COHEN MILSTEIN

Halliburton II – Predicting Implications for Securities Fraud Litigation

On November 15, 2013, the Supreme Court granted Defendants' petition for *certiorari* in *Halliburton Co. v. Erica P. John Fund, Inc.*, 13-317 ("*Halliburton II*")[1], which requested review of the Fifth Circuit's grant of certification, on the following two questions:

> (1) Whether this Court should overrule or substantially modify the holding of *Basic Inc. v. Levinson*, to the extent that it recognizes a presumption of classwide reliance derived from the fraud-on-the-market theory; and (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.

In all likelihood, the Supreme Court will hear and decide this case in its current term, prior to June 2014.[2]

Executive Summary: What is at stake?

While we regularly bring Supreme Court cases involving your interests to your attention, we are sending out this special alert because it calls upon the Supreme Court to decide an issue that could profoundly impact the practical ability of most investors to obtain a meaningful remedy under the anti-fraud provisions of the federal securities laws. What is at stake here is whether investors – including institutional investors – will be able to utilize the class action mechanism to exercise their rights provided by the federal securities laws. Without the class action mechanism, investors must take an active role in litigation – either bringing cases by themselves or in a group action with other investors -- in order to obtain any recovery.

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[1] In 2011 the Supreme Court issued a unanimous decision in this same case, *Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179 (2011) ("*Halliburton I*"), holding that a plaintiff must not prove loss causation in order to obtain class certification.

[2] There is, of course, always the possibility that the parties will settle. Given the history of this particular case, however, that is unlikely.

Immediately following the Supreme Court's announcement that it would grant *certiorari*, practitioners in the securities bar recognized that this case could be a "game changer" and the "potential to be the most significant securities case in a generation" if it significantly alters the presumption of reliance recognized in *Basic Inc. v. Levinson*, 485 U.S. 224, 247 (1988).

Reliance is an element of the implied private right of action derived from the Securities Exchange Act of 1934 ("Exchange Act") which forms the basis for most securities fraud claims. This element of the cause of action, which is a classic "individual" issue of fact, could, in most Exchange Act cases, pose an insurmountable barrier to class certification, were it not for the "fraud- on-the-market" presumption recognized by the Supreme Court in 1988 in its landmark *Basic* decision. Under *Basic's* "fraud on the market" theory, since "most publicly available information is reflected in market price, an investor's reliance on any public material misrepresentations, therefore, may be presumed for purposes of a Rule 10b-5 action." *Basic*, 485 U.S. at 247. This presumption may be rebutted, however, by any "showing that severs the link between the alleged misrepresentation" and the price paid by the plaintiff or his decision to trade at a fair market price. *Id.* at 248. Modifying the rule in *Basic* would literally affect every pending securities class action based on the Exchange Act and could, in the most dire scenario, eliminate most of them as class actions.

What's going to happen?

Background Information

Although the Supreme Court's recent decision in *Amgen Inc. v. Conn. Ret. Plans & Trust Funds*, 133 S. Ct. 1184 (2013) ("*Amgen*"), rejected the requirement that a plaintiff must prove materiality at the class certification stage, four Justices telegraphed their desire to revisit *Basic*. Thus, there is more information

than usual with which to speculate about what will happen when the Supreme Court decides *Halliburton II*. In *Amgen*, Justice Alito, in his concurrence – and Justices Scalia, Thomas, and Kennedy, in their dissents, all indicated a desire to revisit *Basic*. Specifically, Justice Alito wrote that, since "more recent evidence suggests that the presumption may rest on a faulty economic premise," "reconsideration of the *Basic* presumption may be appropriate." *Amgen*, 133 S. Ct. at 1204 (Alito, J., concurring). Justice Thomas, joined by Justices Scalia and Kennedy, noted in a footnote that the "*Basic* decision itself is questionable" and that Justice White's concern in *Basic* that the Court is "not well equipped to embrace novel constructions of a statute based on contemporary microeconomic theory" "remains valid today." *Id*. at 1209 n. 4. (Thomas, J., dissenting).

Notably, in *Amgen*, neither party brought up the continued viability of *Basic*. Instead, it appeared in the case through the brief of an *amicus curiae* submitted on behalf of a group of law professors including Adam Pritchard at Michigan and Todd Henderson at the University of Chicago. These professors argued that rather "than being totally 'efficient' or 'inefficient,' securities markets enjoy varying degrees of efficiency and therefore incorporate information at varying rates" and that "the Court should shift the focus on fraud on the market inquiries from a market's overall efficiency to the question whether the fraud at issue affected market prices."

