

# Michigan Business & Entrepreneurial Law Review

---

Volume 5 | Issue 1

---

2016

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

Victor E. Schwartz  
*Shook, Hardy & Bacon, L.L.P.*

Christopher E. Appel  
*Shook, Hardy & Bacon, L.L.P.*

Follow this and additional works at: <https://repository.law.umich.edu/mbelr>



Part of the [Administrative Law Commons](#), [Litigation Commons](#), [Securities Law Commons](#), and the [Supreme Court of the United States Commons](#)

---

### Recommended Citation

Victor E. Schwartz & Christopher E. Appel, *Rebutting the Fraud on the Market Presumption in Securities Fraud Class Actions: Halliburton II Opens the Door*, 5 MICH. BUS. & ENTREPRENEURIAL L. REV. 33 (2016).  
Available at: <https://repository.law.umich.edu/mbelr/vol5/iss1/2>

This Article is brought to you for free and open access by the Journals at University of Michigan Law School Scholarship Repository. It has been accepted for inclusion in Michigan Business & Entrepreneurial Law Review by an authorized editor of University of Michigan Law School Scholarship Repository. For more information, please contact [mlaw.repository@umich.edu](mailto:mlaw.repository@umich.edu).

# REBUTTING THE FRAUD ON THE MARKET PRESUMPTION 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.*

## TABLE OF CONTENTS

INTRODUCTION .....	34
I. THE EVOLUTION OF SECURITIES FRAUD CLASS ACTION LITIGATION .....	37
A. <i>Origins of the 10b-5 Securities Fraud Action</i> .....	37

---

\* Victor E. Schwartz co-chairs Shook, Hardy & Bacon L.L.P.’s Washington, D.C.-based Public Policy Group. He coauthors the most widely-used torts casebook in the United States, PROSSER, WADE & SCHWARTZ’S TORTS (13th ed. 2015). He has served on the Advisory Committees of the American Law Institute’s Restatement of the Law (Third) Torts: Products Liability, Apportionment of Liability, General Principles, and Liability for Physical and Emotional Harm projects. Mr. Schwartz also served as law clerk to the late Honorable Charles M. Metzner, U.S. District Court judge for the Southern District of New York. Mr. Schwartz received his B.A. *summa cum laude* from Boston University and his J.D. *magna cum laude* from Columbia University.

\*\* Christopher E. Appel is an associate in Shook, Hardy & Bacon L.L.P.’s Washington, D.C.-based Public Policy Group. He received his B.S. from the University of Virginia’s McIntire School of Commerce and his J.D. from Wake Forest University School of Law. The authors would like to thank their Shook, Hardy & Bacon L.L.P. law colleague Dan Wake, who specializes in securities law, for his helpful insights in developing this article.

*B. The Basic Fraud on the Market Presumption* . . . . . 38

*C. Basic’s Aftermath and the Rise of Modern Securities Fraud Class Actions* . . . . . 40

*D. Halliburton II Revisits the Fraud on the Market Presumption* . . . . . 42

II. OPENING THE DOOR FOR EFFECTIVE DISCOVERY TO REBUT THE FRAUD ON THE MARKET PRESUMPTION . . . . . 46

*A. The Supreme Court’s Recent Class Action Jurisprudence Envisions Broader Discovery Prior to the Class Certification Stage* . . . . . 46

*B. Employing Heightened Discovery and Expert Evidence Prior to the Class Certification Stage* . . . . . 49

    1. Challenging Market Efficiency . . . . . 50

    2. Challenging Price Impact . . . . . 54

CONCLUSION . . . . . 58

INTRODUCTION

In *Halliburton Co. v. Erica P. John Fund, Inc. (Halliburton II)*,<sup>1</sup> 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.”<sup>2</sup> 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.”<sup>3</sup> 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.<sup>4</sup> If plaintiffs were required to show individual reliance, class treatment would be unsuitable because individual issues would predominate over common issues of the class.<sup>5</sup> The Court’s decision to reaffirm the reliance presumption, therefore, preserved the viability of modern securities fraud class actions.<sup>6</sup>

1. *Halliburton Co. v. Erica P. John Fund, Inc. (Halliburton II)*, 134 S. Ct. 2398 (2014).

