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Basic* Likely to Survive *Halliburton II

On March 52014, the U.S. Supreme Court heard oral arguments in *Halliburton v. Erica P. John Fund*, 13-317 ("*Halliburton II*"), a securities class action case that has the potential to severely restrict investors' ability to utilize the class action mechanism. As we discussed in a previous Special Alert, the issue in *Halliburton II* is the continued viability of the fraud-on-the-market-presumption recognized by the Supreme Court in *Basic v. Levinson*. 485 U.S. 224 (1988). As you may recall, under the fraud-on-the-market presumption "most publicly available information is reflected in market price, [therefore] an investor's reliance on any public material misrepresentations . . . may be presumed for purposes of a Rule 10b-5 action." *Id.* at 247. This presumption is crucial to class actions. Without it, each individual investor in the class would have to demonstrate the he or she directly relied on the alleged misstatements when deciding to purchase or sell stock, giving Defendants near *carte blanche* to defeat class certification on the grounds that individual issues predominate.

Background and Oral Argument

When the Supreme Court granted *certiorari* in *Halliburton II* commentators and practitioners speculated that this case had the potential to significantly alter the securities class action landscape and could potentially be a death knell for securities fraud class actions. This speculation was fueled in part by the fact that four Justices previously called into question the underpinnings of the fraud-on-the-market theory in *Amgen Inc. v. Conn. Ret. Plans & Trust Fund*, with Justice Alito noting in his concurrence that the presumption rests on a "faulty economic premise" and Justice Thomas dissenting, joined by Justices Scalia and Kennedy, calling the *Basic* decision "questionable." 133 S. Ct. 1184 at 1204, 1209 n. 4 (2013)

By the oral argument in *Halliburton II*, however, Justices Anthony Kennedy and Antonin Scalia seemed to have tempered their positions, with both signaling an interest in adopting a position found in an amicus brief submitted by two law professors. Justice Kennedy referred to this position as the "midway position," and Justice Scalia termed it "Basic writ small." While the position would not overrule *Basic*, it would impose an additional hurdle on plaintiffs by requiring them to prepare an event study demonstrating price impact (i.e., that a specific misrepresentation actually affected the stock price) at the class certification stage. Chief Justice Roberts, who many believe will be the deciding vote in this case, also appeared to support a position that would fall short of overruling *Basic*, as he expressed reluctance to get entangled with the merits of the economic theories underlying the fraud-on-the-market presumption.

Justice Sotomayor was not as receptive of the "midway position," however, bluntly stating "I don't see how this is a midpoint." She continued: "If you're going to require proof of price impact, why not do

away with market efficiency?" She equated requiring proof of price impact at the class certification stage with a "full-blown merits hearing." Even those Justices who appear to support the midway position had questions about the amount of labor and expense that would go into price impact event studies with Chief Justice Roberts noting "So I would think the event study [at issue here] would be a lot more difficult and laborious to demonstrate than market efficiency in a typical case." Justice Kennedy asked for a comparison between the "cost, the extent of time" and the "difficulty" of showing an efficient market (which plaintiffs routinely do during class certification) and the "undertaking of an event study," asking whether the "latter is much more costly, much more time-consuming?" Nevertheless, even with the acknowledged expense and resources that a price impact event study would require, Malcom Stewart, who represented the Solicitor General's Office and opposes overturning *Basic*, told Justice Kennedy that the requirement of a price impact event study at the certification stage "if anything, would be a net gain for plaintiffs, because plaintiffs already have to prove price impact at the end of the day."

The Court also seemed reluctant to overrule *Basic* given that Congress did not do so when it enacted the Private Securities Litigation Reform Act of 1995 or when it enacted Securities Litigation Uniform Standards Act of 1988. Justice Kagan remarked that Congress has had "every opportunity and has declined every opportunity to change *Basic* itself."

Predictions and Implications

Given the Justices' questioning at oral argument, we do not believe *Basic* will be overturned. Rather, our prediction is that the Court will adopt the midway position, requiring plaintiffs to submit event studies demonstrating price impact at the certification stage. While we agree with Justice Sotomayor that this position is not necessarily a midpoint, it is certainly better than a decision to overturn *Basic*. Ultimately, we believe that the class-action mechanism will remain intact for investors, but we will have to make adjustments to address the practical changes that will accompany preparing price impact event studies at class certification—including accounting for the additional costs and resources that such event studies will require. While the midpoint position imposes an additional burden on plaintiffs at the class certification stage, we have always been required to prove price impact in order to prevail on the merits, and we are therefore confident that we have the experience and expertise to successfully make this same showing at an earlier stage in the litigation.

A decision is expected in late June 2014.