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The Pension Fund Perspective on Halliburton II: An Important Decision for Investors, but Not a Game Changer

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After intense discussion about the potential of the U.S. Supreme Court's decision in *Halliburton Co. v. Erica P. John Fund, Inc.* ("*Halliburton II*")[1] to end securities class actions, the opinion rendered on June 23, 2014, turned out to be something of a disappointment for the defense bar. At best, it may give defendants a useful tool in a limited number of cases, but, for those pension fund investors bringing well-litigated, meritorious claims, the decision serves mostly as a reminder for their attorneys to continue following the same best practices that leading plaintiffs' firms have been employing for years.

Background Before the Court in *Halliburton II* was a petition to overturn the fraud-on-the-market presumption created twenty-six years ago in *Basic v. Levinson*.[2] Under the fraud-on-the-market presumption, publicly available information is assumed to be reflected in the market price of a stock, and, in turn, investors are assumed to rely on that price's integrity as they make decisions about whether to buy or sell shares in the stock. This presumption eases the burden on investors, who need not show actual reliance on a defendant's misrepresentations—an essential element of a securities fraud claim—when bringing suits for securities fraud. Without the presumption, investors would need to demonstrate actual reliance on each of the allegedly false statements made by the defendants.[3] This is generally a significant hurdle for any investor, as few actually have the time, inclination, or skill to read and review all of the public information issued by a given company, before an investment is made.

Indeed, the fraud-on-the-market presumption is especially important to pension funds because it would be completely unrealistic and unfair to expect that pension funds—which often have hundreds of investments in their portfolios—could, or even should, themselves, review each public statement made by an issuer before making an investment.

Even if there were some mechanism for pension funds to be able to demonstrate actual reliance, overturning *Basic* would still have enormous adverse consequences for pension funds. This is so because the fraud-on-the-market presumption is essential to the ability of investors to bring and participate in cases on a class action basis. Securities fraud cases are complex and expensive, and frequently take years to litigate. For most investors—even large pension funds—losses in any one investment due to alleged fraud are often too small to justify individual litigation. Instead, class actions, brought on a contingent fee basis, provide an economically rational opportunity for pension funds to either act as lead plaintiffs or recover as non-participating mem-

[1] 134 S. Ct. 2398, 2014 BL 172975 (2014)(126 PBD, 7/1/14; 41 BPR 1413, 7/8/14).

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[2] 485 U.S. 224, 245-47 (1988).
[3] *Halliburton II*, 134 S. Ct. at 2407.

bers of the class. Without use of the *Basic* presumption, however, each investor would be required to individually demonstrate reliance on defendants' false statements.[4] Because this individual issue would predominate over common issues, courts would be unable to certify investor classes.[5] If *Basic* were reversed, pension funds would thus be—in many cases—effectively without any federal securities law remedy. For these reasons, the decision in *Halliburton II* was closely watched by the pension fund community, various members of which weighed in with important *amicus* briefs.[6]

The Much-Awaited Decision

Encouraged by the dissents of Justices Clarence Thomas, Antonin Scalia, Samuel Alito and Anthony Kennedy in the *Amgen* case[7] decided last term, Halliburton argued that *Basic* should be overturned,[8] but its argument was flatly rejected by the Court.[9] Reaffirming the vitality of *Basic*, the Court made clear that the presumption relies only on ''the fairly modest premise that market professionals generally consider most publicly announced material statements about companies, thereby affecting stock market prices.''[10] Thus, Halliburton's arguments about the controversial nature of the efficient capital markets hypothesis were ''largely beside the point.''[11] The fact that the price of a stock ''may be inaccurate does not detract from the fact that false statements affect it, and cause loss, which is all that *Basic* requires.''[12]

The opinion did offer a small consolation prize to the defense bar, though. Overturning the Fifth Circuit, the Court put into place a procedure that was already precedent in the Second and Third Circuits: defendants may now challenge price impact at class certification.[13] While it remains to be seen what burden district courts will impose on defendants that attempt such a rebuttal, it is clear that the burden still falls on the defendant to demonstrate the absence of price impact. For attorneys representing pension fund investors in the Second and Third Circuits, the decision changes nothing. For those practicing in other circuits, it is simply a reminder to continue following best practices in pleading and litigating securities class actions. In the view of Justice Ruth Bader Ginsburg, at least, this rebuttal process is not intended to create a significant obstacle for investors seeking class certification. Indeed, Ginsburg made clear in her concurring opinion that the Court's ruling ''should impose no heavy toll on securities-fraud plaintiffs with tenable claims.''[14]

