Rebutting the Fraud on the Market Presumption in Securities Fraud Class Actions: *Halliburton II* Opens the Door

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REBUTTING THE FRAUD ON THE MARKET PREJUSMPTION IN SECURITIES FRAUD CLASS ACTIONS: HALLIBURTON II OPENS THE DOOR

Victor E. Schwartz* & Christopher E. Appel**

ABSTRACT

In Halliburton Co. v. Erica P. John Fund, Inc. (Halliburton II), the United States Supreme Court reaffirmed the validity of the “fraud on the market” presumption underlying securities fraud class action litigation. This presumption is vital to bringing suits as class actions because it excuses plaintiffs from proving individual reliance on an alleged corporate misstatement on the theory that any public statements made by the company are incorporated into its stock price and consequently relied upon by all investors. Thus, the Court’s decision to uphold the validity of the presumption has been hailed as a significant victory for those who bring securities fraud class actions.

Overlooked by many commentators is the fact that in addition to upholding the fraud on the market presumption, the Court established a new avenue for defendants to rebut the presumption at the class certification stage of a case. Defendants can now rebut the presumption before a class is certified by presenting evidence that an alleged corporate misstatement had no impact on the price of the stock. This ruling is significant because securities fraud class actions, as a practical matter, often settle after a class has been certified. This article examines what that ruling could mean for modern securities fraud class action litigation.

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INTRODUCTION

In Halliburton Co. v. Erica P. John Fund, Inc. (Halliburton II),1 the United States Supreme Court revisited a basic underpinning of a securities fraud class action: whether plaintiff-investors may invoke a judicially created presumption of reliance that a company’s alleged public misstatement perpetrated a “fraud on the market.”2 The Court upheld the validity of the presumption it adopted 26 years earlier in Basic, Inc. v. Levinson that securities markets efficiently incorporate all publicly available information (including misstatements) into a stock’s price and that investors invest “in reliance on the integrity of the [market] price.”3 This presumption is critical to securities fraud litigation brought as a putative class action because class members invoking the presumption can bypass showing individual reliance on an alleged corporate misstatement.4 If plaintiffs were required to show individual reliance, class treatment would be unsuitable because individual issues would predominate over common issues of the class.5 The Court’s decision to reaffirm the reliance presumption, therefore, preserved the viability of modern securities fraud class actions.6

2. Id. at 2408.
5. See Halliburton II, 134 S. Ct. at 2402 (explaining that if investors had to prove reliance on an individual basis, “individual issues would predominate over common ones and class certification would be inappropriate under Federal Rule of Civil Procedure 23(b)(3)”; see also Fed. R. Civ. P. 23(b)(3).
6. See Jill E. Fisch, The Trouble With Basic: Price Distortion After Halliburton, 90 WASH. U. L. REV. 895, 896 (2013) (“The Supreme Court’s decision in Basic, Inc. v. Levinson is widely credited with spawning a vast industry of securities fraud litigation by removing the requirement of individualized proof of reliance as an obstacle to class certification.”); Donald
Whether securities fraud class actions should be preserved has been the subject of debate by economists and legal commentators. This is because the company sued in a securities fraud class action will be made to pay damages to one group of allegedly injured investors from funds that might have otherwise been used to invest in the company, such as through research and development. In doing so, the class action may harm these same plaintiff-investors by a resulting decrease in the company’s stock price. Studies have shown that plaintiff-investors “lose much more than they gain” as the result of the filing of a securities fraud class action. Other investors are estimated to lose hundreds of billions of dollars in the aggregate each year due to the filing of securities fraud class actions. In Halliburton II, however, the Court did not directly address the public policy of whether the securities fraud class action system functions as a fair or effective mechanism for remedying alleged securities violations. The Court simply held that no “special justification” existed for overruling its prior decision in Basic.

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9. Id. at 2.


11. See Halliburton Co. v. Erica P. John Fund, Inc. (Halliburton II), 134 S. Ct. 2398, 2413 (2014) (stating that concerns about the “serious and harmful consequences” of the Basic presumption, including the volume of meritless claims, the costs to shareholders, and the strain on judicial resources, are “more appropriately addressed to Congress”).

12. See id. at 2407–08.
But, the Court did not end its analysis by merely reaffirming the fraud on the market reliance presumption. Instead, the Court recognized a new avenue for corporate defendants to rebut the fraud on the market presumption at the class certification stage by presenting evidence that an alleged corporate misstatement had no impact on the price of the stock. This ruling is significant because, under prior law in a number of federal circuits, a defendant company was permitted to use evidence of “price impact” to directly rebut the presumption only at the merits stage. Thus, the Court opened the door for defendants to mount a more robust defense of a securities fraud class action prior to class certification. This is a key change in the law given that securities fraud class actions, as a practical matter, almost always settle once a class has been certified.

What this ruling means for the landscape of securities fraud class actions remains to be seen. Already, defendants in securities fraud class actions have relied on the Halliburton II decision to challenge or appeal class certification. This Article explores this new avenue for defendants to rebut the fraud on the market presumption at the class certification stage to assist federal judges handling securities fraud cases. Part I of the Article provides a history of securities fraud class action litigation and an analysis of the Halliburton II decision. Part II discusses the scope and use of expert evidence at the class certification stage in the aftermath of Halliburton II.

The Article concludes that the fraud on the market presumption should, when appropriate, be subject to an array of challenges at the class certification stage of a securities fraud case. It further concludes that federal judges should embrace new and well-founded evidence demonstrating market inefficiency or a lack of price impact to rebut the Basic presumption. Such evidence can limit securities fraud class actions that do not ultimately benefit investors and curb the in terrorem effect class certification can have on settlements. It can also refocus securities litigation on instances where a company acts in a deliberate manner to defraud investors as opposed to correcting good-faith public disclosures where circumstances did not unfold as planned.

13. See id. at 2416–17.
14. See id.
15. See infra Part II.4.
16. An explanation for why class actions often settle following class certification is due to the in terrorem effect on a company potentially having to pay substantial sums awarded by a jury. See Richard A. Nagareda, Class Certification in the Age of Aggregate Proof, 84 N.Y.U. L. Rev. 97, 99 (2009) (“With vanishingly rare exception, class certification sets the litigation on a path toward resolution by way of settlement, not full-fledged testing of the plaintiffs’ case by trial.”).
I. THE EVOLUTION OF SECURITIES FRAUD CLASS ACTION LITIGATION

A. Origins of the 10b-5 Securities Fraud Action

Congress enacted the Securities Exchange Act of 1934 (The Act) to protect investors against manipulation of stock prices in the wake of the stock market crash of 1929 and amidst the Great Depression. The Act established the Securities and Exchange Commission (SEC) to regulate capital markets and address excessive speculation, unfair practices, and inadequate disclosures of information to investors. In particular, section 10(b) of The Act prohibited “any manipulative or deceptive device” employed “in connection with the purchase or sale of any security.” Pursuant to this authority, the SEC promulgated Rule 10b-5, which broadly prohibits any act or practice in connection with the purchase or sale of a security that “would operate as a fraud or deceit upon any person.” Together, these laws provide the foundation for a securities fraud claim.

