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HALLIBURTON V. ERICA JOHN P. FUND, INC., FRAUD-ON-THE-MARKET PRESUMPTION OF RELIANCE ESTABLISHED; WHAT NOW?

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I. INTRODUCTION

About 25 years ago, the Supreme Court, through its endorsement of the fraud-on-the-market (FOTM) theory in *Basic, Inc. v. Levinson*,[1] paved the way for modern securities-fraud litigation as we know it.[2] That establishment, which effectively represents the principal way through which shareholders can sue companies for securities fraud, however, was on the brink of destruction in the recent *Halliburton Co. v. Erica P. John Fund, Inc.* (*Halliburton II*) case.[3] Despite years of mounting and, seemingly, never-ending criticism, academic, popular, and otherwise, to the underpinnings of *Basic*'s FOTM theory,[4] the *Halliburton II* Court adhered to its precedent.[5] Criticism of FOTM should now

[1] Basic Inc. v. Levinson, 485 U.S. 224, 249 (1988).

[2] Halliburton Co. v. Erica P. John Fund, Inc., 134 S. Ct. 2398, 2417 (2014).

[3] *See* Lucian Bebchuk, *Rethinking Basic*, THE HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE AND FINANCIAL REGULATION (Jan. 6, 2014, 9:35 AM), http://blogs.law.harvard.edu/corpgov/2014/01/06/rethinking-basic/; Steven Davidoff Solomon, *A Push to End Securities Fraud Lawsuits Gains Momentum*, DEALBOOK (Oct. 15, 2013, 4:35 PM), http://dealbook.nytimes.com/2013/10/15/a-push-to-end-securities-fraud-lawsuits-gains-momentum/?_r=0.

[4] *See* SOME ANOMALOUS EVIDENCE REGARDING MARKET EFFICIENCY, 6 J. FIN. ECON. 95-330 (Jensen ed.

be a moot point. Given the historical background of the securities laws, and the current tension between the increase in both the federal enforcement of those laws and corporate compliance efforts,[6] the Supreme Court's decision should not have been surprising.[7]

Although *Basic* and its endorsement of FOTM have been attacked from many angles, one of the main criticisms of the decision was that, by dispensing with proof of individualized reliance, it facilitated the filing of not only meritorious but also frivolous suits,[8] claims filed irrespective of their merits for the sole purpose of obtaining a quick settlement. These frivolous suits, however, seem to pale in comparison to corporate misbehavior. For example, under one extreme view, the recent Financial Crisis of 2008 has even been called one of the biggest securities-fraud schemes in history.[9]

1978). This work might have started the pendulum swinging in the other direction, that is, away from uncritical acceptance of the EMH, and toward a revisionist approach to the EMH. *See also* Wang, *Some Arguments that the Stock Market is Not Efficient*, 19 U.C. DAVIS L. REV. 341 (1986); Gordon & Kornhauser, *Efficient Markets, Costly Information, and Securities Research*, 60 N.Y.U.L. Rev. 761 (1985); Bernstein, *In Defense of Fundamental Analysis*, 31 FIN. ANAL. J., Jan.-Feb. 1975, at 57; LeBaron, *Reflections on Market Inefficiency*, 39 FIN. ANAL. J., May-June 1983, at 16; Treynor & Ferguson, *In Defense of Technical Analysis*, 40 J. FIN. 757 (1985); Keane, *The Efficient Market Hypothesis on Trial*, 42 FIN. ANAL. J., March-April 1986, at 58; Donald C. Langevoort, *Basic at Twenty: Rethinking Fraud on the Market*, 2009 WIS. L. REV. 151, 160 (2009); Baruch Lev & Meiring de Villiers, *Stock Price Crashes and 10b-5 Damages: A Legal, Economic, and Policy Analysis*, 47 STAN. L. REV. 7 (1994).

[5] *Halliburton*, 134 S. Ct. at 2417.

[6] For a comprehensive look at these changes, *see* David Zaring, *Litigating the Financial Crisis*, 100 VA. L. REV. 1405, 1408 (2014).

[7] For an elaboration of this point, *see infra* Part II.A.1.

[8] Also known as "strike suits," Joshua D. Fulop, *Agency Costs and the Strike Suit: Reducing Frivolous Litigation Through Empowerment of Shareholders*, 7 J. BUS. & SEC. L. 213 (2007). Frivolous suits include those in which the plaintiffs have no expectation of finding any evidence of fraud or culpability on the part of defendants. Arguably, frivolous suits also include, more broadly, situations in which the plaintiffs' expected costs of undergoing a trial exceed the expected benefits of doing so (but the plaintiffs file suit nonetheless to extract a positive settlement from defendants unwilling to go to trial); Stephen Choi, *The Evidence on Securities Class Actions*, 57 VAND. L. REV. 1465, 1466 (2004); Lucian A. Bebchuk, *Suing Solely to Extract a Settlement Offer*, 17 J. LEG. STUD. 437, 437-41 (1988) (providing a formal model of the incentive of plaintiffs' attorneys to file frivolous suits).

[9] *See* Steven A. Ramirez, *The Virtues of Private Securities Litigation: An Historic and Macroeconomic Perspective*, 45 LOY. U. CHI. L.J. 669, 670 n.2 (2014). *See also* Greg Robb, *Bernanke: This may be Worse than Great Depression*, MARKETWATCH (July 26, 2009, 10:21 PM), http://www.marketwatch.com/story/bernanke-explains-crisis-to-average-americans-2009-07-26?siteid=rss&rss=1 ("“A lot of things happened, a lot came together, [and] created probably the worst financial crisis, certainly since the Great Depression and possibly even including the Great Depression.”" (alteration in original) (quoting Federal Reserve Chairman Ben Bernanke)); Vivian Lou Chen, *Greenspan Says Lehman Unleashed 'Most Virulent' Crisis*, Bloomberg (May 7, 2010, 1:07 PM), http://www.bloomberg.com/news/2010-05-07/greenspan-says-lehman-failure-unleashed-most-virulent-crisis-in-history.html ("“The bankruptcy of Lehman Brothers in September 2008 precipitated what, in retrospect, is likely to be judged the most virulent global financial crisis ever.”" (quoting former Federal Reserve Chairman Alan Greenspan)). The financial shock to our economic system rivals and may exceed the shock that led to the Great Depression. Only massive fiscal and monetary stimulus spared the nation from an economic collapse like the Great Depression. *See* Alan S. Blinder & Mark Zandi, *How the Great Recession Was Brought to an End* (July 27, 2010),

After all, losses from the crisis are still being settled, and pursued.[10] Thus, without more, the *Halliburton II* Court should not have been expected to eliminate FOTM and, effectively, most of all private litigation of securities fraud.[11]

Given the survival of FOTM, and thus, in effect, frivolous suits, will *Halliburton II* change anything in private securities litigation? Some commentators think that it will not.[12] To be sure, the Court has now enabled defendants to rebut FOTM at the class certification stage. However, even Justice Ginsburg concedes, in her concurrence, that this "should impose no heavy toll on securities-fraud plaintiffs."[13] Why then did the Supreme Court reach such an arguably "benign" decision?

Although the Supreme Court did not explicitly, and, perhaps, not even implicitly, address corporate fraud in *Halliburton II*, its shadow on the decision should not be overlooked. As has been reported, corporate misbehavior has apparently flourished;[14] at the same time, however, the way that problem is legitimately addressed is evolving substantially. Other branches of government are playing an increasing, and changing, role in policing corporations.[15] For example, it has become common for the government to seek to enforce through the use of substantial fines rather than the

available at https://www.economy.com/mark-zandi/documents/end-of-great-recession.pdf (stating that "the U.S. government's response to the financial crisis and ensuing Great Recession included some of the most aggressive fiscal and monetary policies in history" and finding that "its effects on real GDP, jobs, and inflation are huge, and probably averted what could have been called Great Depression 2.0").

[10] Maureen Farrell, *J.P. Morgan Adds $2.6 Billion to Its $25 Billion Plus Tally of Recent Settlements*, (January 7, 2014, 11:24 AM), WSJ MONEYBEAT, http://blogs.wsj.com/moneybeat/2014/01/07/j-p-morgan-adds-1-7-billion-to-its-25-billion-plus-tally-of-recent-settlements/. Christina Rexrode , *WSJ, Bank of America to Pay $17 Billion in Justice Department Settlement*, (Aug. 20, 2014 2:47 PM), http://online.wsj.com/articles/bank-of-america-reaches-17-billion-settlement-1408560100.

[11] "The class action device is vital to deterring securities fraud and remedying its victims, who almost never suffer losses sufficient to justify an individual suit." Michael J. Kaufman and John M. Wunderlich, *The Unjustified Judicial Creation of Class Action Certification Merits Trials in Securities Fraud Actions*, 43 U. MICH. J.L. REFORM 323 (2010). *See also Halliburton*, 134 S. Ct. at 2407 (2014).

[12] *See The Supreme Court 2013 Term: Leading Case: Federal Jurisdiction and Procedure: Class Actions -- Presumption of Reliance Under SEC Rule 10b-5 -- Halliburton Co. v. Erica P. John Fund, Inc.*, 128 Harv. L. Rev. 291, 296 (2014); Yaron Nili, *Supreme Court Upholds Fraud-On-The-Market Presumption in Halliburton*, THE HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE AND FINANCIAL REGULATION (June 24, 2014, 4:00 PM), http://blogs.law.harvard.edu/corpgov/2014/06/24/supreme-court-upholds-fraud-on-the-market-presumption-in-halliburton/ ("In the typical case—a positive announcement is followed by rise in the stock price, and a bad news announcement is followed by a sharp drop—Halliburton is not likely to change much.").

[13] *Halliburton*, 134 S. Ct. at 2417 (Ginsburg, J., concurring).

[14] *See* sources cited *supra* note 8.

[15] *See supra* note 6.

courts.[16] In such a contentious and uncertain environment, without a clear mandate to do so, the Supreme Court should never have considered directly overruling *Basic*'s FOTM presumption of reliance.[17]

This Note argues that the Supreme Court sought to reach a sensible balance in the adjudication of securities-fraud class actions through *Halliburton II*. It argues that corporate misbehavior is as big a problem as frivolous suits, and that thus, unfortunately, securities-fraud class actions are still necessary, but that their role might be evolving along with the current corporate law environment. Part II describes how the law has progressed in its treatment of securities issues, concluding that the *Halliburton II* case represents a compromise and balance. Part III explores the current state of corporate behavior. It reveals that, as compared to historical standards, potential misbehavior has not subsided, rather it has flourished and somewhat overshadows the equally problematic frivolous suits. Part IV ends by looking at whether *Halliburton II* is a step in the right direction toward fixing the securities class action system for plaintiffs and defendants; it concludes that it can be.