A Reminder to Keep Following Best Practices

From the pension fund investor perspective, the decision is unlikely to change much in what is considered ''best practices'' in preparing for and litigating the class certification motion. As a practical matter, counsel for securities-fraud plaintiffs already routinely develop the type of event study evidence necessary to show price impact, because it is needed to make an affirmative showing of market efficiency. Thus, as before *Halliburton II*, pension fund investors will likely continue to submit event studies in connection with motions for class certification to show how a stock's price responds to information in the market, including the false statement and its eventual disclosure. Investors should continue to ensure their experts are prepared to disaggregate confounding factors from the impact of a false statement on a stock's price and to explain exactly how the false statement affected the stock's price.[15] Although a defendant's attempted rebuttal may force pen-

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[4] *Id.* at 2407-08.

[5] *Id.* at 2408.

[6] Brief of *Amici Curiae* of the Council of Institutional Investors *et al.* in Support of Respondent, *Halliburton Co. v. Erica P. John Fund*, 134 S. Ct. 2398, 2014 BL 172975 (2014)(126 PBD, 7/1/14; 41 BPR 1413, 7/8/14) (No. 13-317), Brief of *Amici Curiae* Institutional Investors Supporting Respondent, *Halliburton Co. v. Erica P. John Fund*, 134 S. Ct. 2398, 2014 BL 172975 (2014)(126 PBD, 7/1/14; 41 BPR 1413, 7/8/14) (No. 13-317), Brief of *Amici Curiae* States of Oregon, Connecticut, Pennsylvania, Washington, Arkansas, Hawaii, Idaho, Illinois, Indiana, Iowa, Kentucky, Maine, Mississippi, Missouri, New Mexico, New York, North Carolina, North Dakota, Rhode Island, Tennessee, Vermont, and Territory of Guam Supporting Respondent, *Halliburton Co. v. Erica P. John Fund*, 134 S. Ct. 2398, 2014 BL 172975 (2014)(126 PBD, 7/1/14; 41 BPR 1413, 7/8/14) (No. 13-317).

[7] *See Amgen Inc. v. Connecticut Ret. Plans & Trust Funds*, 133 S. Ct. 1184, 1204, 2013 BL 51223 (2013) (Alito, J., concurring) (joining the Court only on the understanding that ''the petitioners did not ask us to revisit *Basic*'s fraud-on-the-market presumption,'' and noting his opinion that ''more recent evidence suggests that the presumption may rest on a faulty economic premise''); *id.* at 1206 (Scalia, J., dissenting) (''Today's holding . . . expands [the] consequences [of *Basic*] from the arguably regrettable to the unquestionably disastrous.''); *id.* at 1208 n.4 (Thomas, J., dissenting) (''The *Basic* decision itself is questionable.''). Justice Kennedy joined in Justice Thomas's dissent.

[8] *Halliburton II*, 134 S. Ct. at 2408-13; *see also id.* at 2418 (Thomas, J., concurring).

[9] *Id.* at 2408-13 (Roberts, C.J.).

[10] *Id.* at 2410 (internal quotation marks omitted).

[11] *See id.* at 2410 (''Debates about the precise *degree* to which stock prices accurately reflect public information are thus largely beside the point.'').

[12] *Id.* (internal quotation marks omitted).

[13] *Id.* at 2414-16; *see also, e.g., In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474, 484, 2008 BL 219378 (2d Cir. 2008) (''defendants are allowed to rebut the presumption, prior to class certification, by showing, for example, the absence of a price impact''); *In re DVI, Inc. Sec. Litig.*, 639 F.3d 623, 638, 2011 BL 82497 (3d Cir. Pa. 2011) (''[W]e agree with the Second Circuit that a defendant's successful rebuttal demonstrating that misleading material statements or corrective disclosures did not affect the market price of the security defeats the presumption of reliance for the entire class, thereby defeating the Rule 23(b) predominance requirement.''). Some district courts in other circuits were beginning to follow suit as well. *See, e.g., In re HealthSouth Corp. Sec. Litig.*, 257 F.R.D. 260, 282 (N.D. Ala. 2009) (following *Salomon*).

