Historic Supreme Court Decision in *Halliburton II* Reaffirms Investors' Right to Rely on the Integrity of Market Prices

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We write to alert you to the Supreme Court's decision issued today in *Halliburton Co. v. Erica P. John Fund*, No. 13-317 ("*Halliburton II*"). The Court, in a 6-3 decision by Chief Justice Roberts, reaffirmed that investor securities-fraud claims can invoke a market-wide presumption of reliance, and the burden of rebutting the fraud-on-the-market presumption of reliance remains on defendants. The Supreme Court's decision in *Halliburton II* strongly supports investors' ability to rely on the integrity of securities prices in developed markets, and is a historic victory for investors' rights.

Bernstein Litowitz Berger & Grossmann LLP, together with Brian Stuart Koukoutchos, an experienced Supreme Court practitioner, submitted an *amicus* brief on behalf of over 30 prominent U.S. and international institutional investors in support of the investors in this case.

Background on the *Halliburton II* Decision

Under the U.S. federal securities laws, investors can recover damages in private securities-fraud actions only if they can prove they relied on the defendant's misrepresentations in deciding whether to buy or sell a security. Over 25 years ago, the Supreme Court in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), held that investors could satisfy this reliance requirement by invoking the fraud-on-the-market presumption of reliance.

The fraud-on-the-market presumption is based on a fundamental principle of modern economics that the price of securities traded in well-developed (*i.e.*, "efficient") markets generally reflects all publicly available material information about the company. Thus, a public, material misrepresentation distorts the company's stock price, and anyone who purchases the stock at the market price is presumed to have relied on the misrepresentation.

In *Basic*, the Court recognized that requiring direct proof of reliance from every individual plaintiff "would place an unnecessarily unrealistic evidentiary burden on the . . . plaintiff who has traded on an impersonal market," and effectively would prevent investors from obtaining relief on a class-wide basis because individual issues would overwhelm common issues. Direct, individualized proof of reliance was unnecessary, the *Basic* Court explained, because the typical investor who buys and sells stock at the price set by the market "does so in reliance on the integrity of that price," and thus investors' "reliance on any public material misrepresentations may be presumed for purposes of a Rule 10b-5 action." At the same time, the Court held in *Basic* that the presumption of reliance could be rebutted by defendants.

In *Halliburton II*, the defendant company, Halliburton, urged the Supreme Court to overrule *Basic*'s presumption of reliance. Halliburton contended that investors should *always* have to provide direct reliance. Halliburton argued, among other things, that *Basic*'s view of market efficiency is not supported by subsequent developments in economic theory, and not all investors invest based upon the integrity of market prices. Defendants were supported by the urgent pleas of various business constituencies, including Wall Street interests and the Chamber of Commerce.

The Court's Decision in *Halliburton II*

Today, in *Halliburton II*, the Supreme Court resoundingly rejected these efforts to overturn the fraud-on-the-market presumption of reliance. Chief Justice Roberts, joined by Justices Kennedy, Ginsburg, Breyer, Sotomayor, and Kagan, concluded that Halliburton had failed to show a "special justification" for overturning such "long-settled precedent."

As an initial matter, the Court noted that Halliburton was largely rehashing arguments that had been raised and rejected in *Basic*. These included a textual argument that a direct reliance element should be "borrowed" from section 18(a) of the Securities Exchange Act of 1934, a supposedly "close analogue" to section 10(b) and its implied private right of action under SEC Rule 10b-5. As Chief Justice Roberts concluded, "[t]he *Basic* majority did not find that argument persuasive then, and Halliburton has given us no new reason to endorse it now." Likewise, Halliburton's criticism that capital markets are not fundamentally efficient "was not new." As the Chief Justice explained, in recognizing the "modest premise" that "public information generally affects stock prices," the Court in *Basic* was not "adopt[ing] any particular theory of how quickly and completely publicly available information is reflected in market price." Halliburton improperly focused on the *degree* to which a stock's market price accurately reflects public information, and not whether a misrepresentation affects a stock's market price-which, the Chief Justice noted, "even the foremost critics of the efficient-capital-markets hypothesis acknowledge."

Next, the Court rejected Halliburton's argument that some investors, such as value investors, do not invest based on the integrity of market prices. Justice Roberts noted that *Basic* "never denied" the existence of such classes of investors, but concluded only that it is "reasonable to presume that *most* investors . . . will rely on the security's market price as an unbiased assessment of the security's value in light of all public information." Moreover, the Chief Justice explained, value investors estimate *how* undervalued or overvalued a particular stock is, which "can be skewed by a market price tainted by fraud," and "implicitly rely on the fact that a stock's market price will eventually reflect material information."

The Court emphasized that the fraud-on-the-market presumption is fully consistent with its recent jurisprudence on class certification, including *Wal-Mart Stores, Inc. v. Dukes* and *Comcast Corp. v. Behrend*. As to policy arguments that *Basic*'s presumption of reliance facilitates securities class actions and produces adverse consequences in certain circumstances, the Court determined that Congress can undo the presumption if it so chooses. In fact, however, Congress has already responded to many of the policy issues raised by Halliburton and its supporters by adopting a lead-plaintiff selection process that favors institutional investors, among other reforms.

The Court also rejected Halliburton's argument that plaintiffs should be required to prove that a defendant's misrepresentation actually affected the stock price-so called "price impact"-in order to invoke the presumption of reliance. Instead, the Court "adhered" to *Basic* and "declined to modify the prerequisites for invoking the presumption of reliance."

Finally, the Court addressed an unsettled question regarding *when* defendants may attempt to rebut *Basic*'s presumption of reliance. The Court clarified that defendants may attempt to do so at the class-certification stage, through evidence that an alleged misrepresentation did not actually affect the market price of the stock. Notably, this aspect of the decision provides no new way for defendants to avoid liability. Defendants have always had the opportunity to rebut *Basic*'s presumption of reliance at virtually any stage of the proceeding, even, as the Court noted, *before* class certification. Because Halliburton had been denied the opportunity to demonstrate lack of price impact at the class certification stage, the Court vacated the Fifth Circuit's judgment and remanded the case for further proceedings consistent with the Court's decision.

Conclusion

In *Halliburton II*, the Court has strongly endorsed investors' right to rely on the integrity of market prices by allowing investors to recover securities fraud damages without proving they read and directly relied on defendants' false statements in making individual purchase-and-sale decisions. The Court's decision in *Halliburton II* is a historic victory for investor rights and will help preserve the integrity of the U.S. public capital markets.

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