Neither section 10(b) of The Act nor SEC Rule 10b-5, however, explicitly provide a private cause of action for investors or others who allege fraud in connection with the purchase or sale of a security. When initially confronted with the issue of whether private claims could be brought, some courts implied a private right of action. In 1971, the United States Supreme Court, in Superintendent of Insurance v. Bankers Life & Casualty Co., validated these decisions by recognizing for the first time, in a footnote, the existence of an implied private right of action under section 10(b).
During the ensuing decade (almost forty years after Congress enacted The Act), the scope and elements of this implied private right of action began to crystalize in light of additional rulings by the Supreme Court and lower courts.\textsuperscript{27} The result was an implied private right of action requiring a plaintiff-investor to show: (1) a company’s material misrepresentation (or omission); (2) scienter (i.e., a wrongful state of mind); (3) a connection with the purchase or sale of the security; (4) reliance on the misrepresentation by the plaintiff-investor; (5) economic loss; and (6) loss causation (i.e., a causal connection between the material misrepresentation and the loss).\textsuperscript{28}

B. The Basic Fraud on the Market Presumption

An outstanding issue for plaintiff-investors following the Supreme Court’s recognition of an implied private right of action under The Act (often referred to as a Rule 10b-5 action) was whether, and, if so, how, plaintiffs could pursue a remedy through collective action.\textsuperscript{29} In 1988, the Supreme Court, in a 4-2 decision in \textit{Basic, Inc. v. Levinson},\textsuperscript{30} addressed that issue and opened the door to modern securities fraud class actions through its adoption of the fraud on the market presumption.\textsuperscript{31} This presumption implicates the reliance element of a Rule 10b-5 action, which provides that an investor must have relied on the alleged corporate misrepresentation in his or her decision to buy or sell the stock.\textsuperscript{32} \textit{Basic} established a shortcut for satisfying this element by holding that individual reliance will be presumed by virtue of the fact that an investor traded in an efficient capital market that incorporates any public information into a stock’s price.\textsuperscript{33}

\textsuperscript{27} See, e.g., Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 477–478 (1977) (discussing “manipulative or deceptive” requirement of § 10(b) of Securities Exchange Act); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 731 (1975) (limiting the implied right of action to actual purchasers and sellers of securities); Hochfelder, 425 U.S. at 193 (declining to recognize a right of action for aiding and abetting under Section 10(b) and Rule 10b-5 where the defendant lacked intent to defraud).


\textsuperscript{29} Basic, Inc. v. Levinson, 485 U.S. 224, 230 (1988) (noting a split among courts with respect to a presumption of class-wide reliance on an alleged corporate misrepresentation).

\textsuperscript{30} Three members of the Court, Chief Justice Rehnquist and Justices Scalia and Kennedy, took no part in the consideration of the case. Justice Blackmun authored the majority opinion, which was joined by Justices Brennan, Marshall, and Stevens with respect to the fraud on the market reliance presumption. \textit{See id.} at 225.

\textsuperscript{31} \textit{See id.} at 245–47.

\textsuperscript{32} \textit{See id.}

\textsuperscript{33} \textit{See id.} at 243–44 (stating “[t]here is . . . more than one way to demonstrate the causal connection” of the reliance element of a 10b-5 action).
As the Court explained, “[a]n investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price.”34 “Because most publicly available information is reflected in market price, an investor’s reliance on any public material misrepresentations, therefore, may be presumed for purposes of a Rule 10b-5 action.”35 Consequently, plaintiff-investors are relieved from showing that they specifically relied on the misrepresentation(s) alleged against a defendant company. The fraud on the market theory presumes reliance on a class-wide basis even if none of the plaintiff-investors saw or was aware of the alleged company misstatement or omission.36 Claims may then proceed as a class action under Rule 23(b)(3) of Federal Rules of Civil Procedure because those individual questions of what information each plaintiff-investor saw or did not see, and relied on, are not at issue, permitting common issues of the class to predominate.37

In relaxing the requirements of a Rule 10b-5 action, the Basic Court reasoned that “modern securities markets, literally involving millions of shares changing hands daily, differ from the face-to-face transactions contemplated by early fraud cases, and our understanding of Rule 10b-5’s reliance requirement must encompass these differences.”38 According to the Court, requiring a Rule 10b-5 plaintiff to prove how he or she would have acted in the absence of an alleged corporate misstatement (or omission) would impose an “unrealistic evidentiary burden.”39 The Court further concluded that “considerations of fairness, public policy . . . as well as judi-

34. Id. at 247.
35. Id.; Id. at 241–42 (explaining further that “[t]he fraud on the market theory is based on the hypothesis that, in an open and developed securities market, the price of a company’s stock is determined by the available material information regarding the company and its business. . . . Misleading statements will therefore defraud purchasers of stock even if the purchasers do not directly rely on the misstatements . . . The causal connection between the defendants’ fraud and the plaintiffs’ purchase of stock in such a case is no less significant than in a case of direct reliance on misrepresentations.” (quoting Peil v. Speiser, 806 F.2d 1154, 1160–61 (3d Cir. 1986))).
36. Id. at 242 (“Requiring proof of individualized reliance from each member of the proposed plaintiff class effectively would have prevented respondents from proceeding with a class action, since individual issues then would have overwhelmed the common ones.”).
37. See Fed. R. Civ. P. 23. Courts generally explain the rule as follows: the “predominance requirement is met ‘if the plaintiff can establish that the issues in the class action that are subject to generalized proof, and thus are applicable to the class as a whole . . . predominate over the issues that are subject only to individualized proof.’” Cordes & Co. Fin. Servs., Inc. v. A.G. Edwards & Sons, Inc., 502 F.3d 91, 107–08 (2d Cir. 2007) (quoting In re Visa Check/MasterMoney Antitrust Litig., 280 F.3d 124, 136 (2d Cir. 2001)) (internal quotation marks and citation omitted).
38. Basic, 485 U.S. at 243–44.
39. Id. at 245; but see Paul A. Ferrillo et al., The “Less Than” Efficient Capital Markets Hypothesis: Requiring More Proof from Plaintiffs in Fraud-on-the-Market Cases, 78 St. John’s L. Rev. 81, 107–16 (2004) (identifying various challenges to the efficient market hypothesis); see Burton G. Malkiel, The Efficient Market Hypothesis and Its Critics, 17 J. Econ. Persp. 59 (2003).
cial economy” supported recognition of the fraud on the market presumption.40