II. AN OVERVIEW OF FEDERAL SECURITIES REGULATION

A. Congressional Action

Generally, Congressional action in the field of securities regulation has moved along two different paths. From the Great Depression up until the '90s, Congress' objective was to rein in the markets. Thereafter, a shift toward restrictions on those reins began. What follows is a brief overview of this evolution in securities regulation.

1. Regulations Seeking to Protect Investors

Following the Stock Market Crash of 1929, and the ensuing and unprecedented Great

[16] *Id.* at 1409.
[17] *Id.* at 1406-15.

Depression, Congress enacted what became the first of many federal efforts under the New Deal[18] to regulate the offer and sale of securities, the Securities Act of 1933 (1933 Act).[19] Although prior to the 1933 Act there were blue-sky laws, state laws regulating securities, these were woefully inadequate;[20] their inadequacy was in fact often blamed for the financial collapse that led to the Great Depression. Thus, federal intervention was warranted.

The 1933 Act had two main objectives: informed investor decision-making and prevention of fraud.[21] It sought to accomplish these objectives via the requirement of full disclosure through a registration statement of any original issue of securities using the means and instrumentalities of interstate commerce, unless an exemption from such registration exists under the law.[22] There were regulatory gaps left by the 1933 Act, so Congress moved to address them in subsequent years.

In the seven years after the 1933 Act, Congress passed five additional acts. The Securities Exchange Act of 1934 (1934 Act) sought to regulate securities already issued.[23] It also established the Securities Exchange Commission (SEC), the agency which would be primarily responsible for the enforcement of federal securities law.[24] The Public Utility Holding Act of 1935[25] was designed to correct abuses by holding companies with little or no assets, and to prescribe accounting and recordkeeping requirements. Protection for debt securities holders by requiring an indenture (trust agreement) administered by an independent financial-institution trustee came through the Trust Indenture Act of 1939.[26] Finally, the last two acts to be enacted under the New Deal were the Invest-

[18] *New Deal Legislation*, THE GILDER LEHRMAN INSTITUTE OF AMERICAN HISTORY, https://www.gilderlehrman.org/history-by-era/new-deal/resources/new-deal-legislation.
[19] 15 U.S.C. § 77a (2000).
[20] *A Brief History of Securities Regulation*, State of Wisconsin Department of Financial Institutions, https://www.wdfi.org/fi/securities/regexemp/history.htm; Ramirez, *supra* note 7, at 677.
[21] 15 U.S.C. § 77a (2000).
[22] *Id.*
[23] 15 U.S.C. § 78a (2000).
[24] *Id.*
[25] Public Untility Holding Act of 1935, Pub. L. No. 74-333, 49 Stat. 803 (repealed 2005).
[26] Trust Indenture Act of 1939, Pub. L. No. 76-253, ch. 411, 53 Stat. 1149 (codified as amended at 15 U.S.C. §§ 77aaa-77bbbb (2012)).

ment Company Act of 1940[27] and the Investment Advisers Act of 1940.[28] The desire to stop the deceptive practices employed in the financial markets and the resulting fraud ensured the uncontroversial passage of all these acts.[29]

2. Regulations Seeking to Protect Corporations

Sixty years after the passage of the 1933 Act, Congress' attitude began to shift from that of concern for the average investor to that of concern for the corporate entity. After ongoing concern that some plaintiffs were abusing securities laws, specifically Rule 10b-5,[30] to obtain settlements, rather than bring any legitimate claims,[31] Congress enacted the Private Securities Litigation Reform Act (PSLRA)[32] in 1995.

The PSLRA has been criticized for its deterrence of not only frivolous suits but also meritorious suits.[33] Its creation of "a climate where fraud could flourish" has even been blamed for the Financial Crisis of 2008.[34] Among its impositions,[35] the most notable was its requirement that

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[27] It established requirements and regulated specific type of businesses, principally so-called "mutual funds," which invest in the securities of other companies. Investment Company Act of 1940, Pub. L. No. 76-768, 54 Stat. 789 (codified as amended at 15 U.S.C.§§ 80a-1 to 80a-64 ((2012)).

[28] Required registration (licensing) for all persons engaged for compensation in the business of rendering investment advice or issuing analyses or reports concerning securities. 15 U.S.C. §§ 80b-1 to -21 (2006).

[29] *See* Michael B. Dunn, *Pleading Scienter after the Private Securities Litigation Reform Act: or, a Textualist Revenge*, 84 Cornell L. Rev. 193, 194 n.3 (1998), http://scholarship.law.cornell.edu/cgi/viewcontent.cgi?article=2747&context=clr.

[30] 17 C.F.R. § 240.10b-5 (2013).

[31] Prior to PSLRA, plaintiffs could proceed with minimal evidence of fraud and then use pretrial discovery to seek further proof. This set a very low barrier to initiate litigation. Defending against these suits could prove extremely costly, even when the charges were unfounded, so defendants often found it cheaper to settle than fight and win. *See* Novak v. Kasaks, 216 F.3d 300, 306 (2d Cir. 2000).

[32] 15 U.S.C. § 77z (2014).

[33] Ramirez, *supra* note 7, at 673; *See* Stephen J. Choi, *Do the Merits Matter Less after the Private Securities Litigation Reform Act?* 23 J. L. ECON. & ORGS. 598, 600 (2007) (finding that PSLRA has deterred meritorious as well as meritless securities actions), http://jleo.oxfordjournals.org/content/23/3/598.full.pdf+html.

[34] Amy Widman & Joanne Doroshaw, *Legal Abandon: How Limiting Lawsuits Led to the Financial Collapse and What to do About It*, CENTER FOR JUSTICE & DEMOCRACY, 9 (Feb. 2010), https://centerjd.org/content/white-paper-legal-abandon-%E2%80%93-how-limiting-lawsuits-led-financial-collapse-and-what-do-about.

[35] PSLRA's response to the perceived abuses was to "impos[e] heightened pleading requirements, limit recoverable damages and attorney's fees, provide a 'safe harbor' for forward-looking statements, impose new restrictions on the selection of (and compensation awarded to) lead plaintiffs, mandate imposition of sanctions for frivolous litigation, and authorize a stay of discovery pending resolution of any motion to dismiss." Merrill Lynch v. Dabit, 547 U.S. 71, 81 (2006). [From "impose new restrictions…" the quote appears in the case in full. However, I

private plaintiffs meet heightened pleading standards. Prior to the PSLRA, the pleading of Rule 10b-5 claims was already governed by the more stringent Federal Rule of Civil Procedure 9(b),[36] requiring plaintiffs to state with particularity the circumstances constituting the alleged fraud, rather than the more liberal Federal Rule of Civil Procedure 8(a)(2),[37] requiring simply a "short and plain statement of the claim showing that the pleader is entitled to relief." With the PSLRA, plaintiffs must also, "with respect to each act or omission alleged to violate this title, state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind."[38]

Criticism of the PSLRA, however, turned out to be exaggerated. After its enactment, empirical research has found that the number of securities class action filings has not gone down.[39] The number of frivolous suits filed, on the other hand, might have decreased. Data shows that filings have shifted away from lower value claims,[40] most cases continue to settle, but the time to settlement has lengthened,[41] mean settlement has increased,[42] and there have been more large settlements.[43] Although some meritorious claims are bound to have been filtered out by the PSLRA,[44] something needed to be done by Congress to ameliorate the frivolous suit problem. The PSLRA proved to be right balance.[45]

B. Procedural Process

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am not seeing the beginning of the quoted phrase in the text of the case as it appears in the above quotation.

36 FED. R. CIV. P. 9(b).

37 FED. R. CIV. P. 8(a)(2).

38 15 U.S.C. § 78u-4(b)(2)(A) (2014).

39 Stephen J. Choi & Robert B. Thompson, *Litigation Reform since the PSLRA: A Ten-Year Retrospective: Panel One: Private Securities Litigation Reform Act: Securities Litigation and its Lawyers: Changes During the First Decade After the PSLRA*, 106 COLUM. L. REV. 1489, 1496 (2006).

40 *Id.* at 1497.

41 *Id.* at 1498.

42 *Id.* at 1499.

43 *Id.*

44 *Novak*, *supra* note 31, at 620.

45 It should be noted that Congress enacted the Securities Litigation Uniform Standards Act (SLUSA) in 1998, preempting most state-filed class actions involving nationally traded securities, as a response to plaintiffs who attempted to circumvent PSLRA by bringing suits under state anti-fraud statutes and common law, Pub. L. No. 105-353, §101(b)(1)(B), 112 Stat. 3227, 3230 (1998) (codified as amended at 15 U.S.C. §78bb(f)(2) (2000)).

By default, the overwhelming majority of securities-fraud suits are brought as section 10(b)[46] and Rule 10b-5 class actions. What follows is first, an overview of Rule 10b-5, the main anti-fraud regulation of the securities laws and, later, an explanation of the class certification process.

