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Supreme Court to Revisit Fraud-On-The-Market Presumption

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On November 15, 2013, the Supreme Court agreed to hear a case that could, depending upon its outcome, dramatically change private securities litigation. The case is *Halliburton Co.* v. *Erica P. John Fund, Inc.*, No. 13-317, and it presents the question of whether the Court should reconsider the fraud-on-the-market presumption of reliance that applies in class actions under Section 10(b) of the Securities Exchange Act and SEC Rule 10b-5.

The case is of enormous potential significance. Adopted in 1988 in *Basic* v. *Levinson*, the fraud-on-the-market presumption effectively eliminated the need for plaintiffs to individually prove reliance on alleged misstatements in cases involving securities that trade on "efficient" markets. By dispensing with proof of individualized reliance, *Basic* makes possible the certification of massive Section 10(b) class actions. Without the presumption, classes could not be certified under Federal Rule of Civil Procedure 23(b)(3), because individual reliance questions would predominate over common questions affecting the class as a whole.

The petition for certiorari that was granted in *Halliburton* last week presents the question of whether *Basic* should be "overruled or substantially modified." In tendering that issue, the *Halliburton* defendants have taken up an invitation four justices made earlier this year in *Amgen* v. *Connecticut Retirement Plans and Trust Funds* (see our earlier memo here). Justices Scalia, Kennedy, Thomas, and Alito all indicated in *Amgen* that reconsideration of *Basic* may be appropriate because of the continuing debate among economists over a central premise of *Basic*'s reasoning—the efficiency of capital markets.

But there is another reason why the Court may be willing to reconsider *Basic*. As Stanford law professor and former SEC Commissioner Joseph Grundfest has written, and as we argued in an amicus brief we recently submitted in *Halliburton* on behalf of Prof. Grundfest and a distinguished

group of former SEC officials and law professors, *Basic* fundamentally conflicts with the Court's current approach to construing the judicially-created right of action under Section 10(b). Today, in defining the contours of that implied right, the Court looks to analogous express rights of action and borrows limitations from those provisions. We argue that here, the closest analogue to the 10(b) implied right is Section 18 of the Exchange Act, which requires every plaintiff to prove that he or she actually and individually relied on misstatements made by defendants.

We cannot predict what the Supreme Court will do. But there can be little doubt that, at least as far as American public companies are concerned, *Halliburton* could turn out to be one of the most important cases that the Supreme Court has ever decided to hear.