2. *Id.* at 2408.

3. *Basic, Inc. v. Levinson*, 485 U.S. 224, 247 (1988).

4. See *Class Actions – Presumption of Reliance Under SEC Rule 10B-5 – Halliburton Co. v. Erica P. John Fund, Inc.*, 128 HARV. L. REV. 291, 291 (2014) (characterizing the fraud on the market presumption as “the linchpin of modern private securities litigation”).

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.<sup>7</sup> 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.<sup>8</sup> Studies have shown that plaintiff-investors "lose much more than they gain" as the result of the filing of a securities fraud class action.<sup>9</sup> 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.<sup>10</sup> 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.<sup>11</sup> The Court simply held that no "special justification" existed for overruling its prior decision in *Basic*.<sup>12</sup>

---

C. Langevoort, *Basic at Twenty: Rethinking Fraud on the Market*, 2009 WIS. L. REV. 151, 152 (2009) ("Tens of billions of dollars have changed hands in settlements of 10b-5 lawsuits in the last twenty years as a result of *Basic*.").

7. See, e.g., William W. Bratton & Michael L. Wachter, *The Political Economy of Fraud on the Market*, 160 U. PA. L. REV. 69, 77 (2011) (advocating "removing the *Basic* presumption and imposing an actual-reliance requirement"); Paul G. Mahoney, *Precaution Costs and the Law of Fraud in Impersonal Markets*, 78 VA. L. REV. 623, 670 (1992) (arguing that "[t]he Supreme Court would benefit shareholders by confessing that it erred in *Basic* when it adopted [the fraud on the market presumption]."); Frederick C. Dunbar & Dana Heller, *Fraud on the Market Meets Behavioral Finance*, 31 DEL. J. CORP. L. 455 (2006) (reviewing academic studies raising questions about whether investors and markets are rational to the extent necessary to support *Basic*'s reasoning).

8. See generally MUKESH BAJAJ ET AL., U.S. CHAMBER INSTITUTE FOR LEGAL REFORM, *Economic Consequences: The Real Costs of U.S. Securities Class Action Litigation* (2014) [hereinafter *The Real Costs of U.S. Securities Class Action Litigation*], [http://www.instituteforlegalreform.com/uploads/sites/1/EconomicConsequences\\_Web.pdf](http://www.instituteforlegalreform.com/uploads/sites/1/EconomicConsequences_Web.pdf).

9. *Id.* at 2.

10. For example, according to a 2014 study by NERA Economic Consulting, the average loss for investors due to the filing of securities class actions was over \$248 billion annually from 2005-2013. See Renzo Comolli & Svetlana Starykh, *Recent Trends in Securities Class Action Litigation: 2013 Full-Year Review*, NERA ECON. CONSULTING 8 (Jan. 21, 2014) [hereinafter *2013 Recent Trends in Securities Class Action Litigation*, [http://www.nera.com/content/dam/nera/publications/2014/PUB\\_Year\\_End\\_Trends\\_1.2014.pdf](http://www.nera.com/content/dam/nera/publications/2014/PUB_Year_End_Trends_1.2014.pdf)]. Another 2014 study by Cornerstone Research calculates the average loss of defendant company share prices to be \$126 billion annually from 1997-2012. See *Securities Class Action Filings: 2013 Year in Review*, CORNERSTONE RESEARCH 1 (2014) [hereinafter *2013 Securities Class Action Filings*], <https://www.cornerstone.com/getattachment/d88bd527-25b5-4c54-8d40-2b13da0d0779/Securities-Class-Action-Filings%E2%80%942013-Year-in-Review.aspx>.

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.<sup>13</sup> 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.<sup>14</sup> Thus, the Court opened the door for defendants to mount a more robust defense of a securities fraud class action prior to class certification.<sup>15</sup> 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.<sup>16</sup>

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.<sup>17</sup> 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.”).

17. *See, e.g.,* Local 703, I.B. of T. Grocery & Food Employees Welfare Fund v. Regions Fin. Corp., 762 F.3d 1248 (11th Cir. 2014); *In re Vivendi Universal, S.A. Sec. Litig.*, No. 02-CV-5571 (SAS), 2014 WL 4080950 (S.D.N.Y. Aug. 18, 2014).

