HALLIBURTON II: SUPREME COURT CLARIFIES LONGSTANDING SECURITIES FRAUD CLASS CERTIFICATION ISSUE

Roger B. Greenberg and Zach Wolfe*

In its eagerly anticipated opinion in *Halliburton Co. v. Erica P. John Fund, Inc.* ("*Halliburton II*"), the U.S. Supreme Court rejected Halliburton's invitation to severely limit securities fraud class actions by overruling the "fraud on the market" presumption of reliance established by *Basic Inc. v. Levinson*[1], but the Court agreed with Halliburton that defendants should be allowed to defeat class certification by showing a lack of "price impact" at the class certification stage of the litigation.[2] So what would be the appropriate headline for a story announcing the decision in *Halliburton II*? "Supreme Court Keeps Securities Fraud Class Actions Alive" or "Supreme Court Gives Corporations A New Way to Defeat Securities Fraud Class Actions"? Both descriptions are accurate, so the difference depends on one's perspective and expectations. Securities fraud litigators, fearing the possible elimination of their practice area, must have breathed collective sighs of relief. Conversely, for public companies hoping the Court would end securities fraud class actions, the outcome of *Halliburton II* was a disappointment, but the case does give corporations facing such lawsuits a clear weapon in their arsenals.

I. THE *BASIC* PRESUMPTION OF RELIANCE IN SECURITIES FRAUD CLASS ACTIONS

So what is the *Basic* presumption and why is the presumption essential to securities fraud class actions? The answer has to do with the "reliance" element of a typical federal securities fraud claim and the "predominance" requirement of Rule 23 of the Federal Rules of Civil Procedure. The Supreme Court has long recognized an implied private cause of action under Section 10(b) of the Securities Exchange Act of 1934, as implemented by the SEC's Rule 10b-5 (a "10b-5 claim").[3] One of the elements of a 10b-5 claim is that the plaintiff relied on the defendant's misrepresentation or omission in deciding to buy or sell securities. This can be simple enough for individual plaintiffs to prove, but the reliance element becomes problematic in a class action. Rule 23(b)(3) allows class actions where "common questions" of law or fact "predominate" over individual questions. If every member of a proposed class had to prove direct reliance on a misrepresentation, this "predominance" requirement would not be met, and

---

* Roger B. Greenberg is a Partner at Schwartz Junell Greenberg & Oathout, LLP in Houston Texas. Zach Wolfe is a Partner at Zach Wolfe Law Firm, PLLC in Houston, Texas.

[1] 485 U.S. 224 (1988).

[2] Halliburton Co. v. Erica P. John Fund, Inc., 134 S.Ct. 2398, 2417 (2014); Basic Inc. v. Levinson, 485 U.S. 224 (1988).

[3] 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5; *see Halliburton II*, 134 S.Ct. at 2407.

the case could not proceed as a class action.[4] Thus, the reliance element of a 10b-5 claim would make a 10b-5 class action virtually impossible.

Enter the *Basic* presumption of reliance. *Basic* held that securities fraud plaintiffs could invoke a rebuttable presumption of reliance, rather than proving "direct" reliance on a misrepresentation. The presumption was based on the "fraud-on-the-market" theory, which says that "the market price of shares traded on well-developed markets reflects all publicly available information, and, hence, any material misrepresentations." In a sense, it is a two-part presumption: first, the market as a whole is presumed to have "relied" on the misrepresentation, and second, the individual investor is presumed to rely on the integrity of the market. To invoke the presumption, a plaintiff must show that (1) the misrepresentation was public, (2) the misrepresentation was material, (3) the stock traded in an "efficient" market, and (4) the plaintiff traded the stock between the time of the misrepresentation and when the truth was revealed.[5] By making this showing, a plaintiff can invoke the presumption as a ground for class certification without offering evidence of direct reliance by individual investors.

However, from the start the *Basic* presumption was supposed to be rebuttable, not conclusive. *Basic* stated that "[a]ny showing that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff, or his decision to trade at a fair market price, will be sufficient to rebut the presumption of reliance." If the defendant rebuts the presumption, the plaintiff then has to prove direct reliance on the defendant's misrepresentation. But the question *Basic* left unanswered was *when* the defendant could rebut the presumption. Over 25 years later, the Supreme Court has now clarified that issue.

II. A SHORT HISTORY OF SECURITIES FRAUD CLASS ACTIONS FROM *BASIC* TO *HALLIBURTON II*

Depending on one's point of view, the *Basic* presumption either established an essential tool for investors to vindicate their rights and protect the integrity of U.S. securities markets, or it opened the floodgates to a wave of abusive class actions that force U.S. companies to pay extortionate settlements any time there is a significant dip in their stock prices. But one thing is clear. The *Basic* presumption created a whole new area of litigation and made securities fraud class actions a fact of life for large U.S. companies.

So what happened in the years between *Basic* and *Halliburton II* that led to Halliburton urging the Supreme Court to overrule *Basic*? Here is a short chronology that will help to place the *Halliburton II* case in context:

---

[4] *Halliburton II*, 134 S.Ct. at 2408.

[5] *See Halliburton II*, 134 S.Ct. at 2408 (discussing *Basic*).

1988: The Supreme Court established the fraud-on-the-market presumption for securities fraud class actions in *Basic Inc. v. Levinson*.

