In a highly anticipated decision issued June 23, 2014, the Supreme Court in *Halliburton Co. v. Erica P. John Fund, Inc.*, No. 13-317 (June 23, 2014), declined an invitation to overrule the "fraud-on-the-market" presumption — a result that would have sounded the death knell for most securities class actions. Nonetheless, the Court opened the door for defendants to rebut the presumption at the class certification phase, and thereby offers a new weapon for disposing of some class actions before companies are forced to incur the substantial costs of full-blown merits discovery.

The Reliance Requirement In Securities Class Actions

Halliburton pivots on the interplay between the requirements for class certification and the substantive elements of a Section 10(b) claim — and, in particular, the element of reliance. To certify a class action, a plaintiff must establish (among other things) that "the questions of law or fact common to class members predominate over any questions affecting only individual members." Fed. R. Civ. P. 23(b)(3). Thus, to certify a class, a plaintiff must show that common questions of reliance predominate over individual issues.

To show direct reliance, a plaintiff must establish that it was aware of a defendant's statement and relied on it in purchasing or selling a security. Applied strictly, the reliance element would present enormous challenges to shareholders seeking to show that common issues predominate over individual ones: after all, direct reliance is almost always an inherently individualized inquiry. In *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), the Supreme Court endorsed an "indirect" method of establishing reliance through the fraud-on-the-market presumption. That doctrine is based on the premise that "the market price of shares traded on well-developed markets reflects all publicly available information, and, hence, any material misrepresentations," (*Basic*, 485 U.S. at 246), and allows courts to "presume that investors trading in efficient markets indirectly rely on public, material misrepresentations through their 'reliance on the integrity of the price set by the market.'" *Amgen Inc. v. Connecticut Ret. Plans & Trust Funds*, 133 S. Ct. 1184, 1192-93 (2013) (quoting *Basic*, 485 U.S. at 245). By virtue of this "indirect" method, plaintiffs have generally been able to obtain class certification, which is viewed by the plaintiffs' bar as almost automatic in securities class actions.

Since *Basic*, many commentators have called into question the continuing viability of the fraud-on-the-market presumption. That criticism reached a new level last year, when Justices Alito and Thomas (concurring and dissenting, respectively, in *Amgen*) suggested that the Court might consider jettisoning the doctrine altogether. That is precisely what the defendants in *Halliburton* asked the Court to do.

The Issues Raised In Halliburton

In *Halliburton*, the Erica P. John Fund, Inc. ("plaintiff") brought a securities class action alleging that, by misrepresenting potential liabilities in asbestos litigation, expected revenue from certain construction contracts, and anticipated benefits from a merger with another company, defendants violated Section 10(b) of the Securities Exchange Act of 1934. Halliburton contended that the class should not be certified because the evidence it introduced showed that the alleged misrepresentations had not affected the stock price — *i.e.*, the statements did not cause "price impact." The absence of any price impact, Halliburton argued, served to rebut the *Basic* presumption of reliance. And, without the presumption of reliance, plaintiffs would have to prove individualized reliance, thereby precluding class certification. The District Court, however, declined to consider the evidence that Halliburton proffered on this point, and certified the class. The Fifth Circuit affirmed.

The Supreme Court granted certiorari to consider two issues: (1) whether it should overrule or substantially modify *Basic*'s fraud-on-the-market presumption of reliance; and (2) if not, whether 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.

The Disappointing News: The Fraud-On-The-Market Presumption Survives

Although *Amgen* raised the tantalizing specter of the demise of the fraud-on-the-market theory, only three members of the Court (Justices Alito, Scalia and Thomas) expressed the view that *Basic* should be overturned. The majority made clear that the fraud-on-the-market presumption is here to stay — until and unless Congress wants to change it.

In making the argument that *Basic* should be overturned, Halliburton argued (among other things) that the case rested on an economic principle that could no longer survive judicial scrutiny. Pointing to *Basic*'s premise that "the market price of shares traded on well-developed markets reflects all publicly available information, and, hence, any material misrepresentations," Halliburton asserted that *Basic* relied on a "robust view of market efficiency" that was no longer supportable. According to Halliburton, empirical data now showed that markets were not fundamentally efficient. The Court, however, was not persuaded. It noted that *Basic* itself acknowledged the debate among economists as to market efficiency and declined to "conclusively…adopt any particular theory of how quickly and completely publicly available information is reflected in the market price." Instead, *Basic* rested "on the fairly modest premise that 'market professionals generally consider most publicly announced material statements about companies, thereby affecting stock market prices.'" Moreover, the *Basic* presumption "recognized that market efficiency is a matter of degree and accordingly made it a matter of proof," allowing defendants to rebut the presumption of reliance.

The Good News: Defendants May Rebut The Fraud-On-The-Market Presumption At The Class Certification Stage With Evidence Of Lack Of Price Impact

While it permitted the fraud-on-the-market presumption to survive, *Halliburton* makes clear that defendants may try to rebut the presumption at the class certification stage with evidence that the alleged misstatements did not impact the company's stock price. Many lower courts (some relying on *Amgen*) had refused to consider the issue on class certification, holding that efforts by defendants to rebut the presumption with evidence of a lack of price impact were only proper later, at the merits stage (in other words, after extensive discovery had commenced or been substantially completed). The Supreme Court held that this "restriction" on defendants' ability to rebut the presumption at an earlier phase "makes no sense" and invites "bizarre results." Because price impact is an "essential precondition" for any class action under Section 10(b) and Rule 10b-5, the Court held that that it would hardly be fair to allow plaintiffs to introduce evidence of market efficiency as a proxy for price impact in order to invoke the fraud-on-the-market presumption, while ignoring defendant's "direct, more salient evidence showing that the alleged misrepresentation did not actually affect the stock's market price and, consequently, that the *Basic* presumption does not apply."

What The Decision Means For Securities Class Actions

In the run-up to the *Halliburton* decision, the securities bar faced the possibility — albeit an unlikely one — that the Supreme Court would overturn *Basic*, thereby depriving shareholders of the fraud-on-the-market presumption of reliance, eviscerating class action litigation under Section 10(b) and Rule 10b-5, and changing the face of securities litigation as we know it. Although that scenario did not come to pass, at the end of the day, the defense bar did win a significant victory in *Halliburton*. In holding that defendants may rebut the fraud-on-the-market presumption at the class certification stage with evidence of lack of any such price impact, the Court gave defendants a potentially lethal weapon to combat securities class actions, at least in those cases where price impact is a serious issue.

In addition, the Supreme Court provided a much-needed reminder that the fraud-on-the-market presumption is rebuttable. Over the years, some lower courts seemed to have lost sight of that principle — a point made by Justice Thomas in his concurrence. Not only does *Halliburton* correct that misperception, but it gives defendants another potential basis for disposing of a case relatively early, even if a motion to dismiss is denied. Indeed, there are a number of cases where defendants will be able to provide compelling evidence that the alleged misstatements underlying plaintiffs' claims did not

have an impact on the stock price. Under *Halliburton*, a district court must now consider that evidence at the class certification stage — and if defendants are able to prevail, the case may effectively be resolved before the full costs of merits discovery are incurred.

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