1. Rule 10b-5

As mentioned, most securities-fraud suits are brought pursuant to section 10(b) of the 1934 Act and Rule 10b-5 promulgated thereunder. Congress drafted section 10(b) of the Securities and Exchange Act of 1934 as a "catchall" antifraud provision to fight a wide variety of manipulative and deceptive activities that can occur in connection with the purchase or sale of securities.[47] Based upon the power granted under section 10(b), the SEC promulgated Rule 10b-5. Although Congress explicitly charged only the SEC with enforcement of section 10(b) and Rule 10b-5, the Supreme Court has held that a private cause of action exists based upon these provisions, an essential supplement to the federal government's criminal prosecutions and civil enforcement actions to combat securities fraud.[48]

Rule 10b-5 provides that:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
> (a) To employ any device, scheme, or artifice to defraud,
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

To recover damages for violations of section 10(b) and Rule 10b-5, a plaintiff must allege and prove six elements: (1) that the defendant made a material misrepresentation or omission, (2)

[46] 15 U.S.C. § 78j(b) (2014).
[47] *See* Eric C. Chaffee, *Standing Under Section 10(b) and Rule 10b-5: The Continued Validity of the Forced Seller Exception to the Purchaser-Seller Requirement*, 11 U. Pa. J. Bus. L. 843 (2009).
[48] *See, e.g.*, Ernst & Ernst v. Hochfelder, 425 U. S. 185, 196 (1976); Blue Chip Stamps v. Manor Drug Stores, 421 U. S. 723, 730 (1975).

that the defendant acted with scienter, (3) that the material misrepresentation or omission was made in connection with the purchase or sale of a security, (4) that the plaintiff relied on the material misrepresentation or omission, (5) that the plaintiff suffered an economic loss, and (6) that the material misrepresentation or omission actually caused the loss.[49] The element that has shown to be contentious, and harder to prove, especially in the context of class actions, is reliance.[50]

2. Class Certification

Given the high costs and reward system of litigating securities-fraud suits, private Rule 10b-5 claims usually proceed as class actions.[51] Thus, along with the motion to dismiss, whether plaintiffs obtain class certification is often the defining moment in a private securities lawsuit.[52] If certification of a class is granted, defendants may be forced to settle rather than incur the costs of trial and run the risk of the small prospect of a very large adverse judgment, regardless of the merits of plaintiffs' claims.[53]

In order to obtain class certification, members of the plaintiff class must satisfy Federal Rule of Civil Procedure 23(a) and 23(b).[54] Meeting the requirements of Rule 23(a)[55] (numerosity,

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[49] Amgen Inc. v. Connecticut Retirement Plans and Trust Funds, 133 S. Ct. 1184, 1191 (2013) (quoting Matrixx Initiatives, Inc. v. Siracusano, 131 S. Ct. 1309, 1317-18, (2011)).

[50] *See* Section B.2.

[51] *Kaufman*, *supra* note 9, at 325.

[52] Amanda M. Rose, *Reforming Securities Litigation Reform: Restructuring the Relationship Between Public and Private Enforcement of Rule 10b-5*, 108 Colum. L. Rev. 1301, 1347 (2008).

[53] "…out of 4,226 class actions filed between 1995 and 2013, only 14 were resolved through a trial, and of those, only five resulted in verdicts for the defendant. In between a denial of a motion to dismiss and a trial are i) discovery, ii) opposition to class certification, iii) motion for summary judgment, iv) mediation, and v) settlement. Unfortunately for defendants in securities class actions, class certification is granted in whole or in part 84% of the time, and there is no summary judgment decision at all over 90% of the time." Kobi Kastiel, *Successful Motions to Dismiss Securities Class Actions in 2014*, THE HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE AND FINANCIAL REGULATION (Nov. 23, 2014, 8:23 AM), http://blogs.law.harvard.edu/corpgov/2014/11/23/successful-motions-to-dismiss-securities-class-actions-in-2014/.

[54] Ross v. Abercrombie & Fitch Co., No. 2:05-cv-0819, 2008 WL 4059873, at *2 (S.D. Ohio Aug. 26, 2008).

[55] FED. R. CIV. P. 23(a) provides "(a) Prerequisites to a Class Action. One or more members of a class may sue or be sued as representative parties on behalf of all only if: (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class; (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class; and (4) the representative parties will fairly and adequately protect the interests of the class."

commonality, typicality, and adequacy) is not difficult; it is the requirements of Rule 23(b)[56] that have been more challenging. A class action under Rule 23(b)(3) will not be certified unless questions of law and fact common to the members of the class predominate over any questions affecting only individual members.[57] In other words, each of the elements of a Rule 10b-5 claim must be satisfied with generalized proof applicable to all class members. The Supreme Court has provided guidance on how to accomplish such a feat.[58]

C. Supreme Court

The Supreme Court has held that evidence sufficient to invoke FOTM's rebuttable theory of reliance allows plaintiffs to meet such requirement in Rule 10-b5, as well as the predominance requirement for class action certification under Rule 23(b)(3). Such evidence should show that stock traded on an efficient market, that defendants made public, material misrepresentations, and that the proposed class representative traded shares between the time the misstatements were made and the disclosure of the truth. This section will begin by exploring *Basic*, where FOTM was first recognized, and it will end with an overview of *Halliburton II*, the Supreme Court's re-endorsement of FOTM, more than twenty years after *Basic*.

A. *Basic Inc. v. Levinson*

Basic, decided by a four-to-two majority and with three Justices not participating, formally addressed how securities-fraud plaintiffs can proceed as a class. In the case, respondents, former Basic, Inc. shareholders, traded the corporation's shares on a securities exchange after the issuance

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[56] FED. R. CIV. P. 23 (B) TRIED TO SWITCH TO LOWER CASE B BUT IT WON'T LET ME

[57] FED. R. CIV. P. 23(b)(3) provides"b) Class Actions Maintainable. An action may be maintained as a class action if the prerequisites of subdivision (a) are satisfied, and in addition: (3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include: (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action."

[58] *See Basic*, 485 U.S. at 226.

of a materially misleading statement by the corporation.[59] Respondents alleged that they were injured by selling Basic shares in reliance on artificially depressed prices in a market affected by petitioners' misleading statements.[60] Based on FOTM, the Court held that respondents were entitled to invoke a rebuttable presumption of reliance.[61] First, the Court noted that case precedent has allowed reliance to be established in a number of different ways, including indirect proof.[62] Second, early fraud cases involved face-to-face transactions; modern securities markets, on the other hand, involve "millions of shares changing hands daily," and an understanding of Rule 10b-5's reliance requirement must consider these differences.[63] Now, when there is a market in the way of sellers and buyers, it acts as the agent of the investor conveying "information to the investor in the processed form of a market price."[64] Thus, modern markets no longer involve the face-to-face transactions where valuation would have been performed by the investor himself.[65]

The Court closed its opinion by continuing to elaborate on the benefits of a presumption of reliance. Without the presumption of reliance, each member of the plaintiff class would have been required to demonstrate individual reliance on each alleged misrepresentation, effectively precluding class treatment.[66] Also, congressional policy in enacting the 1934 Act included the facilitation of an investor's reliance on the integrity of the markets.[67] Finally, the presumption of reliance is rebuttable.[68] "Any showing that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff, or his decision to trade at a fair market price, will be

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[59] During the preceding two years of their merger, Combustion Engineering, Inc., and Basic Incorporated officers and directors engaged in various meetings to discuss the possibility of a merger. All the while, however, Basic also "made three public statements denying that it was engaged in merger negotiations." *Id.* at 227.

[60] *Id.* at 228.

[61] *Id.* at 250.

[62] *Id.* at 243.

[63] *Id.* at 244.

[64] *Id.*

[65] *Id.*

[66] *Id.* at 242.

[67] *Id.* at 246.

[68] *Id.* at 248.

sufficient to rebut."[69] In an era precedent to the proliferation of frivolous suits,[70] *Basic*'s result was arguably reasonable.

1. Aftermath of *Basic Inc. v. Levinson*

a. FOTM Criticism

The aftermath of *Basic* centered on criticism of FOTM. More specifically, the criticism has been aimed at the theory's dependence on another economic theory, the efficient market hypothesis (EMH).[71] According to EMH, the price of a security, traded on a public exchange, reflects all publicly available information at all times.[72] It thus follows that any material misrepresentation or omission will also be reflected in a security's price.[73] Such misrepresentations result in a "fraud-on-the-market" because the security's price is said to be distorted by the effects of this information.[74]

However, not only has it been debated whether the price of a publicly traded security can and does reflect all publicly available information,[75] the relevance of EMH altogether has been questioned. Investors trade on emotions, hunches, and intuitions.[76] What's more, academics have posited that no reasonable investor would ever assume price integrity, that market prices are free from fraud. "Fraud and manipulation are predictable enough that it would be foolish for anyone simply to assume that a stock price has integrity."[77] In addition, in an efficient market, the inevitable

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[69] *Id.*

[70] *See* Benjamin A. Leisawitz, *Matrixx Initiatives Inc. v. Siracusano: Rejection of the Statistically Significant Standard Opened the Door to Securities Fraud Strike Suits*, 36 DEL. J. CORP. L. 675, 677 (2011).

[71] L. Brett Lockwood, *The Fraud-On-The-Market Theory: A Contrarian View*, 38 EMORY L.J. 1269, 1270 (1989).

[72] Ronald Gilson & Reinier Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549, 549-550 (1984).

[73] *Basic*, 485 U.S. at 248.

[74] *Id.*

[75] *See* 38 EMORY L.J. 1269, 1315 (1989); Andrei Shleifer & Lawrence H. Summers, *The Noise Trader Approach to Finance*, J. ECON. PERSP., Spring 1990, at 19.

[76] *See* Robert J. Shiller, *Market Volatility and Investor Behavior*, 80 AM. ECON. REV. 58 (1990); *see also* Robert J. Shiller, *Speculative Prices and Popular Models*, J. ECON. PERSP., Spring 1990, at 55.

[77] Donald C. Langevoort, *Basic at Twenty: Rethinking Fraud on the Market*, 2009 WIS. L. REV. 151, 160 (2009).

risk of fraud is priced into stock prices and investors are compensated for taking on the risk.[78] More than twenty years after *Basic*, criticism continues along these same lines.[79]

b. Frivolous Suits

The other problem with *Basic* is the number of securities-fraud suits, especially the frivolous, that it enabled.[80] Often, these suits will be filed based on a drop in stock price, regardless of the reasons or whether the price subsequently recovers.[81] A firm initiating suit may not even have investigated to determine if there is any evidence of actual wrongdoing.[82] For some firms, when stock prices fall a certain percentage--for example 10%--it becomes an automatic trigger to file suit.[83] These claims usually just allege that the directors failed to disclose adverse information to the public, causing losses that would not have occurred otherwise.[84] A few of these frivolous suits might not have been a problem; however, their numbers rose dramatically,[85] so much so that Congress had to step in and enact the aforementioned PSLRA.[86] The following anecdote from a senator serves to illustrate the problem.