[14] *Halliburton II*, 134 S. Ct. at 2417 (Ginsburg, J., concurring).

[15] *George v. China Auto. Sys., Inc.*, No. 11 Civ. 7533 KBF, 2013 BL 178237 (S.D.N.Y. July 3, 2013) (''As courts have noted, event studies are the most reliable way of demonstrating market efficiency.''); *Wagner v. Barrick Gold Corp.*, 251 F.R.D. 112, 120 (S.D.N.Y. 2008) (noting that numerous courts have held that an event study is a reliable method for determining market efficiency); *see also Bricklayers & Trowel Trades Int'l Pension Fund v. Credit Suisse Sec. (USA) LLC*, 752 F.3d 82, 89, 2014 BL 134565 (1st Cir. 2014) (noting at summary judgment, in the context of loss causation, that the ''purpose of an event study, . . ., is to isolate the impact of an alleged misstatement, omission, or disclosure on the stock price''). *But see In re Computer Scis. Corp. Sec. Litig.*, 288 F.R.D. 112, 120, 2012 BL 344047 (E.D. Va. 2012) (holding that while event stud-

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sion fund plaintiffs to argue the additional element of price impact, the necessary evidence will likely already be present in these studies.

Likewise, as has always been the case, plaintiffs should take care in their selection of which statements they choose to allege are actionable and plead those statements along with clear allegations of price and volume impact for each. In a post-*Halliburton II* world, there can be little doubt that each and every statement alleged to be false and misleading will be scrutinized by defense counsel and their experts to determine whether the statement had an impact on the stock price of the issuer. Even if defendants are not successful in eliminating all statements alleged to be false and misleading, success on only a few could significantly alter the scope of the case and materially reduce the recoverable damages for investors.

Moreover, counsel for pension fund investors should also consider the practical case management and case planning implications of *Halliburton*. In particular, sufficient time should be allocated for briefing and discovery on the class certification motion in order to accommodate litigation over whether defendants have been able to demonstrate the absence of price impact with regard to some or all of the statements alleged to have been false or misleading. It is likely that *Halliburton II* will not only make the class certification process more expensive and expand the role of experts, but that it also will make the process more time-consuming. Not only can these issues be expected to be raised on the motion for class certification, but investors' attorneys should be prepared for partial summary judgment motions with respect to price impact, even beyond the class certification stage as the record in the case continues to develop. Although none of this represents a dramatic change in the process by which securities class actions are generally litigated, the landscape will likely change some. Nevertheless, what were always best practices continue to be so. The *Basic* presumption of reliance still exists, the burden remains on defendants to overcome it, and pension fund investors should continue to hold defendants to this burden.

Best Practices for Litigating Securities Class Actions

- Ensure your experts are prepared to disaggregate confounding factors from the impact of a false statement on a stock's price.
- Take care in your selection of which statements you choose to allege are actionable.
- Plead those statements along with clear allegations of price and volume impact for each.
- Allocate sufficient time for briefing and discovery on the class certification motion in order to accommodate litigation over whether defendants have been able to demonstrate an absence of price impact.
- Be prepared for partial summary judgment motions with respect to price impact.

What Defendants Will Make of the Decision

Though the decision in *Halliburton* was a far cry from what the defense side had hoped for, it certainly provides fodder for arguments in opposition to class certification motions. While there has been insufficient time to develop a litigation record of how the defense side will react, all indications are that the contours of the case will be tested by defense counsel. Indeed, major defense firms have quickly posted their thoughts as to strategies to implement *Halliburton II* to oppose class certification.

For example, it is likely that one of the defense bar's initial responses to *Halliburton II* will be to argue that it created open questions about the burden defendants bear when attempting to rebut the presumption of reliance.[16] In particular, defendants may argue for a bright line rule that the mere absence of a price increase at the time of the false statement necessarily disproves price impact, even when the stock price did decline after the fraud was ultimately disclosed.[17] On its face, this argument seems simple: no movement, no impact. This, however, ignores the possibility that, but for the allegedly false information, the stock price would have been trading at a lower price, and so, under this formulation, defendants would not be meeting their burden of proving that the alleged false statement had no impact whatsoever on the stock price. For this reason, this theory has already been rejected by courts pre-*Halliburton II*.[18]

ies may be helpful for proving market efficiency, they are not strictly necessary).