C. Basic’s Aftermath and the Rise of Modern Securities Fraud Class Actions

A result of the Basic Court’s adoption of the fraud on the market presumption was a significant increase in securities class action litigation that continues today.41 The Court may have expected at least some increase in securities litigation as a result of its decision, but the ensuing evolution of modern securities fraud class-action litigation was something the Court probably could not have anticipated.42 In the two decades following Basic, securities fraud class-action litigation transformed into a cottage industry driven primarily by plaintiffs’ attorneys.43

Rather than responding to an investor’s fraud allegations, the business model of many of these attorneys, both then and now, consists of combing through corporate disclosures for potential misstatements and recruitment of plaintiff-investors.44 Some plaintiffs’ attorneys have repeatedly called on professional plaintiff-investors—sometimes on as many as fifty occasions—to bring a shareholder class action.45 Attorneys have often been successful in having a class certified and leveraging class certification into a settlement because, under Basic, reliance on the alleged corporate misstatement is presumed.46

In 1995, Congress intervened to curtail the increase in plaintiff-attorney sponsored securities fraud class actions by enacting the Private Securities Litigation Reform Act (PSLRA).47 PSLRA adopted various changes related to pleading, discovery, class representation, and fee awards, but did not disturb the fraud on the market presumption that the Supreme

40. Basic, 485 U.S. at 245.
41. See The Real Costs of U.S. Securities Class Action Litigation, supra note 8, at 29; see also Schleicher v. Wendt, 618 F.3d 679, 681 (7th Cir. 2010) (Easterbrook, J.) (“When a large, public company makes statements that are said to be false, securities-fraud litigation regularly proceeds as a class action.”).
42. The two dissenting justices, Justices White and O’Connor, expressed the view that the majority’s embrace of the fraud on the market theory “with the sweeping confidence usually reserved for more mature legal doctrines” could have “many adverse, unintended effects as it is applied and interpreted in the years to come.” Basic, 485 U.S. at 250–51 (White, J., dissenting).
44. See id. at 1-2.
45. See id. at 1, 17.
46. See id. at 10–13.
Court adopted in Basic.48 Congress also enacted the Securities Litigation Uniform Standards Act (SLUSA) in 1998 with the objective of precluding many state class actions alleging securities fraud in favor of treatment by federal courts.49 These enactments, however, have had little impact on curbing the filing of questionable securities fraud class actions.50 Each year, plaintiffs’ attorneys file roughly 200 securities fraud lawsuits.51 Over the past twenty years, this has resulted in more than 4,200 cases filed, alleging trillions of dollars in investor losses.52 More than 40% of corporations on major stock exchanges have been the target of a securities fraud class action.53 Pharmaceutical, healthcare, and biotechnology companies, in particular, have been common targets, accounting for 21% of 2013 filings.54

The broad scope of modern securities fraud class action litigation has led economists and other scholars to analyze more carefully the economic theory and supposed benefits of this litigation.55 After all, the costs of securities class actions are shared by the very same class of investors who “win” their lawsuit. The transfer of funds in a successful lawsuit that might have otherwise been used to invest in the company, along with other transaction costs such as the company’s legal fees in defending a multi-million dollar securities fraud class action, may harm these same plaintiff-investors.

48. See id.; see also Frequent Filers, supra note 43, at 7-8.
50. See Frequent Filers, supra note 43, at 5–9 (discussing impact of PSLRA and SLUSA).
52. See The Real Costs of U.S. Securities Class Action Litigation, supra note 8, at 5.
more by a resulting decrease in the company’s stock price.\textsuperscript{56} The market stigma and reputational damage associated with such a lawsuit may also adversely impact the company’s stock price.\textsuperscript{57} Indeed, some studies have concluded that the filing of a securities fraud class action is typically a losing proposition for the class of investors bringing the lawsuit.\textsuperscript{58}

For those stock owners who are not part of a class of plaintiff-investors (and, importantly, are also unconnected to, and innocent of, any alleged securities violation), securities fraud class action litigation is a far greater losing proposition. Studies have estimated the average loss for investors, from decreases in stock price and other costs associated with the filing of a securities fraud class action, at more than $248 billion annually over the past decade.\textsuperscript{59} This suggests that truly innocent investors are ultimately losing trillions of dollars as a result of the litigation.

In contrast, the plaintiffs’ attorneys sponsoring many securities fraud class actions are estimated to collect over $1 billion annually in fees and expenses.\textsuperscript{60} Between 1997 and 2013, plaintiffs’ lawyers earned more than $14 billion in fees and expenses in securities class action settlements.\textsuperscript{61} A substantial amount of these fees have gone to just a handful of plaintiffs’ firms.\textsuperscript{62} Hence, millions of investors—including those who are plaintiffs in a securities fraud class action—are estimated to lose billions of dollars each year so that a relatively few plaintiffs’ attorneys can collect billions of dollars through class action settlements. This dynamic has raised doubts about the utility of the modern securities class action system as a mechanism for fairly addressing fraud claims.\textsuperscript{63}

\textbf{D. Halliburton II Revisits the Fraud on the Market Presumption}\

The Supreme Court decided \textit{Halliburton II} against the backdrop of modern securities fraud class action litigation, described above, as well as many scholarly post-\textit{Basic} critiques of the efficient market theory underly-

\textsuperscript{56} See \textit{The Real Costs of U.S. Securities Class Action Litigation}, supra note 8, at 1–2.  
\textsuperscript{57} See \textit{id.}.  
\textsuperscript{58} See \textit{id.} at 2.  
\textsuperscript{59} See \textit{2013 Recent Trends in Securities Class Action Litigation}, supra note 10, at 8 (estimating the average loss for investors due to the filing of securities class actions at more than $248 billion annually from 2005–2013); \textit{2013 Securities Class Action Filings}, supra note 10, at 5 (calculating the average loss of defendant company share prices to be $126 billion annually from 1997–2012).  
\textsuperscript{60} See \textit{2013 Recent Trends in Securities Class Action Litigation}, supra note 10, at 35 (estimating that plaintiffs’ attorneys collected around $1.1 billion in 2013, which was almost twice the amount collected in 2012).  
\textsuperscript{61} See \textit{id.} at 35 Fig.35; see also Grundfest, supra note 23, at 309.  
\textsuperscript{63} See \textit{id.} at 23–24.
ing the fraud on the market presumption. The Court agreed to hear the case to: (1) reconsider the continued viability of the fraud on the market presumption, and (2) resolve, if necessary, a conflict among the federal circuit courts of appeal over whether a securities fraud defendant may attempt to rebut the Basic presumption at the class certification stage with evidence showing a lack of any price impact from the defendant’s alleged misrepresentation(s). The Court’s decision, therefore, was widely understood to have the potential to introduce profound changes to modern securities fraud class action litigation.

The case itself involved relatively “garden variety” claims of securities violations. The lead plaintiff in the putative class action, an investment fund, alleged that Halliburton made a series of misrepresentations regarding its potential liability in asbestos litigation, the company’s expected revenue from certain construction contracts, and the expected benefits of a merger with another company in a collective attempt to inflate the price of its stock. Plaintiffs’ argued that when Halliburton subsequently made corrective disclosures, it caused the company’s stock price to drop and investors to lose money.