> There is a lawyer in New York who watches [the Company], and whenever the compensation of the directors goes up for whatever reason, he automatically files a lawsuit . . . . [Legal counsel told the director:] "This lawyer knows he will never win his suit. He knows we will never spend the money to take him to court. It would cost us about $ 500,000 to prosecute this suit and take him to court and win and it is cheaper for us to send him a $ 100,000 check to settle this . . . . [Director], you can be as outraged as you want to be, but our alternative is to prosecute this lawsuit, take

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78 *Id.*

79 *Id.*

80 Douglas C. Buffone, *Predatory Attorneys and Professional Plaintiffs: Reforms are Needed to Limit Vexatious Securities Litigation*, 23 HOFSTRA L. REV. 655, 662 (1995).

81 *Id.* at 663.

82 *Id.*

83 *See Senate Panel Hears Views on Reducing Number of Frivolous Rule 10b-5 Actions*, 25 Sec. Reg. & L. Rep. (BNA) 847, 847 (June 18, 1993).

84 Buffone, *supra* note 80, at 663.

85 M. Todd Henderson & Adam C. Pritchard, From *Basic* to *Halliburton*, REGULATION, Winter 2014-2015, at 20.

86 PSLRA was designed "to protect investors, issuers, and all who are associated with our capital markets from abusive securities litigation." H.R. Rep. No. 104-369, at 32 (1995), reprinted in 1995 U.S.C.C.A.N. 730, 731. Congress believed that strike suits, filed in order to extract quick settlements from defendants hoping to avoid the costs of defending such suits, were causing serious damage to the economy. See *Id.* at 31, reprinted in 1995 U.S.C.C.A.N. 730, 730.

> him to court, beat him in court, see a $ 500,000 legal bill run up in the process." [Later, this] lawyer decided to expand his practice and he started suing other companies . . . . One of the companies . . . looked at this and decided the time has come to put an end to it and . . . we can take this man to court and ruin him in his legal costs, trying to defend himself. So the system that had worked for the lawyer in one circumstance then turned against him . . . . They ultimately did put a stop to it because when he was faced with actually proving his position in a court of law and running up the costs connected with that kind of litigation, the lawyer was finally forced to back down.[87]

Although inconclusive and unpromising, empirical studies have been conducted to try to determine whether the PSLRA helped reduce the number of frivolous suits. Michael Perino of St. John's University compiled a database of 1,449 securities fraud class actions filed in federal court from 1996 to 2001, the first six years after passage of the PSLRA.[88] At the very least, as will be shown in the following, his data casts doubt over the effectiveness of the PSLRA.

After the PSLRA, it appears that as many, if not more, class actions have been filed as before. The mean (median) number of issuers sued per year in the five years immediately previous to the passage of the PSLRA was 183.4 (178).[89] In the first six years since passage of the Act, there were 241.5 (210.5).[90] In percentage terms, there was a 32% (18%) increase in mean (median) number of issuers sued per year. However, there is a large year-to-year variation in the number of issuers sued, rendering the resulting means as not statistically significant.[91] Put another way, "looking solely at mean filings, there is insufficient evidence to conclude that the PSLRA affected the total number of issuers sued per year."[92]

The PSLRA's impact on class action filings is not clear from such data for a number of

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[87] 141 Cong. Rec. S19036 (daily ed. Dec. 21, 1995) (Statement of Sen. Bennett). The anecdote, again, illustrates "the use of the litigation process as a device for extracting undeserved settlements as the price of avoiding the extensive discovery costs that frequently ensue once a complaint survives dismissal, even though no recovery would occur if the suit were litigated to completion." In re Time Warner Inc. Sec. Litig., 9 F.3d 259, 263 (2d Cir. 1993).

[88] Michael A. Perino *Did the Private Securities Litigation Reform Act Work?*, 4 U. Ill. L. Rev. 913, 915 (2003).

[89] *Id.* at 930.

[90] *Id.*

[91] *Id.*

[92] *Id.*

reasons. It is challenging to directly compare pre-and post- Act litigation because two circumstances affected the total number of issuers sued in the post-PSLRA period that were not present in the pre-PSLRA period. First, during 1996 and 1997, the first years of litigation under the PSLRA, there was a pointed decline in federal filings.[93] Evidence suggests, however, that the decline was due to a shift in filings from federal to state court.[94] Therefore, it is argued that a more meaningful study of pre- and post-PSLRA litigation would include issuers sued only in state court during those years.[95]

Next, the 2001 surge in litigation is often attributed to the burst of the dot-com bubble.[96] In the so-called initial public offering (IPO) allocation cases of that time, nearly all issuers that went public at the end of the dot-com bubble were sued, along with the underwriters of their offerings.[97] And allegations in traditional securities fraud class actions are substantially different from those in allocation cases. Instead of alleging misrepresentation or omissions with respect to the issuer, allocation cases allege a failure to disclose appropriately a number of practices associated with the IPO process itself.[98] A meaningful comparison of pre-and post-PSLRA litigation would, therefore, omit cases that allege purely IPO allocation issues from the number of issuers sued in 2001.

Surprisingly, adjusted data suggests that passage of the PSLRA is correlated with an increase in the number of issuers sued, exactly the opposite of what Congress intended. The mean (median) number of issuers sued in the post-PSLRA period is 227.17 (210.5), which represents a 24% (18%) increase over the pre-PSLRA period.[99] The mean adjusted increase in post-PSLRA issuers sued is statistically significant at approximately the 10% level.[100] Explanations for these numbers vary.

One view attributes the increase in class action filings following the passage of the PSLRA

[93] Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71, 82 (2006).
[94] *Id.*
[95] Perino, *supra* note 88, at 932.
[96] *Id.* at 932.
[97] *Id.*
[98] *Id.*
[99] *Id.*
[100] *Id.*

to an increased incidence of fraud.[101] The Financial Executives Institute found a substantial increase in accounting restatements from 1998 through 2000.[102] After all, when corporate executives find themselves in a position to benefit coupled with the lower risk of fraud being detected and prosecuted, they may be more likely to act on the fraudulent opportunity.[103]

However, the increase in class action filings was not necessarily the result of a rise in fraud. By staying discovery while a motion to dismiss is pending, the PSLRA may have decreased the fixed costs of each case filed. In addition, the PSLRA might have made securities litigation riskier by increasing the number of actions dismissed in pretrial proceedings. Under such circumstances, plaintiffs' law firms might want to bring more rather than fewer actions and then to make smaller investments in each.[104] With greater portfolio diversification, suing multiple issuers in multiple circuits, plaintiffs' attorneys can diversify against the risks of unpredictable interpretation or application of the pleading standard.[105] This strategy may also be sensible if the expected costs of filing and litigation are less than the cost of doing further pre-filing investigation to determine the merits of a suit.[106] Thus, the unexpected strategic shift toward more filings could have simply been a rational economic response from plaintiffs' attorneys.

B. *Halliburton Co. v. Erica P. John Fund, Inc.*

1. The Opinion

After more than twenty years, a vastly changed economic and regulatory landscape, and relentless attacks on its decision, last year, the Court finally decided to revisit *Basic*'s FOTM

[101] Stephen J. Choi, Karen K. Nelson & A. C. Pritchard, *The Screening Effect of the Private Securities Litigation Reform Act*, 6 J. Empirical Legal Stud. 35, 36 (2009).
[102] *See* Financial Executives Institute, *Quantitative Measures of the Quality of Financial Reporting* 6 (June 7, 2001), http://www.fei.org/download/QualFinRep-6-7-2k1.ppt.
[103] Lori Richards, Director, Securities and Exchange Commission, *Southwest Securities Enforcement Conference*: *Why Does Fraud Occur and What Can Deter or Prevent it?* (Sept. 9, 2008), http://www.sec.gov/news/speech/2008/spch090908lar.htm.
[104] Perino, *supra* note 88, at 936.
[105] *Id. a*t 937.
[106] *Id.* at 936; *See also* John C. Coffee, Jr., *The Regulation of Entrepreneurial Litigation: Balancing Fairness and Efficiency in the Large Class Action*, 54 U. Chi. L. Rev., 877, 889-90 (1987).

presumption of reliance in *Halliburton II*. The Court described the two questions presented in *Halliburton II* as whether it "should overrule or modify *Basic*'s presumption of reliance" and "if not, whether defendants should nonetheless be afforded an opportunity in securities class action cases to rebut the presumption at the class certification stage, by showing a lack of price impact."[107] Without much ado, as a popular business magazine noted, the Court left FOTM absolutely intact.[108]

In the case, the Erica P. John Fund, Inc. (EPJ Fund), was the lead plaintiff in a putative class action (comprised of all investors who purchased stock during the class period) against Halliburton Co. and its CEO (collectively, Halliburton) alleging violations of section 10(b) and Rule 10b-5.[109] According to EPJ Fund, between June 3, 1999, and December 7, 2001, Halliburton made a series of misrepresentations regarding its potential liability in asbestos litigation, its expected revenue from certain construction contracts, and the anticipated benefits of its merger with another company—all in an attempt to inflate the price of its stock.[110] Halliburton subsequently made a number of corrective disclosures, which, EPJ Fund contended, caused the company's stock price to drop and investors to lose money.[111] However, as EPJ Fund moved to certify a class action, it encountered a number of obstacles.

The Northern District of Texas refused to certify the motion for class certification.[112] Although EPJ Fund's proposed class satisfied all the threshold requirements of Federal Rule of Civil Procedure 23(a), it did not meet Rule 23(b)(3).[113] Fifth Circuit precedent required proof of loss causation from plaintiffs at the class certification stage in order for them to invoke *Basic*'s FOTM

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[107] *Halliburton*, 134 S. Ct. at 2405.
[108] Daniel Fisher, *Supreme Court Leaves Fraud On Market Intact, Makes Life a Bit Harder for Securities Plaintiffs*, FORBES (Jun. 23, 2014, 10:55 AM),
[109] *Halliburton*, 134 S. Ct. at 2405.
[110] *Id.*
[111] *Id.* at 2406.
[112] Brief in Opposition at 6, *Halliburton*, 134 S. Ct. 2398 (No. 13-317).
[113] *Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co*., 2008 U.S. Dist. LEXIS 89598, 73 (N.D. Tex. 2008).

presumption of reliance, and EPJ Fund did not offer such proof.[114] The Fifth Circuit affirmed.[115] Granting certiorari to the case for the first time, the Supreme Court reversed and remanded finding nothing in *Basic* or its logic to justify loss causation as a requirement to invoke *Basic*'s presumption of reliance.[116]

Eventually, remand allowed Halliburton to arrive at *Halliburton II*. The Supreme Court wanted to consider whether it should overrule *Basic*'s presumption of reliance, and whether class certification should be inappropriate when a defendant could show that none of its alleged misrepresentations had affected its stock price.[117] As Halliburton argued, it was time to reconsider *Basic*'s presumption of reliance, as well as to allow lack of price impact evidence to rebut the presumption.

