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Presumption of Reliance Survives in Securities Cases, But Defendants Can Dispute Price Impact at Class Certification

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The U.S. Supreme Court today declined to abandon the efficient-market theory, with its rebuttable presumption of reliance that enables securities class actions to proceed without proof of actual reliance on alleged misrepresentations or omissions. However, the Court's ruling in *Halliburton Co. v. Erica P. John Fund, Inc.* allows defendants to try to show at the class-certification stage that the alleged misrepresentations did not in fact affect the price of the securities at issue.

The *Halliburton* decision is likely to increase the complexity, importance, and expense of class-certification proceedings and could influence both sides' settlement strategies in securities class actions.

The Efficient-Market Theory and *Basic*'s Presumption of Reliance

In 1988, the Supreme Court adopted a "fraud on the market" presumption of reliance in securities cases. The Court held in *Basic Inc. v. Levinson* that reliance – a necessary element of a securities-fraud claim – can be rebuttably *presumed*, and need not be individually established, where the defendant's securities trade in an efficient market. An efficient market is supposed to incorporate all information available to the public, so securities traders can be deemed to have relied on the market price – which reflects any alleged misrepresentations or omissions – in making their trading decisions. Without such a rebuttable presumption of reliance, the Court held, securities class actions would "ordinarily" be impossible to certify, because "individual reliance issues would overwhelm questions common to the class."

Ever since 1988, securities plaintiffs routinely have invoked this presumption to satisfy the reliance element of securities-fraud claims. And ever since 1988, securities defendants have sought ways to attack this presumption, including by contesting the fundamental economic tenets of the efficient-market theory itself.

Factual Background

Halliburton is a securities class action alleging that Halliburton's stock price was inflated during the class period by certain purported misrepresentations to the market. Plaintiffs contended that, when the supposed "truth" emerged, Halliburton's stock price declined.

Plaintiffs sought class certification by invoking *Basic*'s "fraud on the market" presumption of reliance. Halliburton opposed class certification by arguing that the alleged fraud had not actually affected the market price of the company's stock – in other words, that the alleged misrepresentations had not caused any "price impact" or "price distortion." Both the district court and the Court of Appeals for the Fifth Circuit rejected this effort to rebut the fraud-on-the-market presumption of reliance *at the class-certification stage*, holding that the alleged lack of price impact was a common, merits-related issue that affected all putative class members equally: if Halliburton could succeed in proving no price impact, *all* class members' claims would fail, because *all* class members would be unable to establish an essential element of their fraud claims, even on an individual basis.

Halliburton sought and obtained review in the Supreme Court on two questions: (*i*) whether the Court "should overrule or substantially modify" *Basic*'s presumption of classwide reliance under the fraud-on-the-market theory, and (*ii*) even if the theory remains viable, whether a defendant may rebut the presumption of reliance *at the class-certification stage* by introducing evidence that the alleged misrepresentations did not distort the market price of its stock. The Supreme Court's grant of certiorari appeared to suggest a show-down on the efficient-market theory, because the grant came shortly after four concurring or dissenting Justices had suggested in *Amgen, Inc. v. Connecticut Retirement Plans & Trust Funds* that the theory was questionable.

The Supreme Court's Decision

The *Halliburton* decision proved to be an anticlimax for those who had hoped that the Supreme Court would revisit and overrule the *Basic* decision. The Court, by a 6-3 vote, declined to throw out the fraud-on-the-market doctrine and its presumption of reliance. The Court thus did not deal a death blow to securities class actions.

The Court ruled that "special justification" did not exist to overturn long-settled precedent allowing the two rebuttable presumptions embodied in *Basic*: (i) a presumption that the misrepresentation affected the stock price, if the plaintiff can show that the misrepresentation was public and material and that the stock traded in a generally efficient market, and (ii) a presumption of reliance, if the plaintiff also can show that he or she purchased the stock at the market price during the relevant period. Those two presumptions remain alive and well.

However, the Court also held that a securities defendant must be allowed to try to defeat the presumptions *at the class-certification stage* through evidence that the misrepresentation did *not* in fact affect the stock price. The Court observed that evidence of lack of price impact would be admissible in any event to show lack of market efficiency, so there was no reason not to allow a defendant also to use it to defeat the presumption of reliance in opposing class certification.

In so holding, the Court rejected the argument that plaintiffs should be *required* to prove price impact in order to obtain class certification. Imposing the burden on plaintiffs, the Court said, would undermine *Basic*'s first presumption.

Three Justices (Justice Thomas, with Justices Scalia and Alito) would have overruled *Basic* and discarded the fraud-on-the-market presumption of reliance in its entirety.

***Halliburton*'s Implications**

The *Halliburton* decision likely will increase defendants' incentive to pull out all stops to litigate price impact at the class-certification stage. Advancing the fight on this issue from the merits stage to an earlier phase of the case could help dispose of meritless claims that might otherwise have survived scrutiny under *Basic*'s presumptions. The defense bar has maintained – and argued to the Supreme Court – that settlement pressures can increase if a class is certified, so defendants likely will try to wage the price-impact war sooner, rather than later. The class-certification phase could thus become a more expensive, protracted part of the case.

In fact, three members of the six-Justice majority (Justices Ginsburg, Breyer, and Sotomayor) filed a one-paragraph concurrence acknowledging that "[a]dvancing price impact consideration from the merits stage to the class certification stage may broaden the scope of discovery available at class certification." But they nevertheless concluded that the Court's decision "should impose no heavy toll on securities-fraud plaintiffs with tenable claims." Were the three concurring Justices leaving themselves an escape hatch to rethink their position if practice shows that the new discovery burdens are becoming too great?