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Commentary: Reliance remains, but is rebuttable

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The reliance theory still lives. On June 23, 2014, the U.S. Supreme Court announced its decision in *Halliburton Co. v. Erica P. John Fund, Inc.*, declining to overrule the holding in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), which allows investors in securities-fraud cases to bring class actions based on a fraud-on-the-market theory of reliance.

The court also recognized that defendants must be given the opportunity to rebut the reliance presumption and defeat class certification through the use of evidence establishing that a stock drop was due to factors unrelated to the actionable statements.

The opinion written by Chief Justice John Roberts was joined by Justices Anthony Kennedy, Ruth Bader Ginsburg, Stephen Breyer, Sonia Sotomayor and Elena Kagan. Concurring opinions were filed by Justice Ginsburg, joined by Justices Breyer and Sotomayor, and Justice Clarence Thomas, joined by Justices Antonin Scalia and Samuel Alito.

The fraud-on-the-market theory

Reliance is a required element that must be plead and proven in any securities fraud claims brought under Rule 10 (b) and Section 10b-5. In *Basic*, the court held that plaintiffs may meet this requirement through the use of the economic theory of fraud-on-the-market. Under this theory the price of securities traded in an efficient market will incorporate all publicly available information — and misrepresentations will therefore cause distorted market prices. The court asserted that those who buy and sell securities rely on the integrity of market prices, justifying a presumption of reliance for securities traded in efficient markets.

'Halliburton Co. v. Erica P. John Fund, Inc.'

The Erica P. John Fund Inc. is the lead plaintiff in a securities-fraud putative class action against Halliburton. The plaintiff alleges Halliburton made misrepresentations on three separate issues, and suffered a drop in stock price when the truth about those matters was disclosed. To meet the class certification requirement that common issues predominate over individual ones, the plaintiff relied on *Basic*'s presumption of investor reliance on the integrity of Halliburton's market price.

This case was previously before the court in *Erica P. John Fund, Inc. v. Halliburton*, 131 S.Ct. 2179 (2011). In that decision, the court unanimously ruled that plaintiffs in federal securities actions do not need to prove loss causation at the class certification stage in order to invoke the fraud-on-the-market presumption established in *Basic*. On remand, Halliburton argued that class certification was nevertheless inappropriate because it had proven that its stock price had not been impacted by the alleged misrepresentations.

The District Court certified the class and declined to address Halliburton's arguments. The 5th Circuit affirmed the certification and subsequently denied Halliburton's petition for a rehearing en banc. Though acknowledging *Basic*'s holding that the fraud-on-the-market presumption was rebuttable, the 5th Circuit reasoned that the court's holding in *Amgen Inc. v. Conn. Ret. Plans and Trust Funds*, 133 S. Ct.1184 (2013) prohibited such arguments from being made at the class certification stage.

On appeal, the U.S. Supreme Court rejected Halliburton's arguments that *Basic* should be overturned, holding that *Basic* did not err in its interpretation of the Securities Exchange Act and reaffirming the fraud-on-the-market theory's underlying premises of efficient capital markets and price integrity.

The court then turned to the question of whether defendants at the class certification stage must be given the opportunity to demonstrate that the price drop was due to factors other than the actionable statements. Noting that price impact evidence is already allowed before courts at the certification stage, the court held it would be inconsistent and illogical to allow such evidence to be considered for indirect purposes while prohibiting direct uses of the same evidence.

Nothing in *Basic*'s acknowledgement that indirect evidence may create a presumption requires courts to ignore "direct, more salient" evidence that the presumption does not apply in a particular case. The court then distinguished *Halliburton* from *Amgen*. In *Amgen*, the court reasoned that materiality was a common issue that could be left to the merits stage without risking improperly certifying a class with predominantly individual issues. Without a price impact, however, there is no fraud on the market which undermines the commonality requirement for class certification.

Impact on securities-fraud litigation

Plaintiffs will continue to bring securities-fraud class actions using a *Basic* presumption to meet the element of reliance. Defendants will retain experts to rebut the presumption by establishing that any price drop was due to factors unrelated to the actionable statements.

Although Justice Ginsberg's concurrence notes that this may broaden the scope of discovery available at the certification stage, the truth is that this has been a common approach to defending security fraud claims in the past. The opinion makes it crystal clear that any federal district court judge who declines to certify a class based on a defendant's rebuttal of the presumption of reliance is no longer a trailblazer but instead is on solid ground.

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