The Court declined to overrule *Basic*. To overturn "a long-settled precedent," Chief Justice Roberts explained, writing for the Court, that there needs to be a "special justification," not simply "an argument that the precedent was wrongly decided." [118] Halliburton's two arguments for overruling *Basic*, congressional intent and subsequent developments in economic theory, failed to provide such justification.[119]

First, the Court found that the argument that *Basic*'s presumption is inconsistent with Congress's intent in passing the 1934 Act was made before—in *Basic*—and remains unpersuasive.[120] Second, the argument that economic theory underlying *Basic*'s presumption of reliance has since changed also fell on deaf ears. Halliburton offered evidence showing that capital markets are not efficient per EMH: "Overwhelming empirical evidence" suggests that "public information is often

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114 *Id.* at 12-14.
115 *Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co*, 597 F.3d 330, 334 (5th Cir. 2010).
116 *Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179, 2182 (2011) (hereinafter *Erica P. John Fund, Inc*).
117 *Id.* at 2184.
118 *Halliburton,*134 S. Ct. at 2407.
119 *Id.* at 2408.
120 *Id.* at 2409.

not incorporated immediately (much less rationally) into market prices."[121] The Court found the evidence beside the point; it explained that *Basic* had based its presumption only "on the fairly modest premise that market professionals generally consider most publicly announced material statements about companies, thereby affecting stock market prices" *not* on the adoption of any "particular theory of how quickly and completely publicly available information is reflected in market price."[122]

After addressing these arguments, the Court focused on stare decisis and policy.[123] *Basic*'s presumption of reliance, although a "judicially created doctrine" is statutory interpretation "Congress remains free to alter" and, as such, is under the "special force" of stare decisis.[124] With Congress able to "overturn or modify any aspect of our interpretations," the Court proffered another reason to adhere to *Basic*.[125] Finally, while *Basic*'s presumption of reliance might have also allowed "meritless claims," punishment of "innocent shareholders," and "excessive costs on businesses," such concerns are, Chief Justice Roberts wrote, "more appropriately addressed to Congress."[126]

Moving on, the Court also declined to require plaintiffs to directly prove price impact in order to invoke *Basic*'s FOTM presumption of reliance.[127] The *Basic* presumption entitles plaintiffs to the presumption that a misrepresentation affected the stock price, if they can show "that the defendant's misrepresentation was public and material and that the stock traded in a generally efficient market."[128] Therefore, for the Court, requiring plaintiffs to prove price impact would simply

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[121] *Id.*
[122] *Id.* at 2410.
[123] *See id.* at 2411-13.
[124] *Id.* at 2411.
[125] *Id.*
[126] *Id.* at 2413.
[127] *Id.* at 2417.
[128] *Id.* at 2414.

be another attempt at overruling *Basic*, something that it was not going to do.[129]

Can Halliburton at least rebut *Basic*'s presumption at the class certification stage with evidence that misrepresentations did not in fact affect its stock price? Yes, the Court held that defendants can defeat the presumption of reliance at the class certification stage by introducing evidence that alleged misrepresentations did not affect stock price.[130] It noted that while *Basic* allows plaintiffs to rely on an indirect proxy for price impact, "fraud-on-the-market theory, market efficiency and the other prerequisites" that should not preclude direct evidence when it is available.[131] Simply put, "an indirect proxy should not preclude direct evidence when such evidence is available."[132]

In contrast to *Basic*, *Halliburton II* had no dissents. Justice Ginsberg, Breyer, and Sotomayor, joined in a brief concurrence, while Justice Thomas, joined by Justices Scalia and Alito, wrote an opinion concurring in the judgment only in which he contended that the Court should have overturned *Basic*.[133] For him, "[l]ogic, economic realities, and our subsequent jurisprudence have undermined the foundations of the *Basic* presumption."[134] Echoing previous arguments, Justice Thomas thought *Basic*'s presumption based on "a questionable understanding of disputed economic theory and flawed intuitions about investor behavior[;]"*Basic* as inconsistent with recent cases clarifying that Rule 23 requires plaintiffs to affirmatively demonstrate predominance; and, finally, *Basic*'s rebuttable presumption as irrebutable in practice.[135]

2. The Analysis

In *Halliburton II*, a modification rather than a complete rejection of *Basic* was probable. First, Congress, in its two most recent enactments of securities litigation reform, with the opportunity to

[129] *Id.*
[130] *Id.*
[131] *Id.* at 2415.
[132] *Id.*
[133] *Id.* at 2417-18 (Thomas, J., concurring in the judgment).
[134] *Id.* at 2418.
[135] *Id.* at 2420.

do so, declined to comment on FOTM.[136] In fact, provisions of the PSLRA depend on *Basic*.[137] Second, and, perhaps, ironically, it could be convincingly argued that markets today are much more efficient than they were in 1988. With the advent of high-frequency trading and the like, information is usually incorporated in market prices instantaneously.[138] Third, the Roberts Court's securities law decisions that have expanded or restricted the reach of securities law have roughly occurred in a 50/50 proportion, signaling, perhaps, a strong bias toward the status quo in securities jurisprudence.[139] And finally, however, as this Note opines, the background of the continuing effects of the Financial Crisis of 2008, which will be discussed in the following part, is too scarring and unprecedented to justify what could have been such a substantial plaintiff defeat.

III. CORPORATE MISBEHAVIOR AND FRIVOLOUS SUITS

A. Corporate Misbehavior in Recent Years

Although the Supreme Court did not explicitly, and, perhaps, not even implicitly, address corporate fraud in *Halliburton II*, its shadow on the decision should not be overlooked.[140] This section will first explore, briefly, the now infamous accounting scandals of the early 2000s; it will then move on to an overview of the unprecedented Financial Crisis of 2008 and its aftermath. The section will end with an analysis of the substantial costs, economic and otherwise, of such crises and scandals, analysis which will later serve a comparison of these costs with those of frivolous suits, another proffered *Basic* problem.

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[136] *See* 109 Stat. 737 (1995); 112 Stat. 3227 (1998).

[137] During oral argument, Justice Scalia noted: "[T]he PSLRA assumes Basic." "[P]rovisions would . . . be useless if *Basic* were entirely overruled." Transcript of Oral Argument at 40, *Halliburton Co. v. Erica P. John Fund, Inc.*, 134 S. Ct. 2398 (No. 13-317).

[138] Burton Malkiel, *High-frequency Trading is a Natural Part of Market Evolution*, THE FINANCIAL TIMES (Dec. 14, 2009 4:53 PM), http://www.ft.com/cms/s/0/1513400e-e8cf-11de-a756-00144feab49a.html#axzz3Q50W5nBa.

[139] *See* John C. Coates IV, *Securities Litigation in the Roberts Court: An Early Assessment*, 56 Ariz. L. Rev. (2015).

[140] *Halliburton II* is, after all, about the principal statutory weapons against fraud, section 10(b) and Rule 10b-5. And again, section 10(b) is the antifraud provision of the Exchange Act, while Rule 10b-5 is the rule the SEC promulgated under that section.

a. Before the Financial Crisis

Lest their lessons are forgotten, the corporate scandals of the early 2000s are worth revisiting.[141] Most notably, the 2000s were victim to the burst of the dot-com bubble.[142] Investor losses from the burst were massive. From its May 2000 high of 5085, NASDAQ collapsed 77.5% to as low as 1139 by October 2002.[143] All profits reported by NASDAQ companies from 1995-2000 disappeared with the subsequent "unforeseen" company write-offs of about $ 148 billion that followed.[144] Attention to the timeline of these write-offs reveals that they do not include those of Enron, WorldCom, and others.

Accounting restatements were notorious during this era, as well. An early case is that of Cendant, created after the merger HFS Inc. and CUC International Inc. (CUC). [145] After investigations, it was revealed that CUC fabricated about $100 million in bogus revenue in 1995, $150 million in 1996, and at least $250 million in 1997, $500 million in total.[146] 61% of CUC's 1997 net income was fake.[147] More impressive, however, is Cendant's stock plunge the day after its fraud revelations, 46.5%, about $14 billion of market capitalization. Four months later, that figure rose to $20 billion.[148] The following class action settled for a fraction of all the losses, but still a then record-

[141] *See, e.g.*, John C. Coffee, *The Political Economy of Dodd-Frank: Why Financial Reform Tends to Be Frustrated and Systemic Risk Perpetuated*, 97 Cornell L. Rev. 1019, 1029-31 (2012). As Prof. Coffee illustrates, financial regulatory reform typically follows a "regulatory sine curve," in which (i) a financial crisis provokes widespread outrage and public demands for reform, which cause Congress and regulators to impose more stringent rules on the financial industry, and (ii) after the crisis has passed and conditions seem to return to "normal," the public loses interest in the financial sector and the industry pushes Congress and regulators to repeal or soften the new rules.

[142] DOTCOM BUBBLE DEFINITION, INVESTOPEDIA, http://www.investopedia.com/terms/d/dotcom-bubble.asp (last visited Feb. 1, 2015).

[143] StreetAuthority, *Should Investors Brace For Another Dot-Com Bubble?*, NASDAQ (Mar. 14, 2014, 03:30 PM), http://www.nasdaq.com/article/should-investors-brace-for-another-dot-com-bubble-cm335499.

[144] Steve Liesman, *Heard on the Street, Nasdaq Companies' Losses Erase 5 Years of Profit*, WALL ST. J., Aug. 16, 2001, at C1.

[145] Emily Nelson & Joann S. Lublin, *How Two Whistle-Blowers Sparked Fraud Probe That Crushed Cendant*, WALL ST. J. (Aug. 13, 1998, 11:39 AM) http://www.wsj.com/articles/SB902894665549692500.