1995: Congress enacted the Private Securities Litigation Reform Act ("PSLRA") to curb perceived abuses of private securities fraud litigation. The PSLRA included heightened pleading requirements, a safe harbor for forward-looking statements, a stay of discovery pending resolution of a motion to dismiss, and a requirement of proving that the misrepresentation caused the plaintiff's loss, i.e. "loss causation."

1998: In response to plaintiffs seeking to get around the PSLRA by filing state law class actions, Congress enacted the Securities Litigation Uniform Standards Act ("SLUSA"), preempting most state court securities fraud class actions.

2005: In *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336 (2005), the Supreme Court held that, to plead the essential element of loss causation, it is insufficient for the plaintiff merely to allege that the security price was inflated because of the misrepresentation.

2007: In *Oscar Private Equity Investments v. Allegiance Telecom, Inc.*, 487 F.3d 261, 269 (5th Cir. 2007), the Fifth Circuit held that a plaintiff must prove loss causation in order to obtain class certification.

2008: The district court in the *Halliburton* case applied the Fifth Circuit's "*Oscar*" rule and denied class certification because the plaintiff failed to establish loss causation.

2010: The Fifth Circuit, applying its *Oscar* decision, affirmed the district court's denial of class certification in *Halliburton*.

2011: The Supreme Court granted cert. to resolve a circuit split over the loss causation issue. In the Supreme Court, Halliburton conceded that plaintiffs should not be required to prove "loss causation" to invoke the *Basic* presumption of reliance, but defended the Fifth Circuit's judgment on the ground that plaintiff failed to prove "price impact."

2011: In *Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179 (2011) (*"Halliburton I*"), the Supreme Court reversed the Fifth Circuit. Disapproving of *Oscar*, the Court held that a plaintiff need not show loss causation at the class certification stage in order to invoke the *Basic* presumption of reliance. The Court declined to reach Halliburton's argument that it should be allowed to defeat class certification by showing lack of "price impact" at the time of the transaction,

instead remanding to the Fifth Circuit to consider that issue. The Fifth Circuit remanded the case to the district court.

2012: On remand, the district court granted class certification, implicitly rejecting Halliburton's argument that it could rebut the presumption of reliance by showing absence of price impact. The Fifth Circuit granted Halliburton leave to appeal the district court's class certification order.

2/27/13: While Halliburton's appeal was pending in the Fifth Circuit, the Supreme Court decided *Amgen, Inc. v. Connecticut Retirement Plans & Trust Funds*, 133 S.Ct. 1184 (2013), holding that plaintiffs are not required to prove materiality in order to obtain class certification. Four justices in *Amgen* expressed willingness to reconsider the validity of the *Basic* presumption of reliance. *See Amgen*, 133 S.Ct. at 1204 (Alito, J., concurring) ("more recent evidence suggests that the presumption may rest on a faulty economic premise . . . reconsideration of the *Basic* presumption may be appropriate"), and 1208 n.4 (Thomas, J., joined by Scalia and Kennedy, JJ., dissenting) ("The *Basic* decision itself is questionable . . . but the Court has not been asked to revisit *Basic*'s fraud-on-the-market presumption").

4/30/13: The Fifth Circuit affirmed the district court's class certification order, finding that allowing the defendant to show lack of price impact at the class certification stage would conflict with the rationale of *Amgen*.

5/24/13: Halliburton moved for rehearing *en banc*, reurging its argument about price impact. In addition, in light of the comments made in *Amgen*, Halliburton made the new argument that *Basic* should be overruled and its presumption of reliance discarded.

6/11/13: The Fifth Circuit denied Halliburton's motion for rehearing.

11/15/13: The Supreme Court granted the writ of certiorari in *Halliburton II*.

6/23/14: The Supreme Court issued its opinion in *Halliburton II*.

As the chronology shows, Halliburton seized an opportunity to argue for abandonment of the *Basic* presumption, as opposed to merely arguing for consideration of price impact evidence at the class certification stage. In response to four justices signaling in *Amgen* that they were willing to reconsider *Basic*, Halliburton made the bold argument that *Basic* should be overruled. This raised the stakes significantly. A case that began by raising an interesting—but not groundbreaking—issue concerning price impact turned into a case threatening the viability of securities fraud class actions generally.

Given these stakes, it was not surprising that numerous amici filed briefs in the Supreme Court on both sides of the case. The amici included the SEC, the Department of Justice, state governments, business groups, institutional investors, former members of Congress, economists, law professors, and former SEC officials.[6] In addition to raising the relatively narrow "price impact" issue, *Halliburton II* provided an opportunity for various interest groups to air their views on the wisdom, or lack thereof, of allowing securities fraud class actions at all.

III. THE MAJORITY OPINION IN *HALLIBURTON II*

Chief Justice Roberts wrote the majority opinion in *Halliburton II*, joined by Justices Kennedy, Ginsburg, Breyer, Sotomayor, and Kagan. The majority opinion declined to overrule *Basic* but ruled in Halliburton's favor on the price impact issue. Justice Ginsburg filed a short concurring opinion, joined by Justices Breyer and Sotomayor, stating her understanding that the Court's holding would do little to affect plaintiffs with tenable claims. Justice Thomas wrote a concurring opinion, joined by Justices Scalia and Alito, that reads more like a dissent. Those three justices would have overruled *Basic* entirely. Thus, in a sense, the tally was 6-3 in favor of upholding the *Basic* presumption, and 9-0 in favor of allowing defendants to refute the presumption by showing a lack of price impact at the class certification stage.