[16] *See, e.g., Supreme Court's Halliburton Decision Opens New Line of Defense*, LATHAM & WATKINS (July 7, 2014), http://documents.jdsupra.com/73c1c5a3-8e3f-46b3-b0da-9d17d95431dc.pdf (''The district courts will have to resolve conflicting event studies and expert opinions, with plaintiffs and defendants arguing over the proper burden defendants should bear to rebut the presumption of reliance.''); *Halliburton Ruling: High Court Affirms ''Basic v. Levinson'' and Confirms Defendants May Rebut Reliance Presumption at Class Certification by Showing Absence of Price Impact*, KING & SPALDING (June 24, 2014), http://www.kslaw.com/imageserver/KSPublic/library/publication/ca062414.pdf (''[A]pplication of the newly announced doctrinal rule can be expected to spawn a host of new questions . . .'').

[17] *See, e.g., Supreme Court Declines to Overrule or Modify ''Basic,'' But Allows Rebuttal of ''Price Impact'' in Opposing Class Certification*, PAUL WEISS (June 24, 2014), http://www.paulweiss.com/practices/litigation/securities-litigation/publications/supreme-court-declines-to-overrule-or-modify-basic,-but-allows-rebuttal-of-price-impact-in-opposing-class-certification.aspx?id=18117 (''Defendants . . . may argue that an absence of price movement at the time of the alleged misstatements disproves price impact in many cases, notwithstanding a price decline at the time of corrective disclosure.'').

[18] *See In re HealthSouth Corp. Sec. Litig.*, 257 F.R.D. 260, 282 (N.D. Ala. 2009) (''UBS contends that it has demonstrated the absence of a price impact, thus rebutting the presumption. . . . However, . . . [t]he court finds that the mere absence of a statistically significant increase in the share price in response to fraudulent information does not sever the link between the material misstatements and the price of the stock. Rather, price stability may just as likely demonstrate the market consequence of fraud where the alleged fraudulent statement conveys that the company has met market expectations, when in fact it has not.'' (internal quotation marks omitted)); *see also City of Livonia Employees' Ret. Sys. v. Wyeth*, 284 F.R.D. 173,

A false statement that artificially maintains a price at inflated levels has an impact no less significant than one that artificially moves the price upwards.[19]

Similarly, defendants may argue that *Halliburton II* left open the question of whether or not they can challenge the second *Basic* premise—that most investors in a given security ''will rely on the security's market price as an unbiased assessment of the security's value in light of all public information.''[20] The *Halliburton* Court made clear that the *Basic* presumption rests both on this assumption and the assumption of price impact.[21] If price impact can be rebutted, so, too, defendants may infer, can reliance upon the price be rebutted. However, the Court's rejection of Halliburton's value-trader hypothetical,[22] and its emphasis on the ''modest'' requirements to invoke *Basic*,[23] makes clear that any investor trading in the market in hopes of turning a profit relies sufficiently on a stock price's integrity for the *Basic* presumption to apply. Even value investors, who presume the market got it wrong, still care how the market priced a stock when deciding to invest in it.[24] While the Court's second premise provides important logical support for the presumption, pension fund investors should have little difficulty satisfying it in practice.

Finally, Defendants may try to argue that even *Halliburton II*'s majority conceded the efficient capital markets hypothesis is no longer dogmatically accepted, and they may try to use the majority's dicta to bolster their arguments against a plaintiff's showing of market efficiency.[25] In particular, defendants may assert that plaintiffs now bear a higher burden in establishing an efficient market in order to certify a class.[26] Market efficiency, however, is proven by reference to a set of widely accepted factors that go directly to the responsiveness of the given market, and do not depend on a broad hypothesis about how markets work in general. The factors most often used are:

- the average weekly trading volume;
- the number of analysts following the stock;
- whether there were numerous market makers for the stock;
- whether the company was entitled to file a registration statement on Form S-3, or, whether its ineligibility to do so was due only to timing factors; and
- whether immediate impacts on the stock's price from unexpected corporate events or financial releases can be demonstrated. [27] These factors are well-established, and, most importantly, were not rejected by the Supreme Court in *Halliburton II* despite the clear invitation and opportunity to do so. Accordingly, there is no reason to expect courts to abandon these long-standing measurements of market efficiency now. As the *Halliburton II* majority makes clear, it does not take anything akin to ''strong'' market efficiency for the *Basic* presumption to apply.[28]

Important, but Not a Game Changer

While *Halliburton II* did not live up to its potential to radically change the way securities class actions are litigated, it nonetheless presents potential challenges to pension fund investors and their counsel. Until district courts have a chance to flesh out the contours of *Halliburton II* with some case law of their own, attorneys for investors should be ready to litigate the issue of what burden defendants bear, and how they may go about meeting that burden when they attempt to rebut price impact.