[146] *Id.*

[147] *Id.*

[148] Emily Nelson, *Cendant's Profit Tops Forecasts For Quarter; 1997 Results Restated*, WALL ST. J. (Aug.

breaking $2.83 billion.[149]

There were many, many other restatements. The top 10 largest include: WorldCom $3.9 billion, Rite Aid $1.6 billion, Critical Path $1.3 billion, Waste Management $1.1 billion, Xerox $980 million, Rite Aid $686 million, Enron $586 million, Cendant $439 million, Conseco $368 million, and National Commerce Financial $363 million.[150] A scathing remark from Warren Buffett sums up the era: "In recent years, probity has eroded. Many major corporations still play things straight, but a significant and growing number of otherwise high-grade managers . . . have come to the view that it's okay to manipulate earnings to satisfy what they believe are Wall Street's desires. Indeed, many CEOs think this kind of manipulation is not only okay, but actually their duty."[151]

b. The Financial Crisis

Who should be assigned most of the blame for the Financial Crisis of 2008 is still a debatable question. Was the cause of the crisis deliberate fraud by financial-industry actors, or simply systemic miscalculations? Numerous market participants engaged in questionable practices, including mortgage originators, securitizers, credit default-swap sellers, rating agencies, and investors.[152] Although the answer to the question is probably systemic miscalculations, the resulting numbers from the crisis do not put financial firms in a favorable light.

The number of SEC enforcement actions against financial firms following the crisis was substantial.[153] There were actions for misleading disclosures to investors about mortgage-related

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14, 1998, 12:01 AM), http://www.wsj.com/articles/SB903016338863096000.

[149] *Cendant settles for $2.83B*, CNN MONEY (Dec. 7, 1999, 1:32 PM), http://money.cnn.com/1999/12/07/companies/cendant/.

[150] Matt Krantz, *The Nine Lives of Ousted Corporate Fat Cats*, USA TODAY (Jul. 17, 2002, 10:44 PM), http://usatoday30.usatoday.com/money/covers/2002-07-18-ceos-nine-lives.htm.

[151] Warren Buffett, Chairman's Letter - Berkshire Hathaway, Inc., http://www.berkshirehathaway.com/1998ar/1998final.html.

[152] *See* Lynne L. Dallas, *Short-Termism, the Financial Crisis, and Corporate Governance*, 37 Iowa J. Corp. L. 265, 267 (2012).

[153] SEC ENFORCEMENT ACTIONS, ADDRESSING MISCONDUCT THAT LED TO OR AROSE FROM THE FINANCIAL CRISIS, http://www.sec.gov/spotlight/enf-actions-fc.shtml (last visited Feb. 1, 2015).

risks and exposure.[154] For example, Bank of America was charged with failing to inform investors that more than 70 percent of the mortgages backing an offering of residential mortgage-backed securities (RMBS) originated through the bank's "wholesale" channel of mortgage brokers unaffiliated with Bank of America entities.[155] Bank of America apparently recognized that such wholesale channel loans – described by its then-CEO as "toxic waste" – presented vastly greater risks of severe delinquencies, early defaults, underwriting defects, and prepayment.[156] It, however, only selectively disclosed the percentage of wholesale channel loans to a limited group of institutional investors.[157] It also never filed this material information publicly as required under the federal securities laws.[158]

There also were actions for the concealment from investors of risks, terms, and improper pricing in collateralized debt obligations (CDOs) and other complex structured products.[159] J.P. Morgan Securities LLC, for instance, was charged by the SEC for misleading investors in a complex mortgage securities transaction just as the housing market was beginning to nosedive.[160] The SEC alleged that J.P. Morgan structured and marketed a synthetic CDO without advising investors that a hedge fund helped select the assets in the CDO portfolio and had a short position in more than half of those assets.[161] Given such latitude, the hedge fund was set to benefit if the CDO assets it was selecting for the portfolio defaulted.

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[154] *Id.*

[155] *SEC Charges Bank of America With Fraud in RMBS Offering*, 2013-148, Washington D.C., Aug. 6, 2013, http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539751924#.VM4tjpU5DIU.

[156] Halah Touryalai, *Bank of America Sold $850M In 'Toxic Waste' Mortgage Securities*, FORBES (Aug. 6, 2013, 4:08 PM), http://www.forbes.com/sites/halahtouryalai/2013/08/06/bank-of-america-hit-with-fraud-suits-over-855m-in-mortgage-securities/.

[157] Dallas, *supra* note 123, at 125.

[158] *Id.*

[159] *Id.* at 128.

[160] *J.P. Morgan to Pay $153.6 Million to Settle SEC Charges of Misleading Investors in CDO Tied to U.S. Housing Market*, 2011-131, Washington, D.C., June 21, 2011, http://www.sec.gov/news/press/2011/2011-131.htm.

[161] *Id.*

The costs of the Financial Crisis of 2008 should not be forgotten. During the period dubbed the "Great Recession" from December 2007 to June 2009, the U.S. suffered the most severe economic contraction since 1947.[162] The difference, losses, between the potential GDP the U.S. would have generated without the financial crisis and the actual GDP already created or currently projected to be created from 2008 to 2018 stands at $7.6 trillion.[163] That number does not take into account the fiscal and monetary policies that the Treasury Department and the Federal Reserve took to avoid further losses in the neighborhood of $5.2 trillion.[164] The grand total of losses is thus $12.8 trillion, not million, not billion, but trillion.

To put these numbers in context, a look at the crisis's effect on the labor market helps. Nonfarm payroll employment declined by about 8.5 million jobs from peak to trough.[165] The unemployment rate increased from 4.7% in November 2007 to a peak of 10.1% in October 2009.[166] Two years after the end of the recession, the unemployment rate was still above 9%.[167] A Labor Department survey found that only a quarter of six million "displaced workers" who lost their jobs between 2009 and 2011 were able to find a job with equivalent pay by January 2012.[168] Almost a third of those workers took a job that paid less, and nearly half were still unemployed or had stopped looking for work by the latter date.[169] By any measure, losses stemming from the Financial Crisis of 2008 were extraordinary.

c. After the Financial Crisis

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[162] Kevin J. Lansing, *Gauging the Impact of the Great Recession*, FRBSF Economic Letter 2011-21 (July 21, 2011).

[163] Karen Weise, *Tallying the Full Cost of the Financial Crisis*, BLOOMBERG BUSINESS (Sept. 14, 2012), http://www.bloomberg.com/bw/articles/2012-09-14/tallying-the-full-cost-of-the-financial-crisis.

[164] *Id.*

[165] Lansing, *supra* note 162.

[166] *Id.*

[167] *Id.*

[168] Peter Whoriskey, *Unemployment woes hit hard for displaced workers, Labor Dept. study shows*, THE WASHINGTON POST (Aug. 24, 2012), http://www.washingtonpost.com/business/economy/2012/08/24/72c7e608-ee00-11e1-b0eb-dac6b50187ad_story.html.

[169] *Id.*

Corporate financial practices since the Financial Crisis of 2008 still need to improve. For instance, in 2012, J.P. Morgan announced losses in its Chief Investment Office (CIO) related to problematic derivatives trades that eventually cost the bank $6 billion.[170] The CIO was created to invest excess deposits that the bank did not channel toward funding its loans, and the bank's senior management encouraged the CIO to take aggressive trading risks.[171] Although the CIO's massive trading positions produced substantial profits in 2010 and 2011, they plummeted in value in 2012.[172] What is more alarming, however, is that the Federal Reserve Bank of New York failed to examine the CIO ahead of the incident, despite a recommendation from other Fed supervisors that it look at the unit involved in the trades.[173] Reasons cited for the failure include "many supervisory demands and a lack of supervisory resources' and weaknesses in planning procedures"[174]

Then there is the London Interbank Offered Rate (LIBOR) scandal.[175] LIBOR is one of the best known and most important interest rates in the world, as it is used as a reference rate for hundreds of trillion dollars' worth of commercial and consumer loans, derivatives, and other financial products across the globe.[176] In 2012, however, banks including Barclays were charged for

[170] Ryan Tracy, *New York Fed Faulted in 'London Whale' Case*, WALL ST. J. (Oct. 21, 2014, 6:32 PM), http://www.wsj.com/articles/new-york-fed-failed-to-examine-j-p-morgan-london-whale-unit-1413900070.

[171] *See* Arthur E. Wilmarth, Jr., *Turning a Blind Eye: Why Washington Keeps Giving in to Wall Street*, 81 U. Cin. L. Rev. 1283 (2013); Dawn Kopecki, *JPMorgan Pays $920 Million to Settle London Whale Probes*, BLOOMBERG BUSINESS (Sept. 20, 2013, 12:00 AM), http://www.bloomberg.com/news/articles/2013-09-19/jpmorgan-chase-agrees-to-pay-920-million-for-london-whale-loss.

[172] *Id.*

[173] Tracy, *supra* note 167.

[174] *Id.*

[175] Every weekday at about 11 a.m., 18 large banks, under the auspices of the British Bankers' Association, report the rate at which they believe they can borrow a "reasonable" amount of dollars from each other in the so-called London interbank market. They report rates for 15 borrowing terms that range from overnight to one year. The financial news agency Thomson Reuters gathers the reported rates on behalf of the bankers' group, throws out the four highest and four lowest, and averages the rest. It then announces that average rate at which banks say they can borrow dollars for each of the 15 maturities. The process is carried out for nine other currencies as well. The average—often referred to in the singular even though there are 150 rates—is called LIBOR. John Kiff, *What is Libor?*, INTERNATIONAL MONETARY FUND, FINANCE & DEVELOPMENT, December 2012, Vol. 49, No. 4, http://www.imf.org/external/pubs/ft/fandd/2012/12/basics.htm.

