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Is the United States Supreme Court Poised to Overrule or Modify *Basic Inc. v. Levinson*?

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The Supreme Court has agreed to revisit its 1988 landmark ruling in Basic Inc. v. Levinson*, which eased the obstacles to certification of putative classes in securities class actions.*

On November 15, 2013, the U.S. Supreme Court granted a petition for writ of certiorari to petitioner Halliburton Company ("Halliburton") in the case entitled *Halliburton Co. v. Erica P. John Fund, Inc., f/k/a Archdiocese of Milwaukee Supporting Fund, Inc*.

Halliburton appeals to the Supreme Court from a decision by the U.S. Court of Appeals for the Fifth Circuit affirming the certification of a class in a securities fraud class action and rejecting Halliburton's attempt to introduce price impact evidence at the certification stage to rebut the presumption of reliance afforded by the fraud-on-the-market theory. By granting Halliburton's writ of certiorari, the Supreme Court has agreed for the second time in connection with this class action to revisit its 1988 landmark ruling in the case of *Basic Inc. v. Levinson* ("*Basic*"),[1] a decision which eased the obstacles to certification of putative classes in securities class actions.

On appeal, Halliburton presents the Supreme Court with two questions:

- whether the Court should "overrule or substantially modify [*Basic*] to the extent that it recognizes a presumption of class wide reliance derived

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from the fraud-on-the-market theory," and

- whether, "in a case where the plaintiff invokes the presumption of reliance to seek class certification, the defendant may rebut the presumption and prevent class certification by introducing evidence that the alleged misrepresentations did not distort the market price of its stock."[2]

BACKGROUND

The underlying lawsuit arises out of conduct by certain Halliburton executives allegedly falsifying financial results and issuing misleading public statements.[3] A putative class of investors who purchased Halliburton shares between June 3, 1999 and December 7, 2001, led by class representative Erica P. John Fund, Inc. ("EPJ Fund"), filed a class action against Halliburton and several of its executives alleging that Halliburton's misrepresentations caused an increase in Halliburton stock price only to be followed by a precipitous decrease after Halliburton publicly corrected the misrepresentations.

In 2008, the Fifth Circuit affirmed the district court's denial of certification on the grounds that the class failed to establish loss causation as a prerequisite to obtaining certification.[4] EPJ Fund sought leave to appeal this decision to the Supreme Court, raising the issue of the appropriateness of *Basic* as a proper framework for certifying shareholder classes in securities fraud class actions.[5]

Finding that proof of loss causation is a conceptually distinct inquiry that is not related to reliance, the Supreme Court reversed the Fifth Circuit and maintained intact *Basic*'s fraud-on-the-market theory.[6]

On subsequent remand to the district court, Halliburton argued that the Supreme Court's 2011 decision notwithstanding, certification should be denied on the alternative ground that Halliburton's "alleged misrepresentation did not cause 'price impact' or 'price distortion.'"[7] The Fifth Circuit, however, retreating from its 2011 decision endorsing loss causation as a condition precedent to certification, rejected Halliburton's argument and affirmed the district court's certification of the class, finding that price impact evidence did not bear on the critical inquiry of whether common issues predominated under Rule 23(b)(3) because price impact "inherently applies to everyone in the class."[8] From this decision, Halliburton now appeals to the Supreme Court.

CLASS CERTIFICATION

In order to obtain class certification, EPJ Fund is required to establish:

- under Federal Rule of Civil Procedure 23(a), that the putative class is sufficiently numerous, there are common questions of law or fact, the claims of the representative parties are typical of the class, and the representative parties would fairly and adequately protect the interest of the class, and
- under Federal Rule of Civil Procedure 23(b)(3), that questions of law or fact common to the putative class predominate over any questions affecting individual class members.

On the issue of certification pursuant to Rule 23, the parties disagree only on whether or not common questions of law and fact predominate under Rule 23(b)(3).[9]

Halliburton challenges the Fifth Circuit's reasoning by attacking *Basic*'s fundamental premise — that an economic theory of inherent market efficiency, raising a presumption of class-wide reliance, should be dispositive, at the class certification stage, on the issue of reliance. Halliburton challenges *Basic* on several levels.

First, Halliburton contends that the presumption of reliance based on an inherently efficient market has been roundly rejected by empirical evidence.

Second, Halliburton cites to the difficulty federal courts have encountered applying the presumption (resulting in various circuit splits on the issue) and to the fact that no state courts have recognized the fraud-on-the-market theory.