## 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<sup>18</sup> (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.<sup>19</sup> 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.<sup>20</sup> 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.”<sup>21</sup> 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.”<sup>22</sup> 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.<sup>23</sup> When initially confronted with the issue of whether private claims could be brought, some courts implied a private right of action.<sup>24</sup> In 1971, the United States Supreme Court, in *Superintendent of Insurance v. Bankers Life & Casualty Co.*,<sup>25</sup> 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).<sup>26</sup>

---

18. Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 (codified as amended at 15 U.S.C. §§ 78a–pp (2006)).

19. See H.R. REP. NO. 73-1383, at 3 (1934); *id.* at 11 (“There cannot be honest markets without honest publicity. Manipulation and dishonest practices of the market place thrive upon mystery and secrecy.”); see also *Basic, Inc. v. Levinson*, 485 U.S. 224, 230 (1988).

20. See H.R. REP. NO. 73-1383; *id.* at 2 (citing President Franklin Roosevelt’s letter) (“[I]t should be our national policy to restrict, as far as possible, the use of these exchanges for purely speculative operations.”); see also S. REP. NO. 73-792, at 5 (1934).

21. Securities Exchange Act § 78j(b).

22. Employment of Manipulative and Deceptive Devices, 17 C.F.R. § 240.10b-5 (2011).

23. See Joseph A. Grundfest, *Damages and Reliance Under Section 10(b) of the Exchange Act*, 69 BUS. LAW. 307, 320–24 (2014) (discussing the history of Section 10(b) and Rule 10b-5).

24. See *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 196 (1976) (“Although § 10(b) does not by its terms create an express civil remedy for its violation, and there is no indication that Congress, or the Commission when adopting Rule 10b-5, contemplated such a remedy, the existence of a private cause of action for violations of the statute and the Rule is now well established.”) (citations omitted); see also *id.* (citing *Kardon v. National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946) as the first case to imply a right of action under § 10(b)).

25. *Superintendent of Ins. of New York v. Bankers Life & Cas. Co.*, 404 U.S. 6 (1971).

26. *Id.* at 13 n.9 (“It is now established that a private right of action is implied under § 10(b).”); see also *Corr. Servs. Corp. v. Malesko*, 534 U.S. 61, 75 (2001) (Scalia, J., concurring) (having since characterized this implied Rule 10b-5 private cause of action as “a relic of the heady days in which this Court assumed common-law powers to create causes of action”);

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.<sup>27</sup> 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).<sup>28</sup>

### 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.<sup>29</sup> In 1988, the Supreme Court, in a 4-2 decision in *Basic, Inc. v. Levinson*,<sup>30</sup> addressed that issue and opened the door to modern securities fraud class actions through its adoption of the fraud on the market presumption.<sup>31</sup> 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.<sup>32</sup> *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.<sup>33</sup>

---

Alexander v. Sandoval, 532 U.S. 275, 286–87 (2001)(taking the view that unless Congress specifically authorizes a private cause of action, “courts may not create one, no matter how desirable that might be as a policy matter”).

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).

28. *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 341–42 (2005).

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).

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. See *id.* at 225.

31. See *id.* at 245–47.

32. See *id.*

33. 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.”<sup>34</sup> “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.”<sup>35</sup> 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.<sup>36</sup> 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.<sup>37</sup>

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.”<sup>38</sup> 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.”<sup>39</sup> 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.<sup>40</sup>

### 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.<sup>41</sup> 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.<sup>42</sup> In the two decades following *Basic*, securities fraud class-action litigation transformed into a cottage industry driven primarily by plaintiffs’ attorneys.<sup>43</sup>

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.<sup>44</sup> Some plaintiffs’ attorneys have repeatedly called on professional plaintiff-investors—sometimes on as many as fifty occasions—to bring a shareholder class action.<sup>45</sup> 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.<sup>46</sup>

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).<sup>47</sup> 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).