A federal district court initially refused to certify the proposed class of investors who traded Halliburton common stock between the time the alleged misrepresentations were made and when the truth was purportedly revealed. At the time, the federal district court relied on Fifth Circuit precedent requiring securities fraud plaintiffs to prove, at the class certification stage, a causal connection between the defendants’ alleged misrepresentations and the plaintiffs’ economic losses (“loss causation”) in order to invoke Basic’s presumption of reliance and obtain class certification. That ruling was affirmed by the Fifth Circuit and granted certiorari by the Supreme Court (Halliburton I). The Court held that proving “loss causation” was not required at the class certification stage because it “addresses a matter different from whether an investor relied on a misrepresentation.” On remand, the district court, invoking Basic’s reliance presumption, found that common issues of the claim predominated
over individual issues and certified the class pursuant to Federal Rule of Civil Procedure 23(b)(3).\textsuperscript{73}

This ruling was affirmed by the Fifth Circuit, which examined the additional question of whether price impact evidence (i.e., evidence showing that Halliburton’s alleged securities misrepresentations had no impact on its stock price) could be used at the class certification stage to rebut Basic’s fraud on the market presumption.\textsuperscript{74} The Fifth Circuit determined that such evidence could not be used because it “does not bear on the question of common question predominance [under Rule 23(b)(3)], and is thus appropriately considered only on the merits after the class has been certified.”\textsuperscript{75}

In \textit{Halliburton II}, Chief Justice Roberts, writing for the majority of the Court, answered the threshold question of whether Basic should be overruled in the negative. The Court, however, answered the question regarding the use of price impact evidence to rebut the Basic presumption at the class certification stage in the positive.\textsuperscript{76} With respect to preserving the fraud on the market presumption, Justice Roberts recognized that the “markets for some securities are more efficient than the markets for others” and that “a misrepresentation can leave a stock’s market price unaffected even in a generally efficient [market].”\textsuperscript{77} Nevertheless, he stated that such “debate is not new” and that the presumption adopted in Basic is based on the “fairly modest premise” that markets generally consider most publicly announced material statements about companies, and that this will affect a stock’s price.\textsuperscript{78} Justice Roberts further explained that principles of stare decisis, which carry “special force” with respect to issues of statutory interpretation, did not support overruling Basic’s longstanding “substantive doctrine of federal securities-fraud law.”\textsuperscript{79} Accordingly, the Court reaffirmed the presumption it adopted from the implied private right of action it created.\textsuperscript{80}

With the viability of Basic’s fraud on the market presumption left intact, the Court proceeded to address whether the presumption may be challenged at the class certification stage by showing a lack of any price impact from Halliburton’s alleged misrepresentations.\textsuperscript{81} In addressing this

\begin{itemize}
\item \textsuperscript{73} See id.
\item \textsuperscript{74} See id. at 2406–07.
\item \textsuperscript{75} See id. (quoting Erica P. John Fund, Inc. v. Halliburton Co., 718 F.3d 423, 435 (5th Cir. 2013)).
\item \textsuperscript{76} See id. at 2407, 2414.
\item \textsuperscript{77} Id. at 2409–10.
\item \textsuperscript{78} Id. at 2410.
\item \textsuperscript{79} Id. at 2411 (quoting Amgen Inc. v. Connecticut Retirement Plans & Trust Funds, 133 S. Ct. 1184, 1193 (2013)).
\item \textsuperscript{80} See id. at 2413. The Supreme Court has more recently expressed the view that courts may not imply a private right of action absent express authorization by Congress. See Alexander v. Sandoval, 532 U.S. 275, 287 (2001).
\item \textsuperscript{81} See \textit{Halliburton II}, 134 S. Ct. at 2413.
\end{itemize}
question, the Court identified four prerequisites for invoking the Basic presumption: (1) the alleged misrepresentations were publicly known; (2) they were material; (3) the stock traded in an efficient market; and (4) the plaintiff traded the stock between when the misrepresentations were made and when the truth was revealed. As the Court explained, if an alleged misrepresentation was not publicly known or “viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available,” it could not have distorted the stock’s price. In addition, if the market where the stock traded was inefficient, a plaintiff-investor “could not be said to have acted in reliance on a fraud-tainted price.”

The Court recognized that there was “no dispute” that defendants may introduce evidence of a lack of price impact at the merits stage to rebut the fraud on the market presumption. It further stated that price impact evidence was permitted at the class certification stage under existing law, “so long as it [was] for the purpose of countering a plaintiff’s showing of market efficiency, rather than directly rebutting the [fraud on the market] presumption.” “This restriction,” according to the Court, made “no sense” and was “inconsistent with Basic’s own logic.” Under Basic, “[a]ny showing that severs the link between the alleged misrepresentation and . . . the price received (or paid) by the plaintiff . . . will be sufficient to rebut the presumption of reliance.” “[T]o artificially limit the inquiry at the class certification stage to indirect evidence of price impact,” the Halliburton II Court continued, would “require courts to ignore a defendant’s direct, more salient evidence showing that the alleged misrepresentation did not actually affect the stock’s market price and . . . that the Basic presumption does not apply.” Accordingly, the Court rejected limiting the introduction of price impact evidence at the class certification stage, and opened the door to a defendant’s direct challenge on this “essential pre-condition for any 10b-5 class action.”

Halliburton II’s two key holdings—first, that fraud on the market presumption remains good law, and, second, that a defendant may now directly challenge that presumption at the class certification stage through price impact evidence—are straight-forward. The impact of these holdings on the future of securities fraud class action litigation, however, is not. Chief Justice Roberts chose neither to speculate about the potential impact of the decision nor offer any insights about how a defendant may use

82. See id.
83. Id. (quoting Basic, Inc. v. Levinson, 485 U.S. 224, 231-32 (1988)) (internal citations omitted).
84. Id. at 2414.
85. Id.
86. Id. at 2415.
87. Id.
88. Id. (quoting Basic, 485 U.S. at 248).
89. Id. at 2416–17.
90. Id. at 2416.
price impact evidence to successfully rebut the fraud on the market presumption in future cases.