Finally, Halliburton emphasizes that case law subsequent to *Basic* calls into question the fraud-on-the-market theory's elimination of the need to show that common issues predominate before certification can be granted.[10]

WHAT WILL THE COURT DO?

There is a possibility that *Basic* may be overruled and the fraud-on-the-market theory rejected. Recent developments in Supreme Court jurisprudence removing certain burdens placed on securities class action plaintiffs

to prove elements of federal securities fraud at the certification stage, to wit, loss causation (*Halliburton I*) and materiality (*Amgen, Inc. v. Connecticut Retirement Plans and Trust Funds*),[11] notwithstanding, overturning *Basic* would stem the tide and significantly frustrate plaintiffs' efforts to certify a shareholder class. Such an intent, in fact, may be evident in the criticism of the fraud-on-the-market theory expressed by the four *Amgen* Justices declining to join the majority.[12] Notably, *Basic* itself was decided by a four-Justice plurality (only Justices Brennan, Marshall and Stevens joined Justice Blackmun's opinion, while Justices White and O'Connor dissented and Chief Justice Rehnquist and Justices Scalia and Kennedy did not participate).

Deciding Halliburton's appeal, the Supreme Court may do one of three things:

- affirm the Fifth Circuit, thereby endorsing wholesale *Basic*'s fraud-on-the-market theory, as it has done in the past;
- modify *Basic*'s holding to, among other things, require a putative class to establish price impact at the certification stage when a defendant introduces evidence that alleged misrepresentations did not distort the market price of its stock; or
- overrule *Basic* in its entirety, rejecting the fraud-on-the-market theory, and, accordingly, negatively and dramatically impacting the future ability of plaintiff shareholder classes to certify.

NOTES

[1] 485 U.S. 224 (1988).

[2] Halliburton Petition for Writ of Certiorari ("Halliburton Pet."), 2013 WL 4855972 (2013).

[3] *Erica P. John Fund, Inc., f/k/a Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co*., 718 F.3d 423, 426 (5th Cir. 2013) (because the Supreme Court has yet to hear argument on this appeal, this article refers to the decision of the Fifth Circuit as "Halliburton II").

[4] *See Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co*., 597 F.3d 330 (5th Cir. 2010).

[5] By way of background, in *Basic*, the Supreme Court resolved the difficulty

inherent in requiring each SEC Rule 10b-5 (*see* 17 C.F.R. §240.10b-5) putative class member trading on a public market to prove individual reliance by fashioning a rebuttable presumption of reliance based on what is known as the "fraud-on the-market" theory. 485 U.S. at 242. According to the theory, "the market price of shares traded on well-developed markets reflects all publicly available information, and, hence, any material misrepresentations." *Id*. at 246. Therefore, "[r]equiring proof of individualized reliance from each member of the proposed plaintiff class effectively would prevent such plaintiffs 'from proceeding with a class action, since individual issues' would 'overwhelm[] the common ones.'" *Erica P. John Fund, Inc. v. Halliburton Co*., 563 U.S.__, 131 S. Ct. 2179, 2185 (2011) ("*Halliburton I*") (quoting *Basic*, 485 U.S. at 242); *see also* Fed. R. Civ. P. 23(b)(3).

[6] *Halliburton I*, 563 U.S. at __, 131 S. Ct. at 2186-87. Although not obligated to prove loss causation at the class certification stage, a plaintiff is still required to prove loss causation, in addition to the following elements of a Rule 10b-5 action, at the merits stage:

(i) a material misrepresentation,
(ii) scienter,
(iii) a connection with the purchase or sale of a security,
(iv) reliance,
(v) economic loss, and
(vi) loss causation.

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

[7] *Halliburton II*, 718 F.3d at 427.

[8] *Id*. at 432, 435; *see also* Fed. R. Civ. P. 23(b)(3).

[9] *Halliburton II*, 718 F.3d at 428.

[10] Halliburton Pet., at *20 (citing the requirements of Rule 23 to "prove…in fact" (*Wal-Mart Stores, Inc. v. Dukes*, 564 U.S.__, 131 S. Ct. 2541, 2551 (2011)) through "evidentiary proof" (*Comcast Corp. v. Behrend*, __U.S.__, 133 S. Ct. 1426, 1432 (2013)) that common issues predominate at the class certification stage).

[11] 568 U.S.__, 133 S. Ct. 1184 (2013).

[12] *See Amgen*, 568 U.S. at __, 133 S. Ct. at 1204 (Alito J., concurring); *see also id*. at 1208 n. 4 (Thomas, J., joined by Scalia and Kennedy, JJ., dissenting).