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In this issue … Halliburton Company takes aim at a central pillar supporting securities class action lawsuits.

BACKGROUND

The foundations for modern securities class action lawsuits were to a large extent laid twenty-five years ago in the U.S. Supreme Court case of *Basic v. Levinson 485.U.S. 224 (1988)*. In that seminal decision —handed down by an unusual four-person majority due to the non-participation of Chief Justice Rehnquist, Justice Kennedy, and Justice Scalia— the "fraud-on-the-market" theory was enshrined into law.

The theory rode upon the then-widespread belief among economists that U.S. securities exchanges were "efficient markets," meaning that the price of a freely traded company's stock accurately reflected all the information about the company that was publicly available. That being so, a falsehood or misrepresentation made by executives of the company would also be duly factored in to the stock price. For example, the release of positive —but flawed— news would tend to push the stock price up. Because the premise behind that increase was incorrect, the elevated price was wrong: a fraud had been committed on the market, and investors in that stock were trading under artificially inflated prices.

According to the *Basic* decision, once the existence of the false information was revealed, investors had only to show they had traded within certain time periods covered by the fraud to have good grounds for commencing a securities class action lawsuit. Like a faithful dog following its master unquestioningly, the "efficient market" had followed bad information and been duped; investors had also been duped, and now they were victims. To achieve class action certification, they would not have the burden of proving they relied on the company's misstatements, merely that they had traded.

Few would dispute the importance of the *Basic* decision over the next quarter-century. It has been estimated that the "fraud-on-the-market" doctrine has been cited almost 17,000 times in securities fraud litigation. Inquisitive readers can visit the Stanford Securities Class Action Clearinghouse web site, look up a securities class action complaint at random, and see for themselves the pervasiveness of this weapon in the plaintiff's arsenal.

Consequently, elimination or modification of the fraud-on-the-market doctrine would almost certainly change the securities class action landscape and the playbook of the plaintiffs' bar. As one commentator puts it:

> *"If the Court chooses to disavow* Basic*, the repercussions to securities fraud litigation would be significant, as plaintiffs in securities fraud class actions would then have the burden of showing class-wide reliance at the class certification stage without the crutch of the [fraud-on-the-market] presumption."*

HALLIBURTON TAKES ON *BASIC*

The case of *Erica P. John Fund v. Halliburton* may ring a bell with readers. Back in 2011 the case was heard by the U.S. Supreme Court and discussed in this newsletter. The Court addressed the narrow question of whether the merits of a putative securities class action filing should be considered during the class certification process, or if instead a merits discussion was only appropriate following certification. The decision was unanimous. Merits discussions have no place in the class certification process, and must wait.

As Halliburton and its legal team regrouped following that defeat, perhaps they wondered if they had been too conservative in their ambitions. Instead of seeking victory on such a limited issue, maybe they should have gone for the heart of the securities class action structure, and attacked *Basic*. That is what they decided to do.

RETURNING TO THE SUPREME COURT FOR CERTIORARI

One of the first steps to having a case heard by the Supreme Court is to formally request that the court hear the case. This is known as "petitioning for a writ of certiorari." After the petitioners have made their case for a hearing, the opposing side can offer reasons why the request should be denied. The Supreme Court justices will consider these submissions, and if four of the nine justices feel it's an issue worth hearing —generally because of the far-reaching impact a decision will have— the case is accepted and is put on the calendar for a full hearing at a later date. Out of some 7,000 petitions made each year, only between 100 and 150 are usually accepted.

Accordingly, in September 2013, counsel for Halliburton submitted their petition, in which this question was presented:

> *Whether this Court should overrule or substantially modify the holding of* Basic Inc. v. Levinson *… to the extent that it recognizes a presumption of classwide reliance derived from the fraud-on-the-market theory.*

As a fallback plan a second question was presented, asking whether during the class certification process the defense could "rebut," or counter, a plaintiff, by introducing evidence to show that alleged misrepresentations by the defendant did not distort the stock price.

HALLIBURTON'S ARGUMENT, AND THE RESPONSE

Halliburton's reasoning for its case rests on four points:

1. That the economic theory ("efficient markets") espoused in *Basic* is outdated and discredited.
2. The inherent weakness of *Basic*'s foundations has caused federal and state courts to struggle with it.
3. The presumption of classwide reliance on the efficiency of the markets is at odds with the Supreme Court's recent actions on class certifications.
4. This is an "ideal" opportunity to review *Basic*.

The opposing brief on behalf of the Erica P. John Fund was submitted by its attorneys in October 2013. Among their arguments for denying the petition were:

1. Halliburton has previously conceded the market for its stock is efficient.
2. If Halliburton wanted to overturn *Basic* it should have tried to do so before.
3. The economic theory behind *Basic* has not been undermined by economic developments, or attempts to discredit the theory.
4. *Basic* has been reaffirmed by the Supreme Court, the U.S. Congress, the Securities and Exchange Commission, and the U.S. Department of Justice.

COMMENT

Even when *Basic* was heard in 1988, dissenting justices had concerns with the Supreme Court dabbling in economic theory: "I dissent from the remainder of the Court's holding because I do not agree that the 'fraud-on-the-market' theory should be applied in this case," wrote Justice White, supported by Justice O'Connor.

"The fraud-on-the-market theory is a mere babe," continued Justice White, adding that "confusion and contradiction in court rulings are inevitable when traditional legal analysis is replaced with economic theorization by the federal courts." Such determinations, he concluded, are better handled by Congress, with its "superior resources and expertise." Not surprisingly, Justice White's dissenting views found their way into Halliburton's petition.

It should be noted that the questions under review apply largely to the class certification phase of a prospective securities class action lawsuit. If and when certification is granted the federal courts can get into the details of the case. But as most readers know, by that time the cat is out of the bag: A securities class action lawsuit that survives attempts to dismiss it will set in motion the inexorable generation of significant —in many cases enormous— expenses, with the eventual outcome typically being a costly pre-trial settlement, rather than a day in court. The battle, as both sides are well aware, is generally won or lost at class certification.

The stakes therefore are potentially huge. Will the Supreme Court grant the petition of certiorari and agree to hear Halliburton's challenge to *Basic*, thereby setting the stage for what might be the most important securities litigation question to reach the Supreme Court in twenty five years?

We will shortly know the answer. The Supreme Court is due to review Halliburton's petition on Friday November 15, and will likely release its decision on Monday morning, November 18. ❖

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