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Reflections on *Halliburton*

The Supreme Court last week delivered its highly anticipated decision in *Halliburton Co.* v. *Erica P. John Fund, Inc.*, No. 13-317 (U.S. June 23, 2014), the background and potential implications of which we previously discussed here, here, and here. The case had the potential to revolutionize securities litigation, but, as decided, it will work no such change. It instead became a lesson on how *stare decisis* applies to statutes: by a 6-3 vote, the Court declined to overrule *Basic* v. *Levinson* or to limit or discard *Basic*'s fraud-on-the-market presumption of reliance. *Stare decisis* requires a "special justification" to overturn precedent, the Court held, and it applies with "special force in respect to statutory interpretation," as opposed to constitutional adjudication, because "Congress remains free to alter what we have done."

Six Justices found no such "special justification" here—despite the potent criticisms leveled at *Basic* by the other three Justices and the defendants and their *amici*. The Court thus ruled that it did not matter that, as Justice Thomas's separate opinion put it, *Basic* was "judge-made law," a "relic of the heady days in which [courts] create[d] causes of action," and "took an implied cause of action and grafted on a policy-driven presumption of reliance" that "result[ed] [in] an unrecognizably broad cause of action ready made for class certification." It also did not matter that, as Halliburton's brief put it, *Basic* was an "accidental anachronism" decided by a bare (four-to-two) majority of a bare quorum of the Court, with three Justices not participating, or that, as our amicus brief put it, *Basic* created "the most powerful engine of civil liability ever established in American law." And it did not matter that, as all the defense-side briefs explained, *Basic* spawned a securities class-action industry that, in the name of protecting investors, inflicts massive net wealth losses upon current shareholders of defendant companies—by one amicus's accounting, nearly $40 billion a year, including settlements and attorney's fees and insurance premiums and other costs ultimately borne by shareholders.

The Court held that, under "ordinary principles of *stare decisis*," it sufficed that "Congress may overturn or modify any aspect of our interpretations of the reliance requirement, including the *Basic* presumption itself." As a result, "concerns" about any "serious and harmful consequences" of *Basic* "are more appropriately addressed to Congress." The three Justices who voted to jettison *Basic* argued that "when we err in areas of judge-made law, we ought to presume that Congress expects us to correct our own mistakes," and they urged their colleagues not "to place upon the shoulders of Congress the burden of the Court's own error."

As disappointing as *Basic*'s survival may be for companies facing Rule 10b-5 class actions, *Halliburton* was not a complete loss for defendants. In fact, Halliburton won its appeal. Adopting a version of the "price impact" argument that two law-professor *amici* had advanced (discussed here), the Supreme Court vacated the Fifth Circuit's decision, and held that the court of appeals had erred in refusing to allow Halliburton to defeat class certification by demonstrating that the alleged misstatements had no effect on price. Ironically, in so holding, the Court showed less than pure fidelity to precedent. Last year in *Amgen* (see our memo here), the Court refused to allow defendants to argue that, because the misstatements were immaterial and thus could not impact price, the presumption did not apply and a class could not be certified. Materiality could not be considered on class certification, *Amgen* held, because it did not affect

whether common issues predominated over individual ones under Rule 23(b)(3): if there was no materiality, then all potential class members' claims would fail and could be decided together, and if there was materiality, then the claims could also be decided together, because the *Basic* presumption would apply and the court could dispense with individual reliance. That arguably should have decided *Halliburton*, because the same could have been said of price impact. If there is no price impact in an efficient market, not only can there be no materiality, there can also be no causation, no damages, and no claim. So by *Amgen*'s logic, as the Fifth Circuit held, the claims rise and fall together, and the common issues predominate, regardless of whether or not there is price impact. Noting that this point was "fair enough," the Court seemed at first to concede its validity. But the Court ultimately decided to allow defendants to rebut the presumption—and defeat class certification—with evidence of a lack of price impact.

This refusal to follow *Amgen* produces a sensible result, but will not be a game changer. Allowing defendants to rebut the *Basic* presumption where there is no price impact will certainly help to get rid of some cases with dubious claims of damage. But as our earlier memo pointed out, in most cases plaintiffs can show *some* price impact. In the typical case, a company's stock price drops because negative, previously undisclosed information comes out, and the key question is whether the defendants fraudulently concealed that information. If the supposed price inflation came out of the stock price when the bad news came out, then it is no stretch to conclude that earlier inconsistent statements contributed to the inflation—and thus impacted price—in the first place. Most cases fit this mold, of course, because plaintiffs' lawyers go where the money is—price impact means damages, and damages mean fees.

One thing is certain after *Halliburton*—the importance of economic analysis in securities litigation will continue to grow. In *Amgen* the defendants tried to defeat class certification with a lawyer's submission attaching news and analyst reports and other public information that showed how the supposedly undisclosed truth was already known to the market. This "truth on the market," they argued, meant no materiality—and thus no price impact. The Court in *Amgen* said that defendants could not do that. Now, after *Halliburton*, defendants can give the same sort of material to economic experts, who will incorporate them into event studies that show how the supposed misstatements did not affect a defendant company's stock price in light of the other information in the market. The Court in *Halliburton* said that this is allowed.

This will accelerate a trend already in place, of defendants employing extensive economic analysis to defeat class certification. Defendants have been more vigorously contesting market efficiency of late, and they also have begun to challenge, under the Supreme Court's decision last year in *Comcast Corp.* v. *Behrend* (see our memo here), whether plaintiffs have proffered consistent theories of damage on a class-wide basis as required by Rule 23(b)(3). Parsing all of this economic analysis will pose challenges for district judges, and will result in less, not more, clarity about what *Basic* and Rule 23 require. Fortunately for the judges who will have to sort all of this out, the majority of cases that are not dismissed will still likely settle. And that is the upshot of *Halliburton*: although there had been hope that the decision might dismantle the litigation machine created by *Basic*, that machine will continue grinding away.

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