A single-paragraph concurring opinion authored by Justice Ginsburg, and joined by Justices Breyer and Sotomayor, suggested that “[a]dvancing price impact consideration from the merits stage to the certification stage may broaden the scope of discovery available at certification.”91 These justices indicated that such a result “should impose no heavy toll on securities-fraud plaintiffs with tenable claims” because the burden of rebutting the fraud on the market presumption through price impact evidence remained with the defendant.92

Justice Thomas, in comparison, authored a concurring opinion, joined by Justices Scalia and Alito, stating, “Basic’s reimagined reliance requirement was a mistake” whose failings had compounded with time to “exempt[] Rule 10b-5 plaintiffs from Rule 23’s proof requirements.”93 The opinion submitted that the key assumption underlying the fraud on the market presumption, namely that “investors categorically rely on the integrity of the market price,” is one that is “simply wrong.”94 Justice Thomas also observed that “in practice, the so-called ‘rebuttable presumption’ is largely irrebuttable,” and cited a report that found only six cases out of the thousands of Rule 10b-5 actions brought since Basic have been rebutted on individual reliance grounds.95

These statements in the concurring opinions suggest that implicit in the majority’s ruling was that such a dearth of successful rebuttals might soon become a remnant of the past in securities fraud class action litigation. How this might play out in future cases is explored in the following section.

II. Opening the Door for Effective Discovery to Rebut the Fraud on the Market Presumption

A. The Supreme Court’s Recent Class Action Jurisprudence Envisions Broader Discovery Prior to the Class Certification Stage

Justice Ginsburg’s statement that the Court’s decision in Halliburton II may acceptably broaden the scope of discovery at the class certification stage of a securities fraud action provides a helpful starting point for examining how a defendant may successfully rebut the fraud on the market presumption.96 It suggests that courts should be inclined to grant discovery requests at the class certification stage where they may have been reluctant before, and that such requests may relate to “[a]ny showing that severs the link between the alleged misrepresentation” and “the price re-

91. Id. at 2417 (Ginsburg, J., concurring).
92. Id.
93. Id. at 2419, 2424 (Thomas, J., concurring).
94. Id. at 2420.
95. Id. at 2424 (citing Grundfest, supra note 23, at 360).
96. See id. at 2417 (Ginsburg, J., concurring).
ceived (or paid) by the plaintiff.” 97 Indeed, Justice Roberts’ majority opinion emphasized this later point, stating that the fraud on the market presumption would not apply “if a defendant could show that the alleged misrepresentation did not, for whatever reason, actually affect the market price.”98

As discussed previously, the Court also expressly identified ways the link between an alleged misrepresentation and stock price could be severed, namely that the alleged misrepresentations were either not publicly known or were immaterial when viewed in combination with the “total mix” of information made available, or that the stock traded in an inefficient market.99 Each of these possibilities, under the reasoning of Halliburton II, may now be the subject of a defendant’s discovery prior to the class certification stage.100

Recognition of a broader scope of discovery prior to class certification is also supported by other recent Supreme Court decisions. In Wal-Mart Stores, Inc. v. Dukes, the Court considered certification of an employment discrimination action brought on behalf of a purported class of 1.5 million current and former employees.101 The Court stated that the “rigorous analysis” required of lower courts at the Rule 23 class certification stage frequently “will entail some overlap with the merits of the plaintiff’s underlying claim.”102 According to the Court, this “necessity of touching aspects of the merits in order to resolve preliminary matters, e.g., jurisdiction and venue, is a familiar feature of litigation.”103 Such a “familiar feature” supports the recognition by courts of broader discovery prior to the class certification stage if issues touching or overlapping with the merits of a claim are to be examined.

In Dukes, the Court specifically recognized that “the most common example of considering a merits question at the Rule 23 stage arises in class-action suits for securities fraud.”104 The Court explained that to invoke the fraud on the market presumption, plaintiffs seeking class certification must prove their shares traded on an efficient market.105 This issue,
the Court said, is one plaintiffs “will surely have to prove again at trial in order to make out their case on the merits.” It, therefore, follows that a defendant’s initial discovery related to an issue that implicates Basic’s reliance presumption should extend to the same bounds as would apply at the merits stage if the class were certified.

After Dukes was decided, and prior to Halliburton II, the Supreme Court examined class certification under Rule 23(b)(3) in Comcast Corp. v. Behrend. Here, the Court considered a putative class action on behalf of consumers alleging antitrust violations against a cable provider. At issue was whether the federal district court properly certified the class where it rejected three of the four theories of “antitrust impact” proposed by the plaintiffs, and where the model used by the plaintiffs’ expert to show damages was based, in part, on these discarded theories. The Court, recognizing that under Dukes it “may be necessary . . . to probe behind the pleadings before coming to rest on the certification question,” held that class certification pursuant to Rule 23(b)(3) was improper. It reasoned that because the proffered expert model, incorporating multiple discarded theories, could not tie the permitted theory of “antitrust impact” to a calculation of damages, it was incapable of measuring damages on a class-wide basis. Consequently, the case turned on a “straightforward application of class-certification principles” whereby “[q]uestions of individual damage calculations [would] inevitably overwhelm questions common to the class.”

In reaching this conclusion, the Court did not just probe beyond the pleadings; it analyzed the plaintiffs’ theories and supporting damages model in effectively the same manner as if at the merits stage. The Court labored to decipher the “scheme” and methodology of the plaintiffs’ expert model that attempted to “show what the competitive prices would have been if there had been no antitrust violations.” In rejecting the model, the Court further rebuked the lower courts’ view that there was “no need . . . to ‘tie each theory of antitrust impact’ to a calculation of damages” because that would “involve consideration of the ‘merits’ having

106. Id. (emphasis in original).
109. See id. at 1430.
110. See id. at 1430–31.
111. Id. at 1432 (quoting Dukes, 131 S. Ct. at 2551.
112. See id. at 1433 (“[A] model purporting to serve as evidence of damages in this class action must measure only those damages attributable to that theory.”).
113. Id. at 1433.
114. See id. at 1433–34.
115. Id. at 1434.
"no place in the class certification inquiry."" 116 “That reasoning,” the Court held, “flatly contradicted . . . cases requiring a determination that Rule 23 is satisfied, even when that requires inquiry into the merits of the claim.” 117

The Supreme Court’s rulings in Dukes, Behrend, and Halliburton II demonstrate an unambiguous view that lower courts should entertain requests by defendants for broader discovery prior to the class certification stage. The Court has also charted a clear path by which judges may scrutinize a plaintiff’s proffered liability theories and the quality of supporting evidence at the class certification stage. Both of these takeaways support new and enhanced challenges by defendants to class certification.

