Client Alert

June 23, 2014

Beyond *Basic*: Supreme Court's *Halliburton* Ruling Strengthens Defenses in Securities Fraud Class Actions

By Jordan Eth and Mark R.S. Foster

Today, the Supreme Court issued its ruling in *Halliburton Co. v. Erica P. John Fund, Inc.*, No. 13-317 (U.S. June 23, 2014), the most anticipated securities decision since its landmark ruling over 25 years ago in *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988). Today's *Halliburton* decision leaves intact the fraud-on-the-market presumption of reliance that the *Basic* Court adopted. At the same time, the decision goes beyond *Basic* by forging new ground. Defendants may now seek to defeat *Basic*'s fraud-on-the-market presumption by introducing evidence at the class certification stage of litigation showing that an allegedly fraudulent statement (or its correction) did not actually affect the stock price of the defendant corporation.

THE *BASIC* PREMISE

In *Basic*, the Court ruled that investors pursuing claims for securities fraud under Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 could satisfy the element of reliance by invoking the fraud-on-the-market presumption of reliance in lieu of showing direct reliance on an alleged misrepresentation. The fraud-on-the-market presumption holds that a public, material misrepresentation will distort the price of stock traded in an efficient market, and that anyone who purchases the stock at the market price may be considered to have done so in reliance on the misrepresentation. Without the benefit of that presumption, plaintiffs would have to prove reliance on an individual basis, meaning that individual issues would predominate over common ones and class certification would be inappropriate under Federal Rule of Civil Procedure 23(b)(3).

The *Basic* decision made the presumption of reliance rebuttable rather than conclusive: "Any 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." In practice, however, defendants have seldom rebutted the presumption and have done so only late in the litigation.

HALLIBURTON PLACES "PRICE IMPACT" FRONT AND CENTER

In *Halliburton*, the Court was asked whether it should overrule or modify *Basic*'s presumption of reliance and, if not, whether defendants should nonetheless be afforded an opportunity to rebut the presumption at the class certification stage by showing a lack of price impact. The Court declined to overrule or modify *Basic*, finding no "special justification" for overruling the precedent set in *Basic*.

Nevertheless, the Court ruled that, consistent with *Basic* itself, defendants may introduce evidence of the lack of "price impact" at the class certification phase of litigation. Price impact evaluates whether an alleged misrepresentation actually affected the market price of a defendant corporation's stock. "In the absence of price impact, *Basic*'s fraud-on-the-market theory and presumption of reliance collapse," concluded Chief Justice Roberts, who wrote the Court's opinion, joined by five others. That is so because the "'fundamental premise'

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underlying the presumption is 'that an investor presumptively relies on a misrepresentation so long as it was reflected in the market price at the time of this transaction." Without evidence of price impact, there is "no grounding for any contention that the investor indirectly relied on that misrepresentation through his reliance on the integrity of the market price."

The *Halliburton* decision does not alter the framework established by *Basic*, which requires plaintiffs to introduce at least indirect evidence of price impact at class certification to invoke *Basic*'s fraud-on-the-market presumption: "We adhere to that decision and decline to modify the prerequisites for invoking the presumption of reliance." Plaintiffs thus can still meet their burden by proving that the stock traded in an efficient market, that alleged misrepresentations were publicly known, and that alleged misrepresentations are material, all of which serve as an "indirect proxy for price impact."

But that "indirect" evidence may no longer carry the day for plaintiffs at the class certification stage after *Halliburton*. Now defendants "may seek to defeat the *Basic* presumption" at class certification, rather than waiting for summary judgment or trial, by seeking to introduce "direct as well as indirect price impact evidence." To do so, defendants can submit expert analyses, including event studies, that demonstrate that specific alleged misrepresentations did not affect the market price of a stock. The Court reasoned that permitting this rebuttal by defendants at class certification was necessary "to maintain the consistency of the presumption with the class certification requirements of Federal Rule of Civil Procedure 23."

In light of the ruling, the Court vacated class certification, and remanded the case so that direct evidence of price impact may be considered. The decision keeps the 12-year-old case in class certification limbo, where it has been for over six years. Indeed, this is the second time that the Supreme Court has itself considered class certification in the case. Previously, in a unanimous opinion, also authored by Chief Justice Roberts, the Supreme Court held in *Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179 (2011) that plaintiffs are not required to prove the element of loss causation at the class certification stage of a case. In today's opinion, the Court explained that that loss causation ruling addressed "a matter different from whether an investor relied on a misrepresentation, presumptively or otherwise, when buying or selling a stock." Nevertheless, in most cases, the analysis of price impact will often overlap with the loss causation analysis.

SIGNIFICANCE: REINVIGORATED CHALLENGES TO CLASS CERTIFICATION

The *Halliburton* decision is unquestionably a win for securities class action defendants. By explicitly allowing defendants to rebut the presumption of reliance with evidence regarding price impact, the *Halliburton* decision alters the status quo of securities litigation, and is likely to breathe new life into the class certification stage of securities class actions.

It is possible that some plaintiffs will react to the *Halliburton* decision by narrowing the scope of at least some of their cases, forgoing a "shotgun" approach in which they challenge dozens of statements over long class periods. Nevertheless, the decision is unlikely to significantly change the volume or frequency of securities litigation. Instead, the decision may help weed out weak cases, or weak parts of cases, and may, in some cases, limit defendants' exposure.

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DIFFERENT PERSPECTIVES

Although all nine Justices unanimously supported the outcome here—vacating the class certification decision—three Justices did not join the Chief Justice's opinion. Instead, they would have done away with the fraud-on-the-market presumption altogether and overruled *Basic*. Justice Thomas, joined by Justices Scalia and Alito, opined that "[l]ogic, economic realities, and our subsequent jurisprudence have undermined the foundations of the *Basic* presumption, and *stare decisis* cannot prop up the façade that remains."

Justices Ginsburg, Breyer and Kagan joined the Chief Justice's opinion, but also joined a separate concurrence by Justice Ginsburg, who emphasized that it is "incumbent upon the defendant to show the absence of price impact." They concluded that permitting defendants to do so "should impose no heavy toll on securities-fraud plaintiffs with tenable claims."

CONCLUSION

The *Halliburton* case produced unprecedented expectations for those involved in securities litigation. Some predicted the end of securities class actions, particularly after Justices Thomas, Kennedy, Scalia, and Alito issued concurring and dissenting opinions last year in *Amgen, Inc. v. Connecticut Retirement Plans and Trust Funds*, 133 S. Ct. 1184 (2013), explicitly calling into question the viability of the fraud-on-the-market presumption.

Instead of bringing an end to securities class actions, the *Halliburton* decision will enable securities class actions to continue, but with an additional check in the form of rigorous price-impact review at class certification. That check bears the hallmark of securities decisions issued by the Roberts Court: an attempt to achieve equilibrium. The Court's securities opinions consistently seek to preserve the ability of investors to pursue cases, while providing defendants with meaningful tools to defeat them. The Court leaves to Congress any significant changes to the framework that governs securities class actions.

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