A. The Court Declines to Overrule Basic

Writing for the Court, Chief Justice Roberts first considered Halliburton's argument for overruling *Basic* and its presumption of reliance. Rather than asking whether *Basic* was correctly decided, the Court asked whether there was any "special justification" for overturning a long-settled precedent and found that Halliburton had failed to make that showing.[7]

After discussing the elements of a 10b-5 claim, the "predominance" requirement of Rule 23, and the rebuttable presumption of reliance established by *Basic*, the Court turned to Halliburton's two chief arguments that *Basic* erred by allowing securities fraud plaintiffs to invoke a presumption of reliance: (1) the presumption contravenes congressional intent; and (2) the presumption has been undermined by subsequent developments in economic theory. But the Court found that neither argument so discredited *Basic* that it provided the required "special justification" for overruling the decision.[8]

---

[6] *See* Roger B. Greenberg, Thane Tyler Sponsel III & Zachariah Wolfe, *Halliburton's Second Trip to the Supreme Court: Basic-ally the End of Securities Fraud Class Actions?*, http://texasbusinesslaw.org/ (last visited Nov. 10, 2014) for a more detailed summary of the arguments made in the amicus briefs.

[7] *Halliburton II*, 134 S.Ct. at 2407.

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

1. Congressional Intent

Halliburton argued that the *Basic* presumption was inconsistent with Congress's intent in passing the 1934 Exchange Act, which did not include an express private cause of action for a violation of Section 10(b), and that the Court should look to Section 18(a), which did create an express private cause of action and did require reliance, as the closest analog in the Act. However, the Court brushed this argument aside because the dissenting justices in *Basic* had made the same argument, the *Basic* majority did not find it persuasive then, and Halliburton provided no new reason to endorse it.[9]

2. Changes in Economic Theory

The Court gave more attention to Halliburton's second argument for overruling *Basic*, the argument that subsequent developments in economics had discredited the "efficient capital markets hypothesis" underlying *Basic*. Characterizing *Basic* as espousing a "robust view of market efficiency," Halliburton argued that "overwhelming empirical evidence" now "suggests that capital markets are not fundamentally efficient." The Court, however, noted that the academic debate cited by Halliburton was not new. The *Basic* court acknowledged that debate, the Court said, and declined to adopt any particular theory about how quickly market prices change in response to publicly available information. Instead, the Court said, *Basic* relied on the "fairly modest premise" that "market professionals generally consider most publicly announced material statements about companies, thereby affecting stock market prices." Thus, the Court found debates about the *degree* to which stock prices reflect public information to be largely beside the point, especially when even the foremost critics of the efficient capital markets hypothesis—and Halliburton—acknowledged that public information *generally* affects stock prices. Thus, the Court in *Halliburton II* found that Halliburton had not identified the kind of *fundamental* shift in economic theory that would justify overruling an established precedent.[10]

Halliburton also attacked the premise that investors rely on the integrity of the market price, identifying several types of investors who do not assume that the market price accurately reflects a stock's value. But *Basic* never denied the existence of such investors, the Court said in *Halliburton II*. Rather, *Basic* merely found it reasonable to presume that *most* investors will rely on a stock's market price as reflecting all public information. Furthermore, the Court said that even the value investor who attempts to "beat the market" implicitly relies on the fact that a stock's market price will *eventually* reflect material information.[11]

After finding that the economic arguments made by Halliburton had not fundamentally

---

[9] *Id*. at 2408-09.

[10] *Id*. at 2409-10.

[11] *Id*. at 2410-11.

undermined the modest economic premises underlying *Basic*, the Court reasoned that the principle of *stare decisis* applies with "special force" to statutory interpretation, because Congress is free to alter the Court's rulings. Given the possibility that Congress could overturn or modify the reliance requirement in 10b-5 claims, including overturning *Basic*, the Court saw no reason to "exempt" the *Basic* presumption from "ordinary principles" of *stare decisis*.[12]

3. Other Arguments for Overruling Basic

Halliburton also argued that the *Basic* presumption improperly expanded the judicially created Rule 10b-5 cause of action, that the presumption was inconsistent with the Court's subsequent decisions, and that the *Basic* presumption produces harmful consequences, but the Court disagreed.

First, the Court explained that the *Basic* presumption does not eliminate the reliance requirement but rather provides an alternative means of satisfying it. Thus, the Court disagreed with Halliburton's argument that the *Basic* presumption expands the Rule 10b-5 cause of action.[13]

Second, the Court rejected Halliburton's argument that the presumption of reliance is inconsistent with the Court's recent class action decisions in *Wal-Mart Stores, Inc. v. Dukes* and *Comcast Corp. v. Behrend*, which require plaintiffs to prove, not merely plead, that a proposed class satisfies the predominance requirement. The Court reasoned that the presumption does not relieve plaintiffs of the burden of proving reliance before class certification but instead establishes a way for plaintiffs to meet that burden.[14]

Third, the Court noted the arguments by Halliburton and several *amici* that securities fraud class actions "allow plaintiffs to extort large settlements from defendants for meritless claims," "punish innocent shareholders," "impose excessive costs on businesses," and "consume a disproportionately large share of judicial resources." However, the Court found that these concerns should be addressed to Congress, which had already responded to some extent by enacting the PSLRA in 1995 and SLUSA in 1998.[15]

B. The Court in *Halliburton II* Holds That Defendants Can Defeat Class Certification by Showing Lack of Price Impact

After declining to overrule the *Basic* presumption of reliance, the Court considered Halliburton's two proposed alternatives: (1) require plaintiffs to prove that a defendant's

---

[12] *Id*. at 2411.