B. Employing Heightened Discovery and Expert Evidence Prior to the Class Certification Stage

The Supreme Court’s incremental endorsement of broader discovery for defendants at the class certification stage presents the question of what this newfound degree of discovery should entail as a practical matter. The answer to this question generally is that discovery may extend to any information related to the plaintiff’s compliance with Rule 23’s requirements, whether class treatment is being challenged under Rule 23(a)’s prerequisites of numerosity, commonality, typicality, and adequacy of class representation, or any of Rule 23(b)’s provisions governing types of class actions. 118 In the specific context of a proposed securities fraud class action, the answer to the scope of discovery may require diving deeper because, in order to satisfy Rule 23(b)(3)’s predominance requirement, judicial innovations—namely Basic’s reliance presumption—must be invoked. 119

In Halliburton II, the Court reaffirmed that anything that “severs the link between the alleged misrepresentation” and “the price received (or paid) by the plaintiff” may be subject to discovery. 120 The Court developed this concept further by identifying potential ways to sever the link

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116. Id. at 1433 (quoting Behrend v. Comcast Corp., 655 F.3d 182, 206–07 (3d Cir. 2011)).
117. Id. (citing Wal-Mart Stores, Inc. v. Dukes, 131 S. Ct. 2541, 2551–52, n.6 (2011)).
119. The predominance element requires a finding that common issues of law or fact “predominate over any questions affecting only individual members.” Fed. R. Civ. P. 23(b)(3). This requirement, although reminiscent of the commonality requirement of Rule 23(a), is “far more demanding” because it “tests whether proposed classes are sufficiently cohesive to warrant adjudication by representation.” Amchem Prods., Inc. v. Windsor, 521 U.S. 591, 623-24 (1997).
and successfully rebut the fraud on the market presumption at the class certification stage. 121 Two of these ways are fundamentally important in a typical securities fraud class action: (1) showing that the stock did not trade in an efficient market; and (2) showing that the alleged company misrepresentation, when viewed in combination with the total mix of information made available, had no price impact. 122 Hence, it follows that the scope of a defendant’s discovery prior to the class certification stage should extend to any information relevant to challenging either of these conditions.

1. Challenging Market Efficiency

A defendant’s ability to challenge the efficiency of a securities market is, as explained previously, a product of the Court’s 1988 decision in Basic. 123 As also explained, both Halliburton II and key Supreme Court decisions such as Dukes and Behrends have recognized greater discretion by courts to examine a claim’s merits at the class certification stage, provided those merits pertain to a Rule 23 requirement. 124 This development, as Justice Ginsberg forecast in her concurrence in Halliburton II, may appropriately broaden discovery in a proposed securities-fraud class action. 125 Although the Court’s decision in Halliburton II focused on challenging the price-impact assumption underlying the fraud on the market presumption, 126 there is nothing to indicate that the Court’s recognition of a broader scope of discovery by defendants prior to the class certification stage would not apply equally to challenging the efficiency of a given stock market.

Since Basic, many securities fraud class-action defendants have not mounted any challenge to a market’s efficiency. 127 This is particularly the case “where heavily-traded or well-known stocks are the target of suits.” 128 In markets that include small-cap stocks traded in less-organized markets, defendants are more likely to challenge the Basic presumption. 129 The form of such a challenge often involves expert evidence to rebut the plaintiffs’ required evidentiary showing of market efficiency,

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121. See id. at 2413.
122. See id.
123. See Basic, 485 U.S. at 248.
124. See supra Part II.A.
125. See Halliburton II, 134 S. Ct. at 2417 (Ginsburg, J., concurring).
126. See supra Part II.A.
127. See Unger v. Amedisys Inc., 401 F.3d 316, 322 (5th Cir. 2005); see also Local 703, I.B. of T. Grocery & Food Employees Welfare Fund v. Regions Financial Corp., 2014 WL 6661918, at *4 (“The law is clear that reliance by investors on alleged material omissions may be presumed. . . . Less clear is the law on how that presumption may be rebutted.”) (citations omitted).
128. Unger, 401 F.3d at 322.
129. Id.
which similarly takes the form of expert evidence in most cases.\footnote{130} A typical challenge to market efficiency, therefore, will involve battling experts.\footnote{131}

In evaluating whether a stock trades in an efficient market, courts have considered various factors. These may include: (1) the average weekly trading volume expressed as a percentage of total outstanding shares of stock; (2) the number of securities analysts following and reporting on the stock; (3) the extent to which market makers and arbitrageurs trade in the stock; (4) the company’s eligibility to file SEC registration Form S–3 (as opposed to Form S–1 or S–2); and (5) the existence of empirical facts showing a causal relationship between unexpected corporate events or financial releases and an immediate price response.\footnote{132} Courts examining such factors have also made clear that “they must be weighed analytically, not merely counted, as each of them represents a distinct facet of market efficiency.”\footnote{133} As the U.S. Court of Appeals for the Fifth Circuit has further explained:

> When a court considers class certification based on the fraud on the market theory, it must engage in thorough analysis, weigh the relevant factors, require both parties to justify their allegations, and base its ruling on admissible evidence. Questions of market efficiency cannot be treated differently from other preliminary certification issues.\footnote{134}

Based on this analysis, a number of courts have concluded there is not an efficient market as a matter of law for stocks trading in an over-the-counter market.\footnote{135}

\textit{Halliburton II}’s import here should be to foster such thorough analysis of whether a market is actually efficient by allowing broader discovery of potential market inefficiencies. This could play out in several ways. First, a court could expand discovery to include the methodology and conclusions of plaintiffs’ retained experts prior to class certification either at the request of a defendant or to further the court’s own analysis and under-

\footnote{130. Plaintiffs in securities fraud cases are required to present evidence demonstrating the existence of an efficient market as a prerequisite for class certification. See, e.g., \textit{In re DVI, Inc. Sec. Litig.}, 639 F.3d 623, 631 (3d Cir. 2011). While courts have not held that this requirement can be satisfied only through expert testimony, they have made clear that this is the normal and expected way to do so. See, e.g. \textit{Bell v. Ascendant Solutions, Inc.}, 422 F.3d 307, 314 n.13 (5th Cir. 2005).

131. \textit{See} \textit{Georgene Vairo, Is the Class Action Really Dead? Is that Good or Bad for Class Members?}, 64 EMORY L.J. 477, 488 (2014) (“\textit{Halliburton II} is good news for the economics professors who will duke out the price impact issue.”).

132. \textit{Cammer v. Bloom}, 711 F. Supp. 1264, 1286–87 (D. N.J. 1989); \textit{see also} \textit{Krogman v. Sterritt}, 202 F.R.D. 467, 473, 477–78 (N.D. Tex. 2001) (considering additional factors that include the company’s market capitalization, the bid-ask spread for stock sales, and the stock’s trading volume without counting insider-owned stock (i.e. float)).

133. \textit{Unger}, 401 F.3d at 323.

134. \textit{Id.} at 325.

standing. Second, a court could expand discovery prior to the class certification stage with respect to whether the putative class members, through either their actions or words, believed they were trading in an efficient market.

As the Court in Halliburton II stated, “Basic does afford defendants an opportunity to rebut the presumption of reliance with respect to an individual plaintiff by showing that he did not rely on the integrity of the market price in trading stock.”136 The Court recognized that this enables a defendant to “pick off” class members prior to the class certification stage.137 By allowing broader discovery of the views and motivations of class members when purchasing or selling their stock, a defendant might be able not only to pick off class members, but also to show that a significant portion of the purported class did not rely on the efficiency of the market. This finding would cut against class treatment altogether.