43. See *Frequent Filers: The Problems of Shareholder Lawsuits and the Path to Reform*, U.S. CHAMBER OF COMMERCE INST. FOR LEGAL REFORM, at 1 (Feb. 2014), <http://www.instituteforlegalreform.com/resource/frequent-filers-the-problems-of-shareholder-lawsuits-and-the-path-to-reform/> [hereinafter *Frequent Filers*].

44. See *id.* at 1-2.

45. See *id.* at 1, 17.

46. See *id.* at 10–13.

47. Private Securities Litigation Reform Act of 1995, Pub. L. 104–67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C.).

Court adopted in *Basic*.<sup>48</sup> 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.<sup>49</sup> These enactments, however, have had little impact on curbing the filing of questionable securities fraud class actions.<sup>50</sup> Each year, plaintiffs' attorneys file roughly 200 securities fraud lawsuits.<sup>51</sup> Over the past twenty years, this has resulted in more than 4,200 cases filed, alleging trillions of dollars in investor losses.<sup>52</sup> More than 40% of corporations on major stock exchanges have been the target of a securities fraud class action.<sup>53</sup> Pharmaceutical, healthcare, and biotechnology companies, in particular, have been common targets, accounting for 21% of 2013 filings.<sup>54</sup>

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.<sup>55</sup> 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.

49. See Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227 (codified as amended in scattered sections of 15 U.S.C.)

50. See *Frequent Filers*, *supra* note 43, at 5-9 (discussing impact of PSLRA and SLUSA).

51. See *Securities Class Action Filings: 2014 Midyear Assessment*, CORNERSTONE RESEARCH, 4 (2014), <https://www.cornerstone.com/getattachment/8b34f0cd-79a2-497a-9821-a2893928506f/Securities-Class-Action-Filings%E2%80%942014-Midyear-Asses.aspx>.

52. See *The Real Costs of U.S. Securities Class Action Litigation*, *supra* note 8, at 5.

53. Bradley J. Bondi, *Facilitating Economic Recovery and Sustainable Growth Through Reform of the Securities Class-Action System: Exploring Arbitration as an Alternative to Litigation*, 33 HARV. J.L. & PUB. POL'Y 607, 615-16 (2010); Richard Wolf, *Supreme Court Seeks to Compromise in Securities Fraud Case*, USA TODAY (Mar. 5, 2014), <http://www.usatoday.com/story/money/markets/2014/03/05/supreme-court-securities-fraud-halliburton-compromise/6076767/>.

54. See *Securities Class Action Filings: 2013 Year in Review*, CORNERSTONE RESEARCH, 1, (2014), <http://www.cornerstone.com/getattachment/d88bd527-25b5-4c54-8d40-2b13da0d0779/Securities-Class-Action-Filings%E2%80%942013-Year-in-Review.aspx>.

55. See Lynn A. Stout, *Are Stock Markets Costly Casinos? Disagreement, Market Failure, and Securities Regulation*, 81 VA. L. REV. 611, 650 (1995) (noting scholars' "[i]ncreasing disillusionment with the concept of fundamental value efficiency"); Carol R. Goforth, *The Efficient Capital Market Hypothesis—An Inadequate Justification For the Fraud-On-The-Market Presumption*, 27 WAKE FOREST L. REV. 895, 901-902 (1992); L. Brett Lockwood, Comment, *The Fraud-on-the-Market Theory: A Contrarian View*, 38 EMORY L.J. 1269, 1302 (1989) (arguing that "efficient market theory is subject to too many reservations to be an adequate foundation for the fraud-on-the-market theory."); see generally Lawrence H. Summers, *Does the Stock Market Rationally Reflect Fundamental Values?*, 41 J. FIN. 591 (1986) (citing evidence indicating the absence of fundamental value efficiency).

more by a resulting decrease in the company's stock price.<sup>56</sup> The market stigma and reputational damage associated with such a lawsuit may also adversely impact the company's stock price.<sup>57</sup> 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.<sup>58</sup>

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.<sup>59</sup> 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.<sup>60</sup> Between 1997 and 2013, plaintiffs' lawyers earned more than \$14 billion in fees and expenses in securities class action settlements.<sup>61</sup> A substantial amount of these fees have gone to just a handful of plaintiffs' firms.<sup>62</sup> 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.<sup>63</sup>

#### D. *Halliburton II Revisits the Fraud on the Market Presumption*

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

---

56. See *The Real Costs of U.S. Securities Class Action Litigation*, *supra* note 8, at 1–2.

57. See *id.*

58. See *id.* at 2.

59. See *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); *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).

