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ALERTS

Financial, Corporate Governance And M&A Litigation Alert - The Supreme Court Agrees To Revisit "Fraud On The Market"

November 18, 2013 | Atlanta | Chicago | Columbus | Delaware | Elkhart | Fort Wayne | Grand Rapids | Indianapolis | Los Angeles | Minneapolis | South Bend

On Friday, Nov. 15, 2013, the United States Supreme Court agreed to hear arguments in a case that has the potential to dramatically reshape how securities class actions have been litigated for the last quarter century.

The Court granted a petition for certiorari filed by Halliburton Co. that asks whether the Court should overturn its 1998 decision in *Basic Inc. v. Levinson*. *Basic* established the "fraud on the market" presumption and provided one of the principal theoretical foundations for class actions in which investors in a publicly-traded company can assert that they have been defrauded by misstatements or omissions made by the company to the public. The "fraud on the market" theory essentially states that investors who buy or sell shares of stock in an efficient market are presumed to rely on the company's statements to the market and that all those statements are accurately and quickly factored into the price of the company's shares. If the Court accepts Halliburton's invitation to overturn Basic, litigating securities fraud class actions could become substantially more difficult for plaintiffs' lawyers when the market for stock in a defendant company is demonstrably inefficient.

The Supreme Court adopted the "fraud on the market" presumption of reliance in *Basic*, in part, because of the difficulties that a group of investors would otherwise have proving they actually relied on a particular statement by the company when purchasing the company's stock. The presumption has as its roots the "efficient market hypothesis," a hypothesis that presumes that most secondary markets (like the New York Stock Exchange or NASDAQ) efficiently incorporate data about the value of a company and reflect it in the company's stock price. Therefore, any statement by or about the company that was materially inaccurate distorted the market price for the company's securities.

The efficient market hypothesis and the fraud on the market presumption have always had critics, however. *Basic* was decided by a 4-2 majority, with several Justices not part of the decision. In recent years, a growing body of academic literature, coupled with the behavior of the stock market beginning in the recent past, has provided growing ammunition for opponents of the presumption. The debate between proponents of the efficient market hypothesis and its critics was brought to popular attention this year when the Royal Swedish Academy of Sciences awarded the Nobel Prize in Economic Sciences to both Eugene Fama (one of the fathers of the hypothesis) and Robert Shiller (one of its most vocal critics).

In an opinion earlier this year, four Supreme Court Justices expressed skepticism about the presumption and signaled their willingness to revisit

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Basic with perhaps a more critical eye. In dissents in *Amgen v. Connecticut Retirement Plans and Trust Funds*, Justices Thomas and Kennedy called the doctrine "questionable." Justice Alito noted that "more recent evidence suggests that the presumption may rest on a faulty economic premise." Justice Scalia asserted that the presumption was "regrettable" and simply "invented by the Court" in Basic. A number of former Commissioners and former senior officials from the Securities and Exchange Commission have already filed a brief in support of Halliburton's position, arguing that *Basic* should be overturned because its presumption of reliance is "effectively irrebutable."

Whether the Supreme Court takes the opportunity to wholly overturn *Basic* remains to be seen. The Court also could simply conclude that, when deciding whether to certify a class, a trial court must consider evidence that tends to rebut the presumption that a stock trades in an efficient market. A decision on this latter question, also presented by Halliburton, may represent a Solomonic middle ground that does not undermine the principal reliance theory outlined in Basic.

A briefing schedule for the merits of the case has not been set, and a date for oral argument is not likely until Spring 2014. However, when it arrives, the decision in *Halliburton v. Erica P. John Fund, Inc*. will likely re-shape securities fraud litigation for perhaps the next quarter century.

To obtain more information, please contact the Barnes & Thornburg attorney with whom you work, or a leader of the firm's Financial, Corporate Governance and M&A Litigation group in the following offices: Trace Schmeltz (Chicago and Washington, D.C.) at 312-214-4830; Brian Casey (South Bend) at 574-237-1285; and Anne DePrez (Indianapolis) at 317-231-7264.

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