[13] *Id*. at 2411-12

[14] *Id*. at 2412; Comcast Corp. v. Behrend, 133 S.Ct. 1426 (2013); Wal-Mart Stores, Inc. v. Dukes, 131 S.Ct. 2541 (2011).

[15] *Halliburton II*, 134 S.Ct. at 2413.

misrepresentation actually affected the stock price, i.e. "price impact," in order to invoke the *Basic* presumption; or (2) allow defendants to rebut the presumption of reliance at the class certification stage with evidence of a lack of price impact. The Court rejected the first alternative but adopted the second.[16]

1. Requiring Plaintiffs to Prove Price Impact

Halliburton's first argument was that plaintiffs should be required to prove price impact directly in order to invoke the *Basic* presumption, but the Court said this would "radically" alter the required showing of reliance. The Court explained that the *Basic* presumption actually incorporates two distinct presumptions. First, there is a presumption that the misrepresentation affected the stock price. Second, there is a presumption that the plaintiff purchased the stock in reliance on the defendant's misrepresentation. By requiring plaintiffs to prove price impact directly, the Court said, Halliburton's first proposal would take away the first constituent presumption. The Court rejected this proposal. "For the same reasons we declined to completely jettison the *Basic* presumption," the Court said, "we decline to effectively jettison half of it by revising the prerequisites for invoking it."[17]

2. Allowing Defendants to Show Lack of Price Impact

The Court viewed Halliburton's second alternative proposal more favorably. Halliburton argued that defendants should be allowed to rebut the *Basic* presumption at the class certification stage by offering evidence that the misrepresentation had no price impact. The Court agreed with Halliburton for two reasons.

First, the Court pointed out that defendants can already show a lack of price impact at the merits stage, and that both plaintiffs and defendants already can and do offer such evidence at the class certification stage, but for the purpose of showing market efficiency (or lack thereof). Specifically, plaintiffs offer "event studies" that seek to show that a stock's price responds to pertinent publicly reported events. The plaintiff in *Halliburton II*, for example, submitted an event study of various episodes expected to affect the price of Halliburton's stock, including one of the alleged misrepresentations forming the basis for the plaintiff's suit. What defendants may not do, the plaintiff argued, is rely on that same evidence for the purpose of rebutting the presumption to defeat class certification.[18]

The Court reasoned that this restriction on defendant's use of price impact evidence makes no sense. Under the plaintiff's approach, the same evidence offered at the class certification stage on the issue of market efficiency could also show a lack of price impact, yet the district

---

[16] *Id.*

[17] *Id.* at 2414.

[18] *Id.* at 2415-16.

court would still certify the class. While it is appropriate to allow plaintiffs to rely on the *Basic* presumption as an "indirect proxy" for price impact, the Court said," "an indirect proxy should not preclude direct evidence when such evidence is available." The Court found that the *Basic* presumption, which provides plaintiffs an indirect way to prove reliance, should not require courts to ignore a defendant's "direct, more salient evidence" showing a lack of price impact.[19]

Second, the Court reasoned that allowing defendants to defeat the presumption of reliance by showing a lack of price impact at the class certification stage was consistent with the rationale of the Court's decision in *Amgen, Inc. v. Connecticut Retirement Plans & Trust Funds*. *Amgen* held that plaintiffs are not required to prove materiality of the misrepresentation at the class certification, reasoning that materiality is an objective element of the 10b-5 claim that is common to the whole class. Plaintiff argued that the same was true of price impact.[20]

The Court disagreed, stating that price impact differs from materiality in the crucial respect that "the common issue of materiality can be left to the merits stage without risking the certification of classes in which individual issues will end up overwhelming common ones." Price impact, in contrast, is *Basic*'s "fundamental premise." It therefore "has everything to do with the issue of predominance at the class certification stage." If there is no price impact, the fraud-on-the-market theory underlying the presumption "completely collapses." Furthermore, evidence of price impact will be before the court at the class certification stage anyway, and the Court saw no reason to artificially limit the use of price impact evidence at that stage. Thus, the Court held that "Defendants may seek to defeat the *Basic* presumption at that stage through direct as well as indirect price impact evidence."[21]

IV. JUSTICE GINSBURG'S BRIEF BUT NOTABLE CONCURRING OPINION

In a very brief concurring opinion joined by Justice Breyer and Justice Sotomayor, Justice Ginsburg wrote:

> Advancing price impact consideration from the merits stage to the certification stage may broaden the scope of discovery available at certification. See Tr. of Oral Arg. 36–37. But the Court recognizes that it is incumbent upon the defendant to show the absence of price impact. See *ante,* at 2413 – 2414. The Court's judgment, therefore, should impose no heavy toll on securities-fraud plaintiffs with tenable claims. On

---

[19] *Id*. at 2415.

[20] *Halliburton II*, 134 S.Ct. at 2416-17 (discussing Amgen, Inc. v. Connecticut Retirement Plans & Trust Funds, 133 S.Ct. 1184 (2013)).

[21] *Id*. at 2416.

that understanding, I join the Court's opinion.

It seems the concurring justices were trying to accomplish two things. First, the comment about broadening the scope of discovery seemed to say to Halliburton and other defendants, "be careful what you wish for." Defendants typically seek to keep the scope of discovery as narrow as possible at the class certification stage, but if evidence concerning price impact is to be considered at the class certification stage, the scope of any discovery may include evidence relating to price impact. As discussed in section VI below, the significance of this change remains to be seen. Second, the concurring justices may have hoped to limit the impact of *Halliburton II* by characterizing its holding as not imposing any "heavy toll" on plaintiffs.