60. See *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).

61. See *id.* at 35 Fig.35; see also Grundfest, *supra* note 23, at 309.

62. See VICTOR E. SCHWARTZ & CAREY SILVERMAN, *THE NEW LAWSUIT ECOSYSTEM: TRENDS, TARGETS AND PLAYERS* 58 (2013), [http://www.instituteforlegalreform.com/uploads/sites/1/web-The\\_New-Lawsuit-Ecosystem-Report-Oct2013\\_2.pdf](http://www.instituteforlegalreform.com/uploads/sites/1/web-The_New-Lawsuit-Ecosystem-Report-Oct2013_2.pdf).

63. See *id.* at 23–24.

ing the fraud on the market presumption.<sup>64</sup> 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).<sup>65</sup> 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.<sup>66</sup> 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.<sup>67</sup> Plaintiffs' argued that when Halliburton subsequently made corrective disclosures, it caused the company's stock price to drop and investors to lose money.<sup>68</sup>

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.<sup>69</sup> 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.<sup>70</sup> That ruling was affirmed by the Fifth Circuit and granted certiorari by the Supreme Court (*Halliburton I*).<sup>71</sup> 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."<sup>72</sup> On remand, the district court, invoking *Basic*'s reliance presumption, found that common issues of the claim predominated

---

64. See generally Fisch, *supra* note 6; see also Bratton and Wachter, *supra* note 7; see also Mahoney, *supra* note 7.

65. See *Halliburton Co. v. Erica P. John Fund, Inc. (Halliburton II)*, 134 S. Ct. 2398, 2406 (2014).

66. See *id.* at 2405-06; see also *Class Actions – Presumption of Reliance Under SEC Rule 10b-5 – Halliburton Co. v. Erica P. John Fund, Inc.*, *supra* note 4, at 292.

67. *Halliburton II*, 134 S. Ct. at 2405.

68. *Id.* at 2405-06.

69. See *id.* at 2406.

70. See *id.*

71. *Id.*

72. *Id.* (citing *Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179, 2185–86 (2011)).

over individual issues and certified the class pursuant to Federal Rule of Civil Procedure 23(b)(3).<sup>73</sup>

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.<sup>74</sup> 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."<sup>75</sup>

In *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.<sup>76</sup> 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]."<sup>77</sup> 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.<sup>78</sup> 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."<sup>79</sup> Accordingly, the Court reaffirmed the presumption it adopted from the implied private right of action it created.<sup>80</sup>

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.<sup>81</sup> In addressing this

---

73. *See id.*

74. *See id.* at 2406–07.

75. *See id.* (quoting *Erica P. John Fund, Inc. v. Halliburton Co.*, 718 F.3d 423, 435 (5th Cir. 2013)).

76. *See id.* at 2407, 2414.

77. *Id.* at 2409–10.

78. *Id.* at 2410.

79. *Id.* at 2411 (quoting *Amgen Inc. v. Connecticut Retirement Plans & Trust Funds*, 133 S. Ct. 1184, 1193 (2013)).

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).

81. *See Halliburton II*, 134 S. Ct. at 2413.

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.<sup>82</sup> 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.<sup>83</sup> 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.”<sup>84</sup>

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.<sup>85</sup> 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.”<sup>86</sup> “This restriction,” according to the Court, made “no sense” and was “inconsistent with *Basic*’s own logic.”<sup>87</sup> 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.”<sup>88</sup> “[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.”<sup>89</sup> 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 precondition for any 10b-5 class action.”<sup>90</sup>

*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.”<sup>91</sup> 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.<sup>92</sup>

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.”<sup>93</sup> 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.”<sup>94</sup> 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.<sup>95</sup>

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.<sup>96</sup> 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.”<sup>97</sup> 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.”<sup>98</sup>

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.<sup>99</sup> 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.<sup>100</sup>

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.<sup>101</sup> 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.”<sup>102</sup> 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.”<sup>103</sup> 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.”<sup>104</sup> 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.<sup>105</sup> This issue,

---

97. *Id.* at 2408 (quoting *Basic, Inc. v. Levinson*, 485 U.S. 224, 248 (1988)).