[176] *See* Jesse Colombo, *This New Libor 'Scandal' Will Cause A Terrifying Financial Crisis*, FORBES (Jun. 3, 2014, 1:51 PM), http://www.forbes.com/sites/jessecolombo/2014/06/03/this-new-libor-scandal-will-cause-a-terrifying-financial-crisis/.

conspiring with each other to manipulate LIBOR for several years beginning in 2005.[177] The European Commission hit financial firms with a total of $2.3 billion in fines for their alleged roles in the global rigging scandal.[178] JPMorgan will pay $107 million and Citigroup will cough up $95 million of that total.[179]

d. The Costs of Misbehavior

There are costs to corporate misbehavior. However, the costs can be not only direct, but also external and social, not to mention systemic.[180] One study examined a comprehensive sample of frauds from securities class action cases.[181] The study eliminated likely frivolous suits and constructed a measure of the cost of fraud, defined as the difference between the enterprise value of a company after fraud is revealed and what the enterprise value would have been in the absence of fraud.[182] Using EBITDA multiples, the results show that fraud destroys 23.2% of enterprise value.[183] Excluding punitive costs, the number drops to 20.4%.[184] Other multiples, however, suggest higher costs; the assets multiple figure is 34.3% while the sales multiple is 40.4%.[185]

The externalities of fraud appear to be substantial. Research has found the following: (a) fraud increases the cost of capital for all firms; (b) fraud results in the misallocation of resources; (c) fraud destroys value through (costly) acquisitions and bankruptcy; (d) fraud prompts precautionary

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177 *Timeline: Libor-Fixing Scandal*, BBC NEWS BUSINESS, http://www.bbc.com/news/business-18671255 (last visited Feb. 1, 2015).

178 Halah Touryalai, *Big Banks Fined $2.3B Over Illegal Libor Cartels, More Fines On The Way*, FORBES (Dec. 4, 2013, 12:16 PM), *http://www.forbes.com/sites/halahtouryalai/2013/12/04/big-banks-fined-2-3b-over-illegal-libor-cartels-more-fines-on-the-way/.*

179 *Id.*

180 John C. Coates IV, *Cost-Benefit Analysis of Financial Regulation: Case Studies and Implications*, 124 YALE L.J. 882, 934 (2015).

181 *See* I.J. Alexander Dyck et al., *How Pervasive Is Corporate Fraud?* (Rotman Sch. of Mgmt. Working Paper No. 222608, Feb. 2013), http://ssrn.com/abstract=2222608 (including frauds involving financial misrepresentations, but, importantly, not limited to those).

182 *Id.* at 3.

183 *Id.* at 29.

184 *Id.*

185 *Id.*

costs; and (e) fraud imposes costs on non-investor third parties.[186] For example, the liquidation of the Madoff entities, resulting from the Madoff scandal, which undoubtedly imposed significant direct losses on investors, has produced over $ 700 million in expenses—an amount over and above that stolen by Madoff himself.[187]

Finally, how much does a financial crisis cost? Estimates vary. Professors Carmen Reinhart and Kenneth Rogoff believe that the figure fluctuates between 1 percent and 20 percent of US GDP, a figure in the range of 150 billion to 3 trillion dollars.[188] Data is unclear, however, as another estimate of the costs of financial crises ranges from 90% to 350% of world GDP.[189] Evidently, fraud is costly to everyone; unfortunately, there does not appear to be enough attention on how to efficiently address the problem.

B. Frivolous Suits in Recent Years

In light of the costs of corporate misbehavior, how do those of frivolous suits compare? Here, due to the surprisingly limited amount of clear empirical data addressing the question,[190] the focus will have to be on the negative aspects of securities class actions in general. However, this data will be problematic, as well. First, research has not been able to uncouple, and thus estimate, the costs of frivolous suits from the meritorious. Second, economic evidence that purports to expose the harms of the system centers solely on stock price drops following the announcements of the

[186] *See* Coates, *supra* note 177, at 934-35.
[187] *Id.* at 936.
[188] Eric Posner & E. Glen Weyl, *Benefit-Cost Analysis for Financial Regulation*, 103 Am. Econ. Rev., May 2013, at 393, 394 (citing Carmen M. Reinhart & Kenneth S. Rogoff, THIS TIME IS DIFFERENT: EIGHT CENTURIES OF FINANCIAL FOLLY (2009)).
[189] Andrew G. Haldane, Exec. Dir., Fin. Stability, Bank of Eng., Address at the Institute of Regulation & Risk in Hong Kong: The $ 100 Billion Question (Mar. 30, 2010), http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2010/speech433.pdf [http://perma.cc/9SEQ-9KYK].
[190] *See* John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 COLUM. L. REV. 1534, 1536 n.5 (2006) ("The true "strike suit" nuisance action, filed only because it was too expensive to defend, is, in this author's judgment, a beast like the unicorn, more discussed than directly observed.").

filing of a securities class action.[191] Finally, the most compelling argument against securities class actions is that of pocket shifting, whether the action is meritorious or frivolous, the costs of such litigation fall on innocent shareholders, not the responsible parties.[192] Nonetheless, the data needs to be presented, and it will show that the costs of securities class actions, meritorious or frivolous, appear to be less than those of corporate misbehavior as previously discussed.

The costs associated with securities class actions can be analyzed by looking at company stock price reactions to announcements of such lawsuits. One study used a sample of 1,456 federal securities class actions involving allegations of artificial stock price inflation that were filed since the passage of PSLRA and subsequently settled.[193] The study found that securities class actions filed within 30 trading days after the date that the suit defines to be the end of the class period results in a cumulative loss of 4.44% of the stock's price.[194] This 4.44% loss, when applied to the available end of class period market capitalization, amounts to $262 billion.[195] By extrapolating these findings to not-settled cases (i.e., dismissed and not-yet settled cases) during the same time period and combining the two sets of results, the claimed losses balloon to $701 billion.[196]

The other substantial cost of securities class actions, frivolous and meritorious, is that they could represent an exercise in pocket shifting. Commonly, a securities class action is brought against a public corporation that has not sold or purchased its own securities, and the action is essentially brought on behalf of shareholders (and former shareholders) who purchased the stock during the time period when the market was allegedly affected by material misinformation, the class period.[197]

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[191] 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 Bajaj), http://www.instituteforlegalreform.com/uploads/sites/1/EconomicConsequences_Web.pdf.

[192] Coffee Jr.,*supra* note 189, at 1537.

[193] The 1,456 settled securities fraud class action cases cover the 18-year period from December 1995 (i.e., post-PSLRA) through January 2014. Bajaj, *supra* note 190, at 2.

[194] *Id.*

[195] *Id.* at 19.

[196] *Id.* at 7.

[197] Coffee Jr., *supra* note 189, at 1557.

Any judgment or settlement in this action will be directly borne by the corporation and so indirectly by all its current shareholders.[198] Thus, as Prof. John C. Coffee Jr. famously noted,

> [S]ecurities litigation in this context inherently results in a wealth transfer between two classes of public shareholders - those in the class period and those outside it - and typically neither class is culpable. Worse still, the most likely beneficiaries of the fraud will be the insiders who sold at inflated prices. Because they bailed out prior to any judgment or settlement, they will escape without bearing any cost when liability is later imposed exclusively on their former corporation.[199]

The problem of pocket shifting is even more pronounced for small, mom-and-pop, undiversified investors. Usually, these investors simply buy and hold stock; they do not trade.[200] They will thus seldom fall within a class period.[201] On the other hand, the more rapidly trading investor, such as the hedge fund, who will on average fall within the class period, comes out winning.[202]

Finally, pocket shifting may also occur when shareholders belong to both the plaintiff class that sues and the holding shareholder class that bears the cost of the litigation. This can occur when shareholders bought stock at different times, outside and inside the class period.[203] The wealth transfer from one pocket to another, however, is chipped away by the high transaction costs of litigation.[204]

There are problems with corporate misbehavior, the same way that there are with frivolous suits and otherwise. Based on the data however, incongruent as it may be, it appears that corporate misbehavior has the bigger problems of the two. Coincidentally, these results mirror those of

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[198] *Id.*

[199] *Id.* at 1557-58.

[200] *See* Symposium, *Capping Damages for Open-Market Securities Fraud*, 38 Ariz. L. Rev. 639, 649 (Summer,1996).

[201] Cyrus Afshar & Paul Rose, Article, *Capital Markets Competitiveness: A Survey of Recent Reports*, 2 Entrepren. Bus. L.J. 439, 471 (2007).

[202] Coffee Jr., *supra* note 189, at 1560.

[203] *See* Donald C. Langevoort,Article& Essay, *On Leaving Corporate Executives "Naked, Homeless and Without Wheels:" Corporate Fraud, Equitable Remedies, and the Debate Over Entity Versus Individual Liability*, 42 Wake Forest L. Rev. 627, 632 (2007).

[204] *See*, Marilyn Johnson et al.,Article, *In re Silicon Graphics, Inc.: Shareholder Wealth Effects Resulting from the Interpretation of the Private Securities Litigation Reform Act's Pleading Standard*, 73 S. Cal. L. Rev. 773, 779 (2000).

Halliburton II, where both plaintiffs and defendants received something.[205] A plaintiff need not prove price impact at the class certification stage in order to invoke a presumption of reliance; but a defendant may rebut the presumption (and thereby ostensibly defeat class certification) by proving that alleged misrepresentations[206] did not distort the price of a company's stock.[207] A more in-depth look at the potential consequences of this aspect of the *Halliburton II* decision follows below in Part IV.

IV. MOVING FORWARD

It is not very clear how much change will be wrought by *Halliburton II*.[208] Again, defendants will be able to avoid certification – the practical equivalent of dismissal – in cases in which they can show no price impact. But the Supreme Court left open the not-necessarily-easy question of what is meant by price impact. In some cases, the price impact of bad news may be offset by the price impact of good news that just happens to be disclosed at the same time (or vice versa).[209] The analysis of this section will be divided into two parts. First, will it be enough if defendants can show that there was no significant price movement upon release of fraudulent information?[210] Or, second, will defendants need to prove a complete lack of price impact? Some answers have begun to appear, but, as of early 2015, no defendant has successfully rebutted *Basic*'s FOTM presumption of reliance.[211]

A. No Significant Price Impact Rebuttal

[205] *See* Richard Booth, *Opinion Analysis: Son of Halliburton*, SCOTUSblog (Jun. 25, 2014, 3:49 PM), http://www.scotusblog.com/2014/06/opinion-analysis-son-of-halliburton/.

[206] It should be noted that ever since *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153 (1972), investors have been entitled to a separate presumption of class-wide reliance (with no showing of market efficiency) in 10b-5 claims alleging "primarily" omissions, rather than misrepresentations. Investors still need to establish a legal duty to disclose the omitted information, however.

[207] Halliburton Co. v. Erica P. John Fund, 134 S. Ct. 2398, 2417 (2014).