V. JUSTICE THOMAS'S CONCURRING OPINION ARGUING FOR OVERRULING *BASIC*

In his opinion concurring in the judgment, Justice Thomas, joined by Justices Scalia and Alito, argued that Basic was wrongly decided, and that *stare decisis* did not compel the Court to uphold *Basic*. He began by questioning the Rule 10-5 private cause of action itself, calling it a "relic" of days when the Supreme Court assumed common-law powers to create causes of action. Rather than interpreting a statute, Justice Thomas wrote, *Basic* went wrong by setting out to solve the policy "problem" that requiring proof of individualized reliance would bar securities fraud class actions. He criticized the Basic court for creating the presumption based on "nascent economic theory" and "naked intuitions" about investment behavior.[22]

A. In the View of Justices Thomas, Scalia, and Alito, the Basic Presumption Was a Mistake, and Time Has Compounded Its Failings.

Justice Thomas wrote that the traditional reliance requirement required a plaintiff to show he was aware of a company's statement and engaged in a transaction based on that statement. *Basic* dispensed with that requirement and created a two-part presumption: (1) the market *had* incorporated the specific misrepresentation into the market price of the security, and (2) the plaintiff *did* transact in reliance on the integrity of that price.[23] Justice Thomas argued that this two-part presumption was based on faulty factual assumptions, was inconsistent with the Court's recent Rule 23 cases, and resulted in a "rebuttable" presumption that is virtually irrebuttable in practice.

1. Faulty Factual Assumptions

In *Basic*, Justice Thomas said, "the Court based both parts of the presumption of reliance on a questionable understanding of disputed economic theory and flawed intuitions about

---

[22] 134 S.Ct. at 2417-18 (Thomas, J. concurring).

[23] *Id.* at 2419.

investor behavior.[24] He argued that the first factual assumption—that public statements are reflected in the market price—"was grounded in an economic theory that has garnered substantial criticism" since *Basic*.[25] In his view, "the second assumption—that investors categorically rely on the integrity of the market price—is simply wrong."[26]

Basic grounded the first assumption in "the nascent economic theory known as the efficient capital markets hypothesis."[27] Specifically, Justice Thomas wrote, *Basic* endorsed the "semi-strong version of that theory, which posits that the average investor cannot earn above-market returns in an efficient market by trading on the basis of publicly available information, and that the market price of shares traded on well-developed markets will reflect all publicly available information."[28] At the time of *Basic*, "this theory was widely accepted, Justice Thomas said, but the theory has since lost its luster."[29] We now know that "even well-developed markets do not uniformly incorporate information into market prices with high speed,"[30] he said, and "overwhelming empirical evidence" suggests that markets often fail to incorporate public information accurately.[31]

Similarly, Justice Thomas rejected the assumption that investors rely on the integrity of the market price:

> It cannot be seriously disputed that a great many investors do *not* buy or sell stock based on a belief that the stock's price accurately reflects its value. Many investors in fact trade for the opposite reason—that is, because they think the market has under- or overvalued the stock, and they believe they can profit from that mispricing.

"Other investors trade for reasons entirely unrelated to price."[32] In short, Justice Thomas wrote, "*Basic*'s assumption that all investors rely in common on 'price integrity' is simply wrong."[33]

---

[24] *Id.* at 2420.

[25] *Id.* (quoting *Basic,* 485 U.S. at 246).

[26] *Id.*

[27] *Id.* at 2420-21 (citing Stout, The Mechanisms of Market Inefficiency: An Introduction to the New Finance, 28 J. CORP. L. 635, 640, and n. 24 (2003)).

[28] *Id.* at 2421 (citing Langevoort, *Basic* at Twenty: Rethinking Fraud on the Market, 2009 WIS. L.REV. 151, 175).

[29] *Id.* (citing Lev and de Villiers, Stock Price Crashes and 10b–5 Damages: A Legal, Economic and Policy Analysis, 47 STAN. L. REV. 7, 20–21 (1994)).

[30] *Id.*

[31] *Id.* (quoting *Basic*, 485 U.S. at 246).

[32] *Id.*

[33] *Id.* at 2422.

2. Inconsistent with Recent Rule 23 Decisions

Justice Thomas's second ground for overruling *Basic* was that "*Basic*'s rebuttable presumption is at odds with our subsequent Rule 23 cases, which require plaintiffs seeking class certification to 'affirmatively demonstrate' certification requirements like the predominance of common questions."[34] In his view, *Basic* "permits plaintiffs to bypass that requirement of evidentiary proof," because the presumption substitutes for evidence of actual reliance. In effect, Justice Thomas argued, *Basic* "exempts Rule 10b-5 plaintiffs from Rule 23's proof requirement, an exemption that was beyond the *Basic* court's power to grant."[35]

3. Irrebuttable in Practice

In his third argument for overruling *Basic*, Justice Thomas reasoned that "*Basic*'s presumption that investors rely on the integrity of the market price is virtually irrefutable in practice."[36] In his view, "the realities of class action procedure make rebuttal based on an individual plaintiff's lack of reliance virtually impossible."[37] At the class certification stage, plaintiff's counsel can avoid rebuttal simply by finding just one class representative who can withstand a challenge. "After class certification", Justice Thomas said, "courts typically refuse to allow defendants to challenge any individual plaintiff's reliance on the market price prior to a determination of class-wide liability."[38] In his view, this results in a presumption that is "conclusive in practice," thus effectively eliminating even *Basic*'s "watered-down" reliance requirement.[39]

For all of the reasons discussed above, Justices Thomas, Scalia, and Alito would have overruled *Basic* and required individual plaintiffs to prove "actual reliance, not the fictional 'fraud-on-the-market' version."[40]

B. In the View of Justices Thomas, Scalia, and Alito, *Stare Decisis* Should Not Have Prevented the Court From Overruling *Basic*.

