthia Jones, undertook an "event study" that divided the days during the relevant class period into "News Days" (i.e., days on which unexpected, potentially material news was released to the public), and "Non-News Days") (i.e., days on which non-material news or no news at all was released). The study found that CCME stock had statistically meaningful price changes on 42% of the News Days versus only 7% of the Non-News Days. As such, Jones concluded that it was six times more likely for CCME's stock price to change on days when there was material news. This finding satisfied the most important indicator of market efficiency under the so-called *Cammer* factors, i.e., that unexpected corporate events or financial releases cause an immediate response in the price of the relevant stock.

The defendant attacked Jones' methodology as unreliable under *Daubert*. Among other things, the defendant introduced its own expert, Rene Stulz, who claimed that Jones' selection of "material news" to characterize a day as a "News Day" was insufficiently objective. Plaintiffs responded with a declaration from another expert, Stephen E. Christophe, who incorporated recommendations urged

by Stulz and generated results that demonstrated market efficiency to an even greater extent than Jones' analysis did. Ultimately, the court concluded that an expert conducting an event study for purposes of establishing market efficiency may use his or her discretion in terms of determining selection criteria. It further found that Jones' methodology was sufficiently reliable and consistent with scientific principles.

Haliburton did make a brief appearance in the decision when the defendant argued that there was no price impact from any of its alleged misstatements since, on the day it released the relevant audit report, CCME's stock did not increase, and in fact decreased slightly. The Court disagreed, holding that plaintiffs could establish "price impact" by showing that the misstatement had improperly maintained the already-inflated stock price; they did not need to show the misstatements caused further inflation.

While *Haliburton* was not the focus in the decision discussed in this blog post, we'd be interested to hear from readers what you see as the long term impact of the *Haliburton* decision on the conduct of securities fraud class actions.