182, 2012 BL 242529 (S.D.N.Y. 2012) (noting that ''many 'courts have suggested that a misstatement may cause inflation simply by maintaining existing market expectations, even if it does not actually cause the inflation in the stock price to increase on the day the statement is made' '' (quoting *In re Vivendi Universal, S.A. Sec. Litig.*, 765 F. Supp. 2d 512, 561 (S.D.N.Y. 2011)).

[19] *See, e.g., In re Vivendi Universal, S.A. Sec. Litig.*, 765 F. Supp. 2d 512, 561-62 (S.D.N.Y. 2011) (holding that ''a statement can cause inflation by causing the stock price to be artificially maintained at a level that does not reflect its true value,'' and not just by affirmatively increasing the price).

[20] *Halliburton II*, 134 S. Ct. at 2411 (internal quotation marks omitted); *see also* PAUL WEISS, *supra* note 17 (''[D]efendants may wish to rebut *Basic*'s second 'constituent premise'—*i.e.*, that 'most investors' in a given security relied on price integrity.'').

[21] *Halliburton II*, 134 S. Ct. at 2414 (''What is called the *Basic* presumption actually incorporates two constituent presumptions: First, if a plaintiff shows that the defendant's misrepresentation was public and material and that the stock traded in a generally efficient market, he is entitled to a presumption that the misrepresentation affected the stock price. Second, if the plaintiff also shows that he purchased the stock at the market price during the relevant period, he is entitled to a further presumption that he purchased the stock in reliance on the defendant's misrepresentation.'').

[22] *Id.* at 2411.

[23] *See id.* at 2410-11 (''To be sure, the value investor does not believe that the market price accurately reflects public information at the time he transacts. But to indirectly rely on a misstatement in the sense relevant for the *Basic* presumption, he need only trade stock based on the belief that the market price will incorporate public information within a reasonable period. The value investor also presumably tries to estimate *how* undervalued or overvalued a particular stock is, and such estimates can be skewed by a market price tainted by fraud.'' (internal quotation marks and citations omitted)).

[24] *Id.* at 2411.

[25] *Supreme Court Modifies Class Certification Procedure in Securities Fraud Class Actions*, GREENBERG TRAURIG (June 25, 2014), http://www.gtlaw.com/News-Events/Publications/Alerts/176987/Supreme-Court-Modifies-Class-Certification-Procedure-in-Securities-Fraud-Class-Actions (''[B]oth the Court's opinion and Justice Thomas' concurring opinion discuss the current state of [the] market efficiency theory which . . . now recognizes that even generally efficient markets can be inefficient at certain times and the market for a specific company's stock can be inefficient for a variety of reasons.'').

[26] *See id.* (''Where the evidence warrants, defendants should use these arguments at the class certification stage to (i) argue that plaintiffs now bear a higher burden in establishing an efficient market, and (ii) to oppose class certification to refute plaintiff's claim that the company's stock was efficient during the relevant time frame.'').

[27] *E.g., Cammer v. Bloom*, 711 F. Supp. 1264, 1285-87 (D.N.J. 1989).

[28] *Halliburton II*, 134 S. Ct. at 2409-11; *see id.* at 2410 (''Debates about the precise *degree* to which stock prices accurately reflect public information are . . . largely beside the point. 'That the . . . price [of a stock] may be inaccurate does not detract from the fact that false statements affect it, and cause loss,' which is 'all that *Basic* requires.' '' (quoting *Schleicher v. Wendt*, 618 F. 3d 679, 685, 2010 BL 193632 (7th Cir. 2010) (Easterbrook, C. J.) (alterations in original)).

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Overall, however, very little is likely to change in how pension fund investors will litigate securities cases. Investors will continue to plead and develop the same type of evidence that they have for years, in order to show that a defendant's fraud was the cause of their losses. A meritorious claim that is properly susceptible to class action treatment will still remain so in the wake of *Halliburton II*, provided that investors' counsel continue to follow the same best practices that have been successful in the past.