In contrast to Justice Roberts' majority opinion, which required a "special justification" for overruling a well established precedent, Justice Thomas said that "[p]rinciples of *stare decisis* do not compel us to save *Basic*'s muddled logic and armchair economics."[41] He

---

[34] *Id*. at 2420 (citing Comcast v. Behrend, 133 S.Ct. 1426, 1432 (2013)).

[35] *Id*. at 2423-24.

[36] *Id*. at 2420.

[37] *Id*. at 2424 (citing Grundfest, Damages and Reliance under Section 10(b) of the Exchange Act, 69 BUS. LAWYER 307, 362 (2014)).

[38] *Id*. (citing Brief for Chamber of Commerce of the United States of America *et al*. as *Amici Curiae* 13–14).

[39] *Id*. at 2424-25.

[40] *Id*. at 2425 (quoting Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S. 148, 163 (2008)).

[41] *Compare* 134 S.Ct. at 2407 (Roberts, J., delivering the majority's opinion), *with* 134 S.Ct. at 2425 (Roberts,

rejected the argument that *stare decisis* had special force in the context of statutory interpretation, where Congress can correct a court's mistakes, by arguing "when we err in areas of judge-made law, we ought to presume that Congress expects us to correct our own mistakes—not the other way around."[42]

Justice Thomas also rejected the notion that Congress had acquiesced in the *Basic* presumption by enacting legislation (such as the PSLRA) concerning private Rule 10b-5 claims without overruling *Basic*.[43] Contrary to the plaintiff's argument, Justice Thomas wrote, "we cannot draw from Congress' silence on this matter an inference that Congress approved of *Basic*."[44] This was especially true with respect to the PSLRA, Justice Thomas pointed out, in which Congress expressly stated that "[n]othing in this Act . . . shall be deemed to create or ratify any implied private right of action."[45] If by passing the PSLRA Congress did not even ratify the implied cause of action, he argued, it certainly did not ratify *Basic*'s expansion of that cause of action.[46]

VI. QUESTIONS RAISED BY *HALLIBURTON II*

The Supreme Court issued its opinion in *Halliburton II* on June 23, 2014. Because the courts below had denied Halliburton the opportunity to defeat the *Basic* presumption with evidence of a lack of price impact, the Court vacated the Fifth Circuit's judgment and remanded the case.[47] The Fifth Circuit issued a short order remanding the case to the District Court for further proceedings consistent with the Supreme Court's opinion.[48] On August 27, 2014, the District Court issued a scheduling order setting a one-day evidentiary hearing on December 1, 2014 to address price impact.[49] The full impact of the *Halliburton II* decision—both in the Halliburton case itself and in other securities fraud class actions—remains to be seen. But there have been some early indications from the other circuit lower courts concerning some of the issues raised.

A. How Much Will *Halliburton II* Really Change the Settlement Value of Securities Fraud Class Actions?

For pending and future securities fraud class actions, how much does *Halliburton II*'s

---

J., concurring).

[42] *Id*. at 2425-26.

[43] *Id*. at 2426.

[44] *Id*.

[45] *Id*.

[46] *Id*. at 2426-27.

[47] *Id*. at 2417.

[48] Erica P. John Fund, Inc. v. Halliburton Co., 718 F.3d 423 (5th Cir. 2013) *aff'g* 2012 WL 565997 (N.D. Tex. 2012), *rev'd*, 134 S.Ct. 2398 (2014).

[49] Scheduling Order, No. 3:02-cv-1152-M (N.D. Tex. Aug. 27, 2014).

price impact ruling really change things? The effect may be limited to weeding out some weaker cases prior to class certification. For two reasons, one could make a case that the impact of the ruling will be minimal.

First, as one district court addressing *Halliburton II* recently noted, it is important to remember that "proof of price impact has always been a part of the equation at the merits stage of a securities fraud case."[50] Thus, *Halliburton II* did not create a new element or defense, but only addressed *when* a defendant can raise the price impact issue. As Justice Ginsburg indicated in her concurring opinion, plaintiffs with tenable claims should not have too much difficulty showing price impact.[51] If the plaintiffs have no evidence of price impact, their case was never likely to have more than nuisance value anyway.

Second, some circuits already allowed defendants to refute price impact at the class certification stage.[52] So in these circuits, *Halliburton II* did not change the law.

Thus, *Halliburton II* will likely have the most impact in circuits where the defendants previously could not refute price impact, and in cases where the plaintiff's evidence on the merits was already weak. In cases that are strong enough to survive a motion to dismiss, but the evidence of price impact is weak, *Halliburton II* gives defendants additional settlement leverage prior to class certification. Plaintiffs in those cases may be more inclined to settle earlier, and for less money. That may be the most likely practical effect of the price impact ruling.