In explaining why the assumption “that investors categorically rely on the integrity of the market price—is simply wrong,” Justice Thomas’ concurrence in Halliburton II may have provided a practical roadmap for using heightened discovery prior to the class certification stage to challenge a market’s presumed efficiency.138 The concurrence concluded that “even ‘well-developed’ markets (like the New York Stock Exchange) do not uniformly incorporate information into market prices with high speed” and that many investors trade precisely because they believe the market to be inefficient.139 These investors “think the market has under- or overvalued the stock, and they believe they can profit from that mispricing.”140

“Other investors,” the concurrence recognized, “trade for reasons entirely unrelated to price—for instance, to address changing liquidity needs, tax concerns, or portfolio balancing requirements.”141 Many investors may simply trade on the advice of a stockbroker or friend, or as a form of gambling, and lack any knowledge of, or interest in, the company they have invested, its stock history, or price.142 Such investment decisions are made “without regard for price ‘integrity’” and “are at odds with Basic’s understanding of what motivates investment decisions.”143

137. Id.
138. See id. at 2420 (Thomas, J., concurring).
139. Id. at 2421.
140. Id. at 2422 (citing Basic, Inc. v. Levinson, 485 U.S. 224, 256 (1988)).
141. Id. (citing Stout, supra note 55, at 657–58.)
143. Halliburton II, 134 S. Ct. at 2422.
Corporate defendants alleged to have made a misstatement about their stock should be able to obtain discovery from investor-plaintiffs prior to the class certification stage to determine whether these individuals truly relied on the efficiency of a market or invested based on any of the myriad possibilities unrelated to market efficiency or integrity. Relatedly, defendants should be able to obtain discovery from lead plaintiffs regarding the methods used to recruit members and to create the proposed class because this information may also bear on the motivations and the types of investors comprising a significant portion, or all, of the proposed class.

Courts should also be receptive to these potentially broad discovery requests by defendants prior to the class certification stage for reasons beyond adherence to the Supreme Court’s rulings in *Halliburton II* and earlier decisions such as *Dukes* and *Behrends*. There are systemic self-correctives that strongly mitigate against a corporate defendant abusing the discovery system in this context. A securities fraud class action imposes high litigation costs on a defendant company related to an alleged misstatement. This consideration provides a built-in monetary incentive for a defendant seeking discovery to control both the scope of the discovery and its content. Investigating and deposing plaintiffs’ experts and potentially all, or significant portions of, named class members would be a costly and onerous undertaking for a company of any size.

A rational business would weigh the expected costs and potential benefits and be unlikely to pursue fruitless discovery. Further, federal discovery rules protect against a defendant’s abuse of discovery if it would harass an opposing party or unnecessarily delay a proceeding.

Allowing broader discovery prior to the class certification stage for the purpose of potentially rebutting the assumption of market efficiency also serves the interests of judicial economy. Expanding the scope of discovery early in a class action for the purposes of determining class certification would, if certification is granted, benefit the court in its “thorough analysis” of market efficiency when considered again at the merits stage. Alternatively, if permitting broader discovery shows that the stock did not trade in an efficient market then the class cannot be certified. This would effectively resolve the dispute before additional, unnecessary judicial resources are exhausted.

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144. A number of studies have endeavored to estimate the total costs of a securities-fraud action, whether in terms of average settlement amounts and/or litigation costs. See, e.g., S. Rep. No. 104-98, at 33 (1995), reprinted in 1995 U.S.C.C.A.N. 679, 711 (estimating an average settlement cost $8.6 million prior to reform such as the Private Securities Litigation Reform Act); Robert A. Prentice & John H. Langmore, *Beware of Vaporware: Product Hype and the Securities Fraud Liability of High-Tech Companies*, 8 Harv. J.L. & Tech. 1, 2 (1994) (reporting an average settlement figure at $10.8 million per suit and average cost of litigation was $692,000 per suit); *The Real Costs of U.S. Securities Class Action Litigation*, supra note 8, at 12 (estimating the average settlement amount of a securities class action case at around $58 million between 1997-2014).

145. See FED. R. CIV. P. 26(g).

2. Challenging Price Impact

If a securities market is shown to be efficient, the same broad scope of discovery prior to class certification may still reveal evidence that the alleged company misrepresentation(s) had no price impact. As explained, this price impact analysis examines whether the alleged company misrepresentation(s) claimed by plaintiff-investors in a putative class action would have "been viewed by the reasonable investor as having significantly altered the "total mix" of information made available."147 If the "total mix" of market information is not significantly altered, there is no price impact and the claim must fail.148

Discovery prior to class certification can, and should, play an important role in determining whether a company's alleged misstatements significantly altered this "total mix" of market information. For example, if it was learned in deposition testimony prior to class certification that plaintiff-investors in a putative class action were generally unaware of either the initial alleged company misrepresentation(s) or the company's subsequent disclosure of the "truth" (i.e. corrective statement), that may show how little the alleged misrepresentation(s) meant in the "total mix" of market information. Similarly, pre-class certification discovery of how the market reported on company information later alleged to contain a misrepresentation or reporting of the company's subsequent corrective statement may show how relatively insignificant this information was in the "total mix" of market information.

Litigants in a securities fraud class action often resort to expert testimony to establish the existence or nonexistence of stock price impact.149 They rely on "event studies" and other methods of data analysis to capture stock price differences in ever-fluctuating markets that are specifically attributable to an alleged company misrepresentation and its subsequent corrective statement.150 "In other words, event studies seek to "disentan-
... the stock price movement (if any) attributable to the release of new, allegation-related information from the movement attributable to the release of other, non-allegation-related news." Plaintiff-investors commonly rely on such evidence to show the existence of a stock price impact as well as its magnitude. The latter is often used to support plaintiffs’ claimed damages. In fact, to the extent securities fraud class action plaintiffs have not been providing expert evidence of price impact, even plaintiffs’ attorneys concede that “plaintiffs’ event studies may have to cover the price impact” at the class certification stage in light of Halliburton II.

Like any data regression analysis, event studies are imperfect. In the context of some securities markets, they may be as much art as science. This is because many modern securities markets, particularly public securities exchanges, involve innumerable pieces of information made available very quickly and from many different and varied sources. It is difficult to construct a controlled event study that faithfully excises a minute subset of information—perhaps only a single statement made by a company—and calculates the precise share-price impact to compare with a hypothetical world in which the statement was never made.

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153. Id.


155. A “regression analysis is a statistical tool used to understand the relationship between or among two or more variables.” See FED. JUDICIAL CTR., REFERENCE MANUAL ON SCIENTIFIC EVIDENCE 305 (3d ed.2011) [hereinafter Reference Manual]. In most scientific work, the level to obtain a statistically significant result is set at a 5% level of significance, i.e., that there is no more than a 5% chance that the observed relationship is purely random. Id. at 320; see United States v. Delaware, No. Civ. A. 01-020-KAJ, 2004 WL 609331, at *10 n.27 (D. Del. Mar. 22, 2004); cf. Dean v. China Agritech, No. CV 11-01331-RGK (PJWx), 2012 WL 1835708, at *7 (C.D. Cal. May 3, 2012). In other words, a 5% significance level equates to being 95% confident in the observed relationship. See Reference Manual, supra note 158, at 284–85.

