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Securities Litigation ADVISORY ■

JUNE 25, 2014

The Supreme Court Makes Clear Defendants' Right to Rebut the Presumption of Reliance at Class Certification

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On June 23, 2014, the Supreme Court issued its opinion in ***Halliburton II***, in which the Court vacated the Fifth Circuit's prior ruling that denied defendant Halliburton the right at class certification to offer evidence to rebut the presumption of reliance that is sometimes available to investors for claims brought under Section 10(b) of the Securities Exchange Act of 1934.[1] The Court's unanimous ruling in ***Halliburton II*** makes clear that defendants have the right to challenge the presumption that all class members relied on the alleged misstatements in the case through, *inter alia*, evidence that these statements had no impact on the trading price of the stock at issue.

The presumption of reliance at issue in ***Halliburton II*** is based on the notion that, when shares of a company's stock trade in a so-called "efficient market," the price of that stock reflects all material publicly available information about that company. Thus, when investors buy stock at the market price, they are presumed under this theory to have relied on all material statements, including any alleged misstatements, that are released publicly because those statements have the opportunity to influence or "impact" the trading price of the stock. This is known as the "fraud-on-the-market" theory.[2]

Under ***Halliburton II***, if a defendant can show no "price impact" from the alleged misstatements, then a class of investors may not be certified under Fed. R. Civ. P. 23(b)(3). This is so because the presumption of reliance is entirely premised on the notion that the alleged misstatements had an effect on the trading

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1 *Halliburton Co. v. Erica P. John Fund, Inc.*, No. 13-317, slip op. (June 23, 2014). Chief Justice Roberts delivered the opinion of the Court in which Justices Kennedy, Ginsburg, Breyer, Sotomayor and Kagan joined. Justice Ginsburg also submitted a concurring opinion in which Justices Breyer and Sotomayor joined. Justice Thomas filed a separate opinion, concurring in the judgment in which Justices Scalia and Alito joined. Justice Thomas' separate opinion states that the Court should have taken this opportunity to revoke the presumption of reliance for Section 10(b) claims.

2 *See id*. at 6.

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price of the stock. If there is no price impact, then presumption cannot apply. Under those circumstances, individualized reliance issues with respect to whether each class member actually relied on the alleged misstatements will necessarily predominate over issues common to all class members in violation of Rule 23's predominance requirement.[3] Indeed, the Supreme Court has previously recognized that, without the ability to invoke this presumption of reliance, certification of an investor class under Section 10(b) would be impossible.[4]

Halliburton II delivers a significant blow to plaintiffs who in the past argued that any rebuttal of the presumption of reliance was a "merits" inquiry that could not be addressed at class certification and was instead reserved only for summary judgment or trial. ***Halliburton II*** makes clear that defendants must be afforded the opportunity prior to any certification decision to raise fundamental price impact issues and a court's ruling on such issues has the potential to end the litigation through denial of class certification.

Overview of the Court's Decision. On appeal from an order certifying a class of Halliburton investors, Halliburton asked the Supreme Court (1) to overrule or modify the presumption of reliance it first recognized in ***Basic Inc. v. Levinson***[5] or (2) in the alternative to rule that defendants must be afforded the opportunity to rebut the application of the presumption at class certification through a showing of a lack of price impact.[6]

The Court Refuses to Overturn *Basic*. Despite prior indications that certain Justices were willing to consider overruling ***Basic***, it appears that there were simply not enough votes on the Court for overruling or substantially modifying that decision. The Supreme Court in ***Halliburton II*** observed that, before overturning settled precedent, a "special justification" is required beyond just the argument that the precedent was wrongly decided.[7] The Court concluded that Halliburton had failed to make the required showing—a result that many predicted based on the questioning of Halliburton's counsel during oral argument.

The Court specifically rejected Halliburton's argument that ***Basic***'s presumption of reliance contravenes congressional intent because such arguments had failed to persuade a majority of the Court in ***Basic*** and "Halliburton has given us no new reason to endorse [them] now."[8] The Court also rejected Halliburton's contention that ***Basic*** had been undermined by subsequent developments in economic theory.[9] The Court stated that any subsequent academic debate about whether or when the markets are truly

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[3] Subpart (b)(3) of Rule 23 of the Federal Rules of Civil Procedure requires that "the questions of law or fact common to class members predominate over any questions affecting only individual members." Unless a presumption of reliance applies, a plaintiff seeking to recover under Section 10(b) must plead and prove that he or she directly and personally relied on the specific statements alleged to be false or misleading. *See Halliburton II*, slip op. at 5.

[4] *Id.* at 6.

[5] 485 U.S. 224 (1988).

[6] *Halliburton II*, slip op. at 1-2.

[7] *Id.* at 4.

[8] *Id.* at 8.