B. What Evidence Is Necessary to Prove a Lack of "Price Impact"?

The issue in *Halliburton II* was *when* defendants can address price impact, so the Court did not focus on *what* defendants must do to show a lack of price impact. Is it sufficient to offer evidence that the price of the company's stock did not move in response to the alleged misrepresentations at the time when the misrepresentations were made? What is the threshold showing? In an effort to defeat class certification, Defendants will typically try to offer evidence that the stock price did not move in response to the alleged misrepresentation, but that may not be enough.

In "price maintenance" cases, the plaintiff will argue that the defendant's misrepresentation or omission was "confirmatory information" that helped to maintain the

---

[50] *In re* Vivendi Universal, S.A. Sec. Litig., No. 02-CV-5571 (SAS), 2014 WL 4080950, at *1 (S.D.N.Y. Aug. 18, 2014).

[51] 134 S.Ct. at 2417 (Ginsburg, J., concurring).

[52] *See* McIntire v. China MediaExpress Holdings, Inc., No. 11-cv-0804 (VM), 2014 WL 4049896, at *13 (S.D.N.Y. Aug. 15, 2014) (holding that"*Halliburton II* did not change Second Circuit case law, which already permitted a securities-fraud defendant 'to rebut the presumption, prior to class certification, by showing, for example, the absence of a price impact'").

price of the company's stock, rather than causing a price increase. Typically, the plaintiff will offer evidence that the stock price declined when the truth became public, i.e. when there was a "corrective disclosure." Is the evidence of price decline following a corrective disclosure sufficient for a plaintiff to show price impact at the class certification stage? The Supreme Court did not address these questions in *Halliburton II*, so it will be up to the lower courts to determine whether the defendant has carried its burden to prove a lack of price impact at the class certification stage.

The Eleventh Circuit touched on the interaction between the *Halliburton II* ruling and the price maintenance theory in *Local 703 v. Regions*.[53] In that case, the District Court ruled—prior to issuance of the *Halliburton II* opinion—that the plaintiffs had met the prerequisites for invoking the *Basic* presumption of reliance, including showing an efficient market, and certified a class of purchasers of Regions stock.[54] On appeal, Regions argued that the evidence was insufficient to support the District Court's finding that the stock traded on an efficient market.[55] The Court of Appeals rejected this argument, but in the meantime the Supreme Court had decided *Halliburton II*, and both sides agreed that the case should be remanded to the District Court to review the evidence of "price impact" in light of the Supreme Court's decision.[56]

Not surprisingly, the Court of Appeals agreed to the parties' request and remanded the case for that purpose.[57] The more notable thing about the opinion was that the Court of Appeals gave this guidance strongly suggesting the District Court not apply too strict a standard for proof of price impact:

> But we are mindful, and the District Court is no doubt aware, that its work on remand will be limited in scope. The Supreme Court only said that defendants "*may* seek to defeat the *Basic* presumption" with evidence that the misrepresentations did not impact the price. *Halliburton II* by no means holds that in every case in which such evidence is presented, the presumption will always be defeated. Indeed, this Court has recognized the distinct role that confirmatory information may have in this analysis. But in any event, because the District Court is in the best position to review all the facts and conduct the inquiry now required in the wake of *Halliburton II,* we vacate and remand this case for that purpose.[58]

---

[53] Local 703, I.B. of T. Grocery & Food Employees Welfare Fund v. Regions Fin. Corp., 762 F.3d 1248 (11th Cir. 2014).

[54] *Id*. at *1.

[55] *Id*. at *3.

[56] *Id*. at *10.

[57] *Id.*

[58] *Local 703,* 762 F.3d at 1259 (internal citation omitted).

The Eleventh Circuit seems to be signaling that evidence of price *maintenance* may be sufficient for the plaintiff to show a price impact and to obtain class certification.

In an opinion issued shortly after *Local 703 v. Regions*, a district court in the Second Circuit directly addressed this issue. In *McIntire v. China MediaExpress Holdings, Inc.,*[59] the plaintiffs asserted Rule 10(b)(5) claims and moved for class certification. The defendant, DTT HK, argued that, even if the company's stock traded on an efficient market, the fraud-on-the-market presumption was rebutted because the company's alleged misrepresentations did not impact the company's stock price.[60] However, the district court reasoned that a showing of price maintenance was sufficient to establish price impact:

> DTT HK correctly notes that on the day after it released its 2009 audit opinion—which contains the misstatements that Plaintiffs allege to be actionable—CCME's stock price did not increase, and in fact decreased slightly. DTT HK thus concludes that it has shown the absence of any price impact from its material misstatements. But this simple line of reasoning is flawed. A material misstatement can impact a stock's value either by improperly causing the value to increase *or* by improperly maintaining the existing stock price. *See, e.g., In re Pfizer Inc. Sec. Litig.,* 936 F.Supp.2d 252, 264 (S.D.N.Y. 2013) ("[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."). Misstatements by an auditor confirming the accuracy of a company's (inaccurate) financial statements may be particularly likely to maintain an already-inflated stock price because the market likely expects an auditor to issue such an opinion.[61]

Thus, the defendant could not refute price impact—and defeat class certification—merely by showing that the stock price did not go up immediately after the alleged misrepresentation was made. Looking at the evidence, the district court was "not persuaded that DTT HK has met its burden to prove that its alleged misstatements did not improperly maintain CCME's already-inflated stock price."[62] The court granted class certification.[63] Thus, at least one post-*Halliburton II* case has held that the plaintiff can show price impact and obtain class certification through a price maintenance theory.