156. See Frank Torchio, Proper Event Study Analysis in Securities Litigation, 35 J. CORP. L. 159, 159 (2009) (“More often than not, however, such uses of event studies are plainly incorrect and at odds with accepted economic literature regarding the appropriate and proper use of event studies.”).

157. See Halliburton Co. v. Erica P. John Fund, Inc. (Halliburton II), 134 S. Ct. 2398, 2409–10 (“[A] misrepresentation can leave a stock’s market price unaffected even in a generally efficient [market].”).
made. An alleged misrepresentation that is an omission may be even more challenging to assess price impact because there may not be a definite point in time at which it is clear the alleged fraud began.

Further, it is axiomatic that there are countless pieces of information unrelated to a company’s alleged misrepresentation (or omission) that could impact a stock’s price. This includes everyday changes in things such as gas prices, food costs, interest rates, employment rates, and any other economic benchmarks or reports, as well as ever-changing global conditions that include war, drought, or political instability, among countless others. These data only make up the systematic risks that impact all companies on a particular stock exchange, but not necessarily to the same degree. A global change in fuel prices, for instance, may have a greater impact on an automaker’s stock than on the stock of an Internet-based service company that trades on the same exchange.

There is also a universe of information that relates to non-systematic risks that are unique to a specific company, industry, asset, or investment. For instance, this could include changes in material costs or availability, labor disputes, the threat of new industry-specific regulation, or even the filing of a securities fraud class action. Event studies, or other data regression analyses, must wade through this morass to pinpoint the stock price impact of perhaps only a single piece of data.

158. See, e.g., In re Groupon, Inc. Securities Litigation, 2015 WL 1043321, at *5 (N.D. Ill. Mar. 5, 2015) (defendant challenging event study on the basis that methodology was flawed and used an incorrectly selected control period).

159. See Torchio, supra note 159, at 159–60 (stating that “an event study is designed to quantify the effect of disclosed information, not undisclosed information”); see also Peri Nelsen & Stephen Prowse, Dura’s Impact on Damages, Insights, July 2008, at 16–24 n.4 (explaining how certain damage models have changed over time and “declined in popularity mainly due to [their] inability to measure the stock price impact of alleged omissions by the company”).


161. See In re N. Telecom Ltd. Sec. Litig., 116 F.Supp.2d 446, 460 (S.D.N.Y. 2000) (discussing use of event studies to determine whether “the price changes at issue in [a] case were related or unrelated to the representations in dispute” by eliminating other factors, such as “the effects on stock price of market and industry information . . . ”).


164. See, e.g., Fredric J. Bendremer, Modern Portfolio Theory and International Investments Under the Uniform Prudent Investor Act, 35 REAL PROP. PROP. & TR. J. 791, 799–800 (2001) (“Nonsystematic risk relates to the particular risks associated with the issuer of individual securities, such as poor earnings performance, adverse circumstances in the issuer’s business, and shareholder litigation against the issuer.”).
In addition, many of the pieces of information to be studied, even in a market said to be “efficient,” may not conform to rational behavior or other assumptions that generally underlie a statistical analysis.165 For example, events such as the election of a new President might result in significant changes to a stock’s price that realistically have little or nothing to do with that company’s current or expected future performance.166 Phenomena that include investors’ “irrational exuberance” and overconfidence, as well as other behaviors studied by behavioral and experimental economists, muddy the possibility of any straightforward price impact assertion.167

Stated plainly, constructing a reliable event study is a daunting task for any expert, which may lead to imprecision. It is in this imprecision where event studies purporting to demonstrate a definite price impact can, and should be, challenged through broader discovery prior to the class certification stage.

The scope of discovery here could implicate sources of information beyond the publicly available information often relied upon by plaintiffs’ experts. It could include data collected by plaintiffs but not used (perhaps because it does not show a clear price impact), as well as any non-public information obtained. It could also provide defendants’ greater latitude in deposing plaintiffs’ experts, and understanding the many assumptions underlying an event study or other type of price impact analysis.168

In addition, broader discovery of price impact evidence could apply to information sought by defendants’ experts to conduct their price impact analysis, not simply challenge the sufficiency of plaintiffs’ expert analysis. Defendants, for instance, might wish to pursue greater information from third-parties such as financial institutions or market makers that demonstrate the impact, or lack thereof, of a company’s alleged misstatement from the vantage point of the entities brokering investor transactions or analysts closely monitoring the company or industry. Each of these avenues of broader discovery could improve reliability and fairness in answering the threshold question of whether an alleged misstatement actually impacted a stock’s price when viewed against a potential ocean of other pieces of data.

165. See Dunbar & Heller, supra note 7.


167. See, e.g., In re PolyMedica Corp. Sec. Litig., 453 F. Supp. 2d 260, 272 n.10 (D. Mass. 2006) (“The emerging field of behavioral finance suggests that differing investor assessments of value appear to be the rule, rather than the exception.”); see also Paul C. Tetlock, All the News That’s Fit to Reprint: Do Investors React to Stale Information?, 24 REV. FIN. STUD. 1481, 1481 (2011) (showing that markets overreact to stale information).

168. Cf. Comcast Corp. v. Behrend, 133 S. Ct. 1426, 1433-34 (2013) (analyzing methodology of plaintiffs’ expert); see also Behrend, supra notes 111 to 115 and accompanying text.
Allowing broader discovery related to price impact would also facilitate the same fairness and judicial economy interests as allowing defendants broader discovery related to the assumption of market efficiency. Courts can, in essence, benefit from economies of scale in permitting broader discovery prior to the class certification stage if it may be used to show either market inefficiency or a lack of price impact.

CONCLUSION

The U.S. Supreme Court’s decision in Halliburton II may have kept alive the fraud on the market presumption ushered in by the Court’s earlier ruling in Basic, but it also underscored that it is only a presumption. In light of that fact, the Court recognized a new path for defendants to rebut the presumption at the class certification stage; a path that envisioned broader discovery prior to the class-certification stage. The Court’s ruling provides defendants with an opportunity to show that plaintiffs’ fraud allegations had no impact on the stock’s price before that defendant is forced to make the difficult trade-off of yielding to settlement pressures if the proposed class is certified or potentially expending substantial resources in defense of the claim at the merits stage. It remains to be seen how defendants will take advantage of this new opportunity, and how judges will respond to broader requests for information. As explained in this article, judges should be more receptive to such requests to faithfully adhere to the Supreme Court’s development of securities law and to ensure that the considerable time and expense incurred by defendants as a result of the filing of a putative securities fraud class action is justified by legitimate claims of fraudulent activity.