[208] Nonetheless, for an excellent article on the benefits of shifting the focus when adjudicating securities class action suits toward price impact rather than market efficiency, *see* Lucian A. Bebchuk & Allen Ferrell, *Rethinking Basic*, The Business Lawyer, May 2014, at 690, http://ssrn.com/abstract=2371304.

[209] Booth, *supra* note 205.

[210] *Id.*

[211] Maeve O'Connor & Elliot Greenfield, *Lower Court Decisions In The Wake of Halliburton II*, THE REVIEW OF SECURITIES & COMMODITIES REGULATION, Feb. 18, 2015, at 41.

Evidence of no significant price movement upon release of fraudulent information might not be enough for defendants to rebut *Basic*'s FOTM presumption of reliance. In light of *Halliburton II*, the U.S. Court of Appeals for the Eleventh Circuit, in *Local 703, I.B. of T. Grocery & Food Employees Welfare Fund v. Regions Financial Corp.* (*Regions*),[212] remanded a class action certification for further consideration of defendant's price impact evidence. In the process, however, the court hinted at the difficulty of a successful rebuttal in such cases.[213] In the case, the plaintiff shareholders, who purchased Regions Financial Corporation's (the Corporation) stock in the period between the Corporation's first allegedly misleading financial disclosure and the last trading day before a corrective disclosure, alleged that the Corporation made a series of misrepresentations about its financial health before and during the recent economic recession, which allowed it to avoid a precipitous decline of its stock price that would have resulted absent the misleading disclosures.[214] As it occurred, on the day a corrective disclosure was made reporting $5.6 billion in losses, the Corporation's stock traded at $4.60 per share, compared to $23 per share on the first day of the proposed class period.[215]

First, to no avail, the Corporation argued that plaintiffs were not entitled to *Basic*'s presumption of reliance since the market could not have been efficient, the alleged misrepresentations did not have an immediate effect on the stock price.[216] The court opined otherwise; "[w]hen a company releases expected information, truthful or otherwise, the efficient market hypothesis underlying *Basic* predicts that the disclosure will cause no significant change in the price."[217] Thus, "plaintiffs justified application of the *Basic* presumption."[218]

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[212] Local 703, I.B. of T. Grocery & Food Emps. Welfare Fund v. Regions Fin. Corp., 762 F.3d 1248 (11th Cir. 2014).

[213] *Id.* at 1259.

[214] *Id.* at 1252.

[215] *Id.*

[216] John E. Clabby, *2 New Cases Temper Post-Halliburton Expectations*, LAW360 (Oct. 30, 2014, 10:17 AM), http://www.law360.com/articles/591273/2-new-cases-temper-post-halliburton-expectations.

[217] *Regions*, 762 F.3d at 1256.

Moving to a rebuttal of the presumption, although the court and all parties agreed that remand was appropriate in light of the intervening *Halliburton II* decision, the remand was ominous.[219] The court reminded the District Court "that its work on remand will be limited in scope."[220] It noted that *Halliburton II* "only said that defendants 'may seek to defeat the *Basic* presumption.'"[221] "*Halliburton II* by no means holds that in every case in which such evidence is presented, the presumption will always be defeated."[222] And so, on remand, the District Court certified the class action.[223] The Corporation's event study had not proved "its corrective disclosures had no impact on the price of its stock."[224] And the fact that the plaintiffs did not show there was price impact was irrelevant because *Halliburton II* placed that burden of proof on the defendants.[225] Finally, to emphasize its point, the court noted: "nothing in *Halliburton II* requires the plaintiffs to produce an event study in opposition to defendants' event study on a class certification motion."[226]

The District Court for the Southern District of New York, which, prior to *Halliburton II*, already permitted a securities-fraud defendant to rebut the presumption of reliance before class certification by showing absence of price impact, reached a similar decision when it certified a class of investors of common stock of China MediaExpress Holdings, Inc. (CCME) against CCME and its auditor, Deloitte Touche Tohmatsu in Hong Kong SAR (DTT HK).[227] In *McIntire v. China MediaExpress Holdings, Inc.*, DTT HK noted that on the day after it released material misstatements in

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[218] *Id.* at 1258.
[219] *Id.* at 1259.
[220] *Id.*
[221] *Id.*
[222] *Id.*
[223] Local 703, I.B. of T. Grocery & Food Emps. Welfare Fund v. Regions Fin. Corp., No. CV 10-J-2847-S, 2014 U.S. Dist. LEXIS 162403, at *30 (N.D. Ala. 2014).
[224] Stephanie Russell-Kraft, *Regions Investors Again Win Class Cert. In Stock Inflation Suit*, LAW360 (Nov. 19, 2014, 7:02 PM), http://www.law360.com/articles/597905/regions-investors-again-win-class-cert-in-stock-inflation-suit.
[225] *Id.*
[226] *Regions*, 2014 U.S. Dist. LEXIS 162403, at *25.
[227] McIntire v. China MediaExpress Holdings, Inc., 38 F. Supp. 3d 415, 421 (S.D.N.Y. 2014).

its audit opinion CCME's stock price did not increase, and in fact decreased slightly.[228] Thus, DTT HK tried to argue that it had shown the absence of any price impact from its material misstatements.[229] The court thought otherwise, however, as "[a] material misstatement can impact a stock's value either by improperly causing the value to increase or by improperly maintaining the existing stock price."[230]

B. No Price Impact Rebuttal

To rebut *Basic*'s FOTM presumption of reliance defendants might need to prove an absolutely complete lack of price impact, as was shown in *Aranaz v. Catalyst Pharmaceutical Partners Inc.* (*Aranaz*).[231] There, shareholders sued Catalyst Pharmaceutical Partners Inc. (Catalyst), a drug manufacturer, and its CEO alleging false statements in a press release announcing (1) the Food and Drug Administration's designation of Catalyst's new drug as a Breakthrough Therapy, and (2) that there was no other effective and available treatment for the particular ailment.[232] On the day of the press release, the price of Catalyst common stock soared from $1.42 to $2.01 (42%).[233] A few weeks later, an article revealed another similar drug therapy which had been available for years and was being offered for free, sending "the price of Catalyst common stock down from $2.61 to $1.90 that day, and then to $1.52 the following day."[234]

After plaintiffs established their entitlement to *Basic*'s FOTM presumption of reliance, defendants unsuccessfully tried to rebut the presumption. First, the court dismissed Catalyst's argument that alleged misrepresentation had no impact on the price of its stock because the availability of a similar drug therapy was already known to the public, the so-called "truth-on-the-

[228] *Id.* at 434.
[229] *Id.*
[230] *Id.*
[231] Aranaz v. Catalyst Pharm. Partners Inc., 302 F.R.D. 657 (S.D. Fla. 2014).
[232] *Id.* at 662.
[233] *Id.*
[234] *Id.*

market"[235] defense.[236] It simply noted: "truth-on-the-market defense may not be used at the class certification stage to prove an absence of price impact so as to show a lack of predominance because it goes to materiality."[237] In other words, a truth-on-the-market defense goes to materiality as to every putative class member and could thus end the controversy in its entirety, something best left to the merits stage as it does not bear on predominance requirement of Rule 23(b)(3). [238] Alternatively, Catalyst argued that the truthful announcement that its new drug received Breakthrough Therapy designation, not the accompanying misrepresentations, fully accounted for its stock 42% spike.[239] To explain the later price drop, Catalyst, through their expert, argued that the price drop was based entirely on bad press and market overreaction rather than on a true corrective disclosure, adding that no analyst who covered the stock changed their price targets after the article was published.[240] The court, however, rejected these arguments, as well. Catalyst showed "that an absence of price impact is consistent with their analysis" but not "that price impact is inconsistent with the results of their analysis," and, hence, that "the alleged misrepresentation did not at all contribute to the 42% spike in the price of Catalyst common stock[.]"[241] As to the later price drop, Catalyst's expert did not conduct "any of the accepted quantitative analyses used to determine whether price movements were caused by market overreaction."[242]

The court summarized its opinion as follows:

> Here, Defendants' burden is particularly onerous; not only is there a clear and drastic spike following the alleged misrepresentation and an equally dramatic decline

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[235] *See* Ganino v. Citizens Utils. Co., 228 F.3d 154, 167 (2d Cir. 2000) ("A defendant may rebut the presumption that its misrepresentations have affected the market price of its stock by showing that the truth of the matter was already known.").

[236] *Aranaz*, 302 F.R.D. at 670.

[237] *Id.* at 671; *see also* Amgen Inc. v. Conn. Ret. Plans & Trust Funds, 133 S. Ct. 1184, 1203 (2013) (holding that the district court did not err by disregarding the defendant's truth-on-the-market defense at the class certification stage, which was proffered to rebut the presumption of price impact so as to show that class certification was improper for lack of predominance).

[238] *Aranaz*, 302 F.R.D. at 671.

[239] *Id.* at 671-72.

[240] *Id.*

[241] *Id*. at 672.

[242] *Id.* at 675.

> following the revelation of the truth, but all agree that the publications containing the misrepresentation and its revelation respectively caused those price swings. Under these circumstances, proving an absence of price impact seems exceedingly difficult, especially at the class certification stage in which it must be assumed that the alleged misrepresentation was material.[243]

The facts of *Aranaz* are fairly stark and show, at least, for the ordinary securities fraud class action, that *Halliburton II* will allow defendants to attempt to rebut *Basic*'s FOTM presumption of reliance but that meeting the rebuttal's standard of a lack of price impact could be a challenge.[244] There is no benefit to just chipping away at the presumption; the successful defendant will have to eliminate it entirely.[245]

V. CONCLUSION

Whatever the reasoning behind the opinion in *Halliburton II*, the historical background of the securities laws, corporate fraud, frivolous suits, or otherwise, the case's allowance of a "lack of price impact" to enter the class certification stage, for the purpose of rebutting plaintiffs' *Basic*'s FOTM presumption of reliance, will force the lower courts to shoulder the burden of interpreting and applying such phrase. Two approaches have already developed, neither of which have allowed defendants to rebut the presumption. And more will probably develop, hopefully, after a careful weighting of the stakes at play. Yet, it is too early to make any strong predictions; the Supreme Court did not leave many things clear. One message was clear, however: any other grievances with *Basic* will have to be addressed to Congress.

243 *Id.* at 673.
244 Clabby, *supra* note 214 .
245 *Id.*