98. *Id.* (emphasis added).

99. *Id.* at 2413 (quoting *Basic*, 485 U.S. at 231–32). The Court also identified as a prerequisite to invoking the fraud on the market presumption that the plaintiff traded the stock between when the alleged misrepresentations were made and when the truth was revealed. *See id.* As a practical matter, this prerequisite is unlikely to be challenged at the class certification stage because there would be no basis for an alleged securities fraud violation if such a fact was not part of the plaintiffs’ class action complaint.

100. *See supra* Part II.4.

101. *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541, 2547 (2011).

102. *Id.* at 2551 (quoting *Gen. Tel. Co. of Sw. v. Falcon*, 457 U.S. 147, 160 (1982)). *Dukes* was decided under Rule 23(a)(2), which requires a plaintiff to show “commonality,” namely that “there are questions of law or fact common to the class.” *Id.* at 2550–51.

103. *Id.* at 2552.

104. *Id.* at 2552 n.6.

105. *See id.*

the Court said, is one plaintiffs “will surely have to prove *again* at trial in order to make out their case on the merits.”<sup>106</sup> 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.<sup>107</sup>

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*.<sup>108</sup> Here, the Court considered a putative class action on behalf of consumers alleging antitrust violations against a cable provider.<sup>109</sup> 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.<sup>110</sup> 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.<sup>111</sup> 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.<sup>112</sup> 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.”<sup>113</sup>

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.<sup>114</sup> 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.”<sup>115</sup> 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).

107. See Suzette M. Malveaux, *The Power and Promise of Procedure: Examining the Class Action Landscape After Wal-Mart v. Dukes*, 62 DEPAUL L. REV. 659, 670 (2013) (stating that a “significant impact that will likely play out [after *Wal-Mart, Inc. v. Dukes*] is more discovery at the class certification stage”).

108. See *Comcast Corp. v. Behrend*, 133 S. Ct. 1426, 1430 (2013).

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.’”<sup>116</sup> “That reasoning,” the Court held, “flatly contradict[ed] . . . cases requiring a determination that Rule 23 is satisfied, even when that requires inquiry into the merits of the claim.”<sup>117</sup>

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.<sup>118</sup> 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.<sup>119</sup>

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.<sup>120</sup> The Court developed this concept further by identifying potential ways to sever the link

---

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)).

118. Courts in securities fraud class actions often expressly review compliance with each requirement of Rule 23. *See, e.g.*, *Plumbers & Pipefitters Nat’l Pension Fund v. Burns*, 292 F.R.D. 515 (N.D. Ohio 2013); *In re Thornburg Mortg., Inc. Sec. Litig.*, 912 F. Supp. 2d 1178 (D. N.M. 2012); *In re IMAX Sec. Litig.* 283 F.R.D. 178 (S.D.N.Y. 2012); *In re Cooper Cos. Sec. Litig.*, 254 F.R.D. 628 (C.D. Cal. 2009).

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).

120. *Halliburton Co. v. Erica P. John Fund, Inc.* (*Halliburton II*), 134 S. Ct. 2398, 2415 (2014) (quoting *Basic, Inc. v. Levinson*, 485 U.S. 224, 248 (1988)).

and successfully rebut the fraud on the market presumption at the class certification stage.<sup>121</sup> 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.<sup>122</sup> 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*.<sup>123</sup> 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.<sup>124</sup> This development, as Justice Ginsberg forecast in her concurrence in *Halliburton II*, may appropriately broaden discovery in a proposed securities-fraud class action.<sup>125</sup> Although the Court's decision in *Halliburton II* focused on challenging the price-impact assumption underlying the fraud on the market presumption,<sup>126</sup> 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.<sup>127</sup> This is particularly the case "where heavily-traded or well-known stocks are the target of suits."<sup>128</sup> In markets that include small-cap stocks traded in less-organized markets, defendants are more likely to challenge the *Basic* presumption.<sup>129</sup> The form of such a challenge often involves expert evidence to rebut the plaintiffs' required evidentiary showing of market efficiency,

---

121. *See id.* at 2413.

