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SECURITIES LAW: FRAUD ON THE MARKET

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The U.S. Supreme Court is taking a hard look at a key foundation of securities class actions: the fraud-on-the-market doctrine. The stakes are high, as the fraud-on-the-market doctrine is crucial to class-action plaintiffs. Without it, individual issues of reliance and causation would dominate over common questions, and most securities cases would not qualify for class action treatment.

Established 25 years ago in *Basic v. Levinson*, the fraud-on-the-market doctrine creates a rebuttable presumption that investors have relied on all material misrepresentations or omissions disseminated to the public. In *Basic*, the court opined that the fraud-on-the-market presumption is supported by "common sense and probability," noting that "an investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price." Because publicly available information is reflected in the market price of a security, investor reliance on publicly disseminated misrepresentations "may be presumed."

In recent years, there has been considerable uncertainty and disagreement over the requisite proof needed to invoke the presumption at the class certification stage. Two years ago, in *Erica P. John Fund Inc. v. Halliburton Co.* (*Halliburton I*), the Supreme Court reversed a decision by the U.S. Court of Appeals for the Fifth Circuit, that required plaintiffs to prove "loss causation" (i.e., that the defendant's misconduct directly caused the plaintiffs' losses) before invoking the fraud-on-the-market doctrine. The court explained that the Fifth Circuit's approach "contravene[d] *Basic*'s fundamental premise—that an investor presumptively relies on a misrepresentation so long as it was reflected in the market price at the time of his transaction."

Halliburton I eliminated the need to prove loss causation at the class certification stage, but some lower courts continued to require proof of materiality in order to invoke the fraud-on-the-market presumption. Earlier this year in *Amgen Inc. v. Connecticut Retirement Plans and Trust Funds*, the Supreme Court rejected this approach as well, holding that proof of materiality is not a prerequisite for class certification under *Basic*.

On its face, Amgen represented a victory for plaintiffs, particularly on the heels of *Halliburton I*. But it may be short-lived. At least four justices appear ready to strike down the fraud-on-the-market doctrine altogether. Writing in dissent in Amgen, Justices Antonin Scalia, Clarence Thomas and Anthony Kennedy criticized Basic as "questionable" and regrettable." In a concurring opinion, Justice Samuel Alito Jr. also encouraged the court to reconsider the doctrine: "[M]ore recent evidence suggests that the presumption may rest on a faulty economic premise. In light of this development, reconsideration of the Basic presumption may be appropriate."

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In the aftermath of *Amgen*, Halliburton Co. has taken up the court's invitation to reconsider the fraud-on-the-market theory. Filing a second petition for writ of certiorari in the Erica P. John Fund case, Halliburton has asked the court to reverse its prior holding in Basic and strike down the fraud-on-the-market presumption. The court granted Halliburton's petition for writ of certiorari on Nov. 15, and it is expected to hear argument in early 2014.

The securities bar will be watching. The presumption of reliance is the linchpin of modern securities class actions. As The New York Times'"deal professor" Steven Davidoff recently noted, *Halliburton II* threatens to "put a stake through the heart of securities fraud cases."