Whether evidence of "price maintenance" is sufficient to show "price impact" is just one of the issues that may arise when a defendant tries to show a lack of price impact under

---

[59] No. 11-cv-0804, 2014 WL 4049896, *1 (S.D.N.Y. Aug. 15, 2014).

[60] *Id.* at *13.

[61] *Id.*

[62] *Id.* at *40.

[63] *Id.* at *15.

Halliburton II. Although the Supreme Court made it clear that the burden of showing a lack of price impact is on the defendant at the class certification stage, it did not specifically address how the district court should address conflicting evidence. If the defendant offers some evidence demonstrating a lack of price impact in opposition to class certification, then the burden shifts to the plaintiff, but what is the plaintiff's burden? Is it sufficient for the plaintiff merely to offer some evidence of price impact—and raise a fact issue—or does the district court then act as fact-finder and resolve the conflicting evidence? More pointedly, if there is conflicting expert testimony on price impact at the class certification stage, does the plaintiff automatically win, or is the court's job to decide the battle of experts? It remains to be seen how this will play out after *Halliburton II*.

C. How Will *Halliburton II* Affect the Scope of Discovery Prior to Class Certification?

As Justice Ginsburg noted, advancing consideration of price impact evidence to the class certification stage may broaden the scope of class certification discovery.[64] Under *Halliburton II*, parties should be permitted to seek discovery relevant to price impact prior to class certification. But how much does this really broaden discovery? Market efficiency was already an issue at the class certification stage. As the *Halliburton II* majority noted, price impact evidence was already part of the evidence at class certification because one of the ways to show an efficient market is to show that a company's public statements tend to affect its stock price, i.e. price impact.[65] So in practical terms the scope of discovery may not change significantly. Of course, discovery rulings will depend on the specific facts and circumstances of each case.

Taking depositions of corporate executives concerning price impact is likely to be a recurring issue in proposed securities fraud class actions. Plaintiffs may try to use *Halliburton II* as a basis for taking early depositions of company officers prior to class certification, arguing that the officers may have knowledge relevant to price impact. Defendants will tend to try to avoid such depositions, arguing that internal corporate knowledge has little or no bearing on price impact.

The Halliburton case itself provides a good example. After remand to the district court, the plaintiff sought the depositions of Halliburton CEO, David Lesar, and former CFO, Douglas Foshee, arguing their depositions should be allowed even during a stay of merits discovery because they have personal knowledge relevant to price impact. Halliburton argued that these executives are not experts in econometrics or price impact, and that their views on why or how any Halliburton statement impacted the stock price are not relevant. "Non-public information—including Halliburton's internal knowledge and beliefs—is irrelevant to the

---

[64] Halliburton Co. v. Erica P. John Fund, Inc., 134 S. Ct. 2398, 2417 (2014) (Ginsberg, R., concurring).

[65] 134 S.Ct. at 2415.

fraud-on-the-market presumption and price impact," Halliburton said. The district court declined to allow the depositions, but left the door open for plaintiff to come back with any new grounds showing that a specific deposition would be relevant to price impact.[66]

This may be a preview of similar arguments to come in other securities fraud class actions. Plaintiffs will likely try to use *Halliburton II* to expand the scope of discovery regarding price impact before class certification, while defendants will typically argue that depositions of corporate executives have nothing to do with price impact. Even aside from depositions, there are likely to be similar arguments over the scope of document discovery. Earlier discovery disputes about what is relevant to price impact—and what is not—may be an unintended consequence of *Halliburton II*'s price impact ruling.

D. What Will the Role of Experts Be After *Halliburton II*?

To show price impact or a lack thereof, parties will often hire expert economists, who will perform "event studies" to analyze the effect of a particular event, e.g. a misrepresentation or a corrective disclosure, on a company's stock price. After *Halliburton II*, will it become routine for parties to hire experts at the class certification stage to analyze and testify regarding price impact? That seems likely, but it may not be a drastic change. Experts can already testify at the class certification stage on the issue of market efficiency, which indirectly addresses price impact. The difference after *Halliburton II* is that now experts will address price impact directly. In the remanded Halliburton case, for example, the district court issued a scheduling order setting deadlines for expert reports for both sides on the issue of price impact.[67] This seems likely to become the norm.

VII. CONCLUSION

The biggest news about the *Halliburton II* opinion is not what the Supreme Court did, but what it did not do. The Court did not overrule *Basic* and abolish the fraud-on-the-market presumption. Thus, the Court kept private securities fraud class actions intact. However, the Court did make it a little easier for defendants to eliminate them earlier in the litigation. Thus, the decision in *Halliburton II* to allow defendants to defeat class certification by showing lack of price impact can be viewed as the latest in a series of steps that both Congress and the Supreme Court have taken to tilt the balance in securities fraud class actions towards defendants. Like the PSLRA and SLUSA, which gave defendants new substantive and procedural advantages, *Halliburton II* gives defense counsel an additional peremptory tool for seeking dismissal of securities fraud class actions. It remains to be seen how powerful a tool this will be, and whether plaintiffs will turn *Halliburton II* to their advantage by seeking

---

[66] *See* Document 576, Halliburton's Motion for Protective Order, Case No. 3:02-cv-1152-M.

[67] *See* Document 568, Scheduling Order: A Full Day Hearing, to Consider the Issue of Price Impact as it Relates to the Fraud on the Market Presumption, as Germane to Class Certification, Case No. 3:02-cv-1152-M.

broader discovery in the early stages of securities fraud class actions.