122. *See id.*

123. *See Basic*, 485 U.S. at 248.

124. *See supra* Part II.4.

125. *See Halliburton II*, 134 S. Ct. at 2417 (Ginsburg, J., concurring).

126. *See supra* Part II.4.

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.<sup>130</sup> A typical challenge to market efficiency, therefore, will involve battling experts.<sup>131</sup>

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.<sup>132</sup> 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."<sup>133</sup> 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.<sup>134</sup>

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.<sup>135</sup>

*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-

---

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., 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. Bell v. Ascendant Solutions, Inc.*, 422 F.3d 307, 314 n.13 (5th Cir. 2005).

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

132. *Cammer v. Bloom*, 711 F. Supp. 1264, 1286-87 (D. N.J. 1989); *see also* 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. *Unger*, 401 F.3d at 323.

134. *Id.* at 325.

135. *See id.* at 323 (citing *In re Data Access Sys. Sec. Litig.*, 103 F.R.D. 130, 138 (D. N.J. 1984), *rev'd on other grounds*, 843 F.2d 1537 (3d Cir. 1988); *Epstein v. Am. Reserve Corp.*, No. 79 C 4767, 1988 WL 40500 (N.D. Ill. Apr. 21, 1988)).

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.”<sup>136</sup> The Court recognized that this enables a defendant to “pick off” class members prior to the class certification stage.<sup>137</sup> 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.<sup>138</sup> 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.<sup>139</sup> These investors “think the market has under- or overvalued the stock, and they believe they can profit from that mispricing.”<sup>140</sup>

“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.”<sup>141</sup> 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.<sup>142</sup> Such investment decisions are made “without regard for price ‘integrity’” and “are at odds with *Basic*’s understanding of what motivates investment decisions.”<sup>143</sup>

---

136. *Halliburton Co. v. Erica P. John Fund, Inc.* (*Halliburton II*), 134 S. Ct. 2398, 2412 (2014).

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.)

142. *See, e.g.,* Stout, *supra* note 55, at 657–60 (discussing different investor motivations); Thomas Lee Hazen, *Rational Investments, Speculation, or Gambling?—Derivative Securities and Financial Futures and Their Effect on the Underlying Capital Markets*, 86 NW. U. L. REV. 987, 995–1007 (1992) (discussing irrational investor behaviors); Donald C. Langevoort, *Theories, Assumptions, and Securities Regulation: Market Efficiency Revisited*, 140 U. PA. L. REV. 851, 857–69 (1992) (discussing noise theory in capital markets).

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 *Behrens*. 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.<sup>144</sup> 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.<sup>145</sup>

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.<sup>146</sup> 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.

---

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).

146. See *Unger v. Amedisys, Inc.*, 401 F.3d 316, 325 (2005).

## 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.”<sup>147</sup> If the “total mix” of market information is not significantly altered, there is no price impact and the claim must fail.<sup>148</sup>

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.<sup>149</sup> 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.<sup>150</sup> “In other words, event studies seek to ‘disentan-

---

147. *Halliburton II*, 134 S. Ct. at 2413 (quoting *Basic, Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988)).

148. Importantly, the challenge of “price impact” of a stock is distinguished from a challenge to the materiality of an alleged misrepresentation. The U.S. Supreme Court in *Amgen Inc. v. Connecticut Retirement Plans & Trust Funds*, 133 S. Ct. 1184, 1197 (2013), expressly stated that materiality is not a prerequisite to the certification of a securities fraud class action and thus may not be subject to defendants’ challenge; however, a showing that the alleged misrepresentation impacted the stock’s price may be challenged at the class certification stage. *See Halliburton II*, 134 S. Ct. at 2414.

149. *See Halliburton II*, 134 S. Ct. at 2415 (discussing expert “regression analyses that seek to show that the market price of the defendant’s stock tends to respond to pertinent publicly reported events.”); *see also In re BP P.L.C. Sec. Litig.*, MDL No. 10-md-2185, 2013 WL 6388408, at \*15 (S.D. Tex. Dec. 6, 2013) (“Event studies are commonly used in securities fraud class actions.”); *see also U.S. v. Hatfield*, No. 06-CR-0550, 2014 WL 7271616, at \*3 (E.D.N.Y. Dec. 18, 2014) (“[E]vent studies are widely accepted”).

