Client Alert

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Supreme Court to Review the *Basic* Premise of Securities Class Actions

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The Supreme Court has agreed to revisit the basic premise of Section 10(b) securities class actions that was first articulated in *Basic v. Levinson*, 485 U.S. 224 (1988). On November 15, 2013, the Court granted a petition for certiorari in *Halliburton Co. v. Erica P. John Fund, Inc.*, No. 13-317 (U.S. Nov. 15, 2013) to consider two questions:

1. Whether the Court should overrule or substantially modify the holding of *Basic* to the extent that it recognizes a presumption of class-wide reliance derived from the fraud-on-the-market theory.

2. Whether, in a case where the plaintiff invokes the presumption of reliance to seek class certification, the defendant may rebut the presumption and prevent class certification by introducing evidence that the alleged misrepresentations did not distort the market price of its stock.

BACKGROUND

Twenty-five years ago, the Supreme Court ruled (4-2) in *Basic* that investors' reliance on allegedly misleading statements can be presumed in cases where complaints assert violations of Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5, the antifraud provisions most frequently invoked by plaintiffs in securities class actions.

The *Basic* presumption was based on the developing economic theory that robust capital markets efficiently incorporate all publicly available material information into a stock's price. Based on that "fraud-on-the-market" theory, the Court held that investors who buy or sell stock at the price set by the market presumptively do so in reliance on the integrity of that market price. The *Basic* holding had significant implications, effectively giving rise to the modern era of securities fraud class actions. That is because the presumption spares a putative class of investors from having to prove that each of them actually relied on an alleged misrepresentation in order to obtain class certification. Without the *Basic* presumption, shareholders would be required to prove actual reliance on an alleged misrepresentation, making Section 10(b) securities class actions nearly impossible to pursue.

Last year, four justices signaled an interest in reconsidering *Basic*'s fraud-on-the market presumption in *Amgen, Inc. v. Connecticut Retirement Plans and Trust Funds*, 133 S. Ct. 1184 (2013). *Amgen* held that plaintiffs need not prove the alleged misrepresentations or omissions are material in order to obtain class certification. Justice Alito wrote a one-paragraph concurrence noting that the *Amgen* case did not squarely present an opportunity to reconsider the fraud-on-the-market presumption, but that "more recent evidence suggests that the presumption may rest on a faulty economic premise." A dissenting opinion by Justice Thomas, which Justices Scalia and Kennedy joined, noted that the "*Basic* decision itself is questionable." The Court previously decided that it was

unnecessary to reach the viability of the presumption in an earlier class-certification ruling in the same case against Halliburton, *Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179 (2011), where the Court held that plaintiffs are not required to prove the element of loss causation at the class certification stage of a case.

SIGNIFICANCE

The Court has shown significant interest in securities cases in recent years. Indeed, *Halliburton* is the third case in three terms that puts the requirements of class certification in securities cases front and center. *Halliburton*, however, has the potential to be the most significant securities case in a generation, given the possibility that the Court could overrule the presumption in light of significant questioning of the fraud-on-the-market theory. The plaintiff in the case argues against that possible outcome, placing principal emphasis on the fact that Congress declined to alter the presumption when reshaping securities fraud class actions with the enactment of the Private Securities Litigation Reform Act and the Securities Litigation Uniform Standards Act in 1995 and 1998, respectively.

If *Basic*'s fraud-on-the-market presumption is overturned, Section 10(b) securities litigation would be radically altered. If the presumption survives in any form, the Court may provide much-needed guidance about the means and timing of rebutting it, a relatively rare occurrence in securities litigation given the lack of precedent from the Court. A decision in *Halliburton* is expected by the end of June 2014.

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