In other words, proving that the market is efficient as a "general matter" should not be the inquiry, it should be whether "a market functions well enough that the specific representation at issue was incorporated into a security's price." They base this argument on their view that economists have concluded that "levels of efficiency" "vary," even in the same market – "if one piece of information is more easily collected and understood than another, it will make its way into the market price more quickly," citing as evidence data showing that the market moves on Wall Street Journal articles reporting

insider trading despite the fact that the SEC reported the same data days earlier.[3] The brief concludes by recommending the event study as "a reliable and practical method for courts to determine whether misstatements distorted the market." This brief, which plausibly could have inspired the four Justices to question *Basic*, provides one data point for hypothesizing about what the Court will do in *Halliburton II*.

A second data point is provided by the majority decision in *Amgen*, authored by Justice Ginsberg, in which she applied *Basic* without questioning its basic tenets. Moreover, she affirmatively noted that the Basic decision was made by "a majority of the quorum of six Justices who participated in the case." *Id*. at 1192, n. 1. Justice Ginsberg, did note, however, the argument "founded on modern economic research tending to show that market efficiency is not "'a binary, yes or no question'" and noted that "this research suggests, differences in efficiency can exist within a single market," for example that "a market may more readily process certain forms of widely disseminated and easily digestible information, such as public merger announcements, than information more difficult to acquire and understand, such as obscure technical data buried in a filing with the Securities and Exchange Commission." *Id*. at 1197, n. 6. Justices Breyer, Sotomayor, Kagan, and, most surprisingly and potentially importantly, Justice Roberts – all joined her majority decision without comment or caveat.

A third set of data points is provided by the briefing on the successful petition for *certioriari* in *Halliburton II*. Defendants' petition, based essentially on the same research pushed forward by the law professor *amicus* brief in *Amgen*, argues that *Basic* should be modified or overruled so that "plaintiffs seeking class certification should at least be required to prove that the alleged misrepresentations *actually*

[3] *Amgen*'s brief did bring up this new economic theory, but did not advocate for the reconsideration of *Basic*.

distorted the market price" at the class certification stage or, failing that, to "clarify that price distortion … may be rebutted at the class certification stage."[4] *Amicus curiae* briefs in favor of the Supreme Court granting *certiorari* were also filed by the Chamber of Commerce/National Association of Manufacturers, DRI – the "voice of the defense bar," and a brief filed by "former SEC Commissioners and Law Professors."

The Chamber of Commerce brief focuses mostly on public policy, lobbing a number of well worn attacks at securities class actions, including that the "fraud on the market theory has provided securities fraud plaintiffs with a free pass to class certification in many cases, leading to excessive litigation and *en terrorem* settlements," that choice of defendants has little to do with the merits, and that "class actions built on the fraud-on-the-market presumption have brought neither protection for investors nor meaningful deterrence" given that it just results in money being passed from one set of shareholders to another. The "voice of the defense bar" takes the relatively moderate position that "because price impact is central to the justification for the Basic presumption, defendants should be able to use it to sever the link between the alleged misrepresentation and the stock price at the class certification stage."

The most extreme position is taken by the former SEC Commissioner and Law Professor brief, which argues that – as the private cause of action under Section 10(b) is implied, statutory rules of construct require that it be given narrow dimensions and follow the most similar provision in the Exchange Act, which they argue is Section 18(a) of the Exchange Act which requires plaintiffs, to obtain damages, to show that they "'transacted in reliance upon such [false or misleading] statement', actual 'eyeball reliance,'" This requirement, that the plaintiff show that they "actually read and relied on the filed

[4] A position that the Second and Third Circuit used to follow, it is unclear if they continue to do so post-*Amgen*.

document" would raise an individualized issue that would destroy the possibility of Exchange Act class actions in most circumstances.

Plaintiffs' opposition brief points out that the SEC and DOJ have never challenged *Basic*, that Congress explicitly chose not to modify or overturn *Basic* when it passed the PSLRA, that the economic theory behind *Basic* is still sound, that even the academics cited by Defendants do not advocate for the modification or reconsideration of *Basic*, and that *Basic* was decided based not on economic theory alone, but on the purpose of the 1934 Act.

Possibilities

Based on the above, there are five major possibilities for what the Supreme Court will decide in *Halliburton*.

Potential Supreme Court Decision in *Halliburton II*
Retain *Basic* in its current form and rule that price impact cannot be challenged at the certification stage
Retain *Basic* in its current form and rule that price impact can be challenged at the certification stage
Modify *Basic* so that a plaintiff must prove that the market absorbed, and reacted to, the misstatement or omission at issue (as opposed to the market for a stock being efficient in general) to get the benefit of fraud on the market
Eliminate *Basic* and adopt "actual eyeball reliance" requirement for 10(b)-5
Fail to reach either issue due to Halliburton's failure to raise argument earlier in the case, dismiss appeal on procedural grounds.

Conclusion

In light of the potential widespread impact of *Halliburton II*, Cohen Milstein is factoring in these possible results in its current litigation and in our advice to clients regarding potential matters. Please do not hesitate to contact us with any questions.