150. *See IBEW Local 98 Pension Fund v. Best Buy Co., Inc.*, No. 11-429 (DWF/FLN), 2014 WL 4746195, at \*5 n.5 (D. Minn. Aug. 6, 2014) (“An event study is a method used to estimate the relation between a particular event (such as the release of information) and changes to a company’s stock price.”); *In re Imperial Credit Indus., Inc. Sec. Litig.*, 252 F.

gle . . . 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.”<sup>151</sup> Plaintiff-investors commonly rely on such evidence to show the existence of a stock price impact as well as its magnitude.<sup>152</sup> The latter is often used to support plaintiffs’ claimed damages.<sup>153</sup> 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*.<sup>154</sup>

Like any data regression analysis, event studies are imperfect.<sup>155</sup> In the context of some securities markets, they may be as much art as science.<sup>156</sup> 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.<sup>157</sup> 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

---

Supp. 2d 1005, 1014 (C.D. Cal. 2003) (“An event study is a statistical regression analysis that examines the effect of an event on a dependent variable, such as a corporation’s stock price.”).

151. U.S. v. Martoma, 993 F. Supp. 2d 452, 458 (S.D.N.Y. 2014) (alterations and ellipsis in original) (quoting *In re Xerox Corp. Sec. Litig.*, No. 3:99CV02374 (AWT), 2009 WL 8556135, at \*4 (D. Conn. Apr. 22, 2009)).

152. See, e.g., *Skeway v. China Natural Gas, Inc.*, No. 1:10-CV-728-RGA, 2015 WL 451435, at \*1 (D. Del. Jan. 30, 2015) (approving \$10.4 million judgment in securities fraud class action based on event study stating same damages amount).

153. *Id.*

154. Salvatore J. Graziano, *Halliburton II: A Net Positive for Plaintiff Investors*, TRIAL, Apr. 2015, at 19.

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.<sup>158</sup> 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.<sup>159</sup>

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.<sup>160</sup> 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.<sup>161</sup> These data only make up the systematic risks that impact all companies on a particular stock exchange, but not necessarily to the same degree.<sup>162</sup> 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.<sup>163</sup> 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.<sup>164</sup> 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 Nielsen & 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”).

160. See *In re Verifone Sec. Litig.*, 784 F. Supp. 1471, 1479 (N.D. Cal. 1992) (“Market professionals obtain information from myriad sources . . .”).

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 . . .”).

162. See Timm O. Sprenger & Isabell M. Welpel, *News or Noise? The Stock Market Reaction to Different Types of Company-Specific News Events* 4 (Technische Universität München (TUM) – School of Management, Working Paper, 2011), <http://ssrn.com/abstract=1734632> (finding that “the market reaction differs substantially across various types of news events . . .”); see also Navin Chopra, Josef Lakonishok & Jay R. Ritter, *Measuring Abnormal Performance: Do Stocks Overreact?*, 31 *J. FIN. ECON.* 235 (1992).

163. See RICHARD A. BREALEY & STEWART C. MYERS, *PRINCIPLES OF CORPORATE FINANCE* 191–201 (Michael W. Junior et al. eds., 6th ed. 2000).

164. See, e.g., Fredric J. Bendremer, *Modern Portfolio Theory and International Investments Under the Uniform Prudent Investor Act*, 35 *REAL PROP. PROB. & 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.<sup>165</sup> 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.<sup>166</sup> 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.<sup>167</sup>

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.<sup>168</sup>

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.

166. See, e.g., Mark Gongloff, *Stock Market Collapse: Obama Reelection Not to Blame*, THE HUFFINGTON POST, [http://www.huffingtonpost.com/2012/11/07/stock-market-collapse-obama-reelection\\_n\\_2089090.html](http://www.huffingtonpost.com/2012/11/07/stock-market-collapse-obama-reelection_n_2089090.html) (discussing irrational behavior of public stock market around Presidential elections).

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.