[9] *Id.* at 8-12.

efficient processors of publicly available information does not refute the modest premise on which ***Basic***'s presumption of reliance was based, i.e., that "'market professionals generally consider most publicly announced material statements about companies, thereby affecting stock market prices.'"[10]

The Court pointed out that Halliburton had essentially conceded that "[e]ven the foremost critics of the efficient-capital markets hypothesis acknowledge that public information generally affects stock prices."[11] And, thus, in the Court's view, debates about the degree to which stock prices accurately reflect public information were largely beside the point, given that "Halliburton had not identified the kind of fundamental shift in economic theory that could justify overruling a precedent on the ground that it misunderstood, or has since been overtaken by, economic realities."[12]

The Supreme Court also rejected the argument offered by Halliburton that ***Basic*** was wrongly decided because that decision could not be reconciled with other recent class certification decisions from the Supreme Court. Halliburton argued that those decisions made clear that plaintiffs must prove, not simply plead, compliance with all of Rule 23's requirements.[13] The Supreme Court reasoned that ***Basic*** does not relieve plaintiffs of the burden of proving that the predominance requirement is satisfied before a class may be certified. Under ***Basic***, a plaintiff must still prove the requirements for invoking the presumption of reliance, which, as the Court explained previously, are publicity (the alleged misstatements were public), market efficiency (the stock at issue traded in an efficient trading market), and market timing (the investors bought after the alleged misstatements but before the truth was revealed).[14]

The Court Chooses to Emphasize the Rebuttable Nature of the Presumption. The Court also addressed the two alternatives to overruling ***Basic*** proposed by Halliburton. The Court first discussed Halliburton's argument that plaintiffs should be required to prove affirmatively that the defendants' misstatements had an effect on the stock price to invoke ***Basic***'s presumption of reliance. Halliburton argued that a plaintiff should not be able to invoke the presumption solely by demonstrating "the general efficiency of the market in which the stock traded."[15] The Supreme Court acknowledged that the "fundamental premise" on which the presumption of reliance is based is "that an investor presumptively relies on a misrepresentation so

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10 *Id*. at 10 (quoting ***Basic***, 485 U.S. at 247 n. 24).

11 *Id*.

12 *Id*. at 11. Halliburton also challenged the premise underlying ***Basic***'s presumption of reliance that investors rely on the integrity of the market price. Halliburton pointed out that investors may decide to invest because they believe the market is undervaluing or overvaluing a stock and, thus, their investment decisions are premised on the notion that the market price is not an accurate reflection of the stock's value. *See id*. The Court observed that ***Basic*** never denied the existence of such investors, but instead concluded only that "most" investors rely on the market price. *Id*. at 11-12. The Court also noted that even investors who believe they can beat the market implicitly rely on the notion that a stock's price will eventually reflect all material information, which is necessary for realization of profits based on their successful guess on where the market will ultimately go. *Id*. at 12.

13 *Id*. at 14.

14 *Id*. at 16. Another requirement for invoking the presumption of reliance is materiality, but the Court held in *Amgen Inc. v. Connecticut Retirement Plans and Trust Funds*, 133 S. Ct. 1184 (2013), that materiality need not be proven at class certification. *See Halliburton II*, slip op. at 14.

15 *Halliburton II*, slip op. at 16.

long as it was reflected in the market price at the time of the transaction."[16] The Court essentially conceded (consistent with its prior precedent) that, without price impact from the alleged misstatements, there is no basis on which to assume that an investor indirectly relies on the misrepresentations through reliance on the trading price.[17] But the Court nevertheless declined to require affirmative proof of price impact from plaintiffs to invoke the presumption, which it viewed as being a "radical alter[ation]" of the status quo.[18]

As noted above, the Court ultimately embraced the second alternative argument made by Halliburton, i.e., that a defendant should be allowed at class certification to rebut the presumption of reliance through evidence of a lack of price impact.[19] The Court's ruling that the presumption could be rebutted at class certification is hardly surprising given that ***Basic*** expressly said that the presumption could be rebutted and ***Basic*** was also a class certification decision. The Court took the opportunity in ***Halliburton II*** to remove any lingering doubt that "defendants must be afforded an opportunity before class certification to defeat the presumption through evidence that an alleged misrepresentation did not actually affect the market price of the stock."[20]

The Court found support for this view in the fact that plaintiffs often introduce price impact evidence at class certification through "event studies" for the purpose of seeking to show that the market price of a stock tends to respond to material, publicly available news about the company.[21] In other words, plaintiffs' practice of offering an event study to support class certification supports the view that evidence of price impact (or the lack thereof) is relevant to class certification in securities cases. Indeed, the plaintiff in ***Halliburton II*** had done precisely that and had purported to analyze via an event study the market's reaction to at least one of the alleged misstatements in the case, among other statements.[22] The Court therefore reasoned that it is only fair that "[d]efendants—like plaintiffs—may . . . submit price impact evidence prior to class certification."[23]

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16 *Id*. at 17.

17 *See id.*

18 *Id.* The Court observed that there are really two components to the presumption of reliance or "constituent presumptions." *Id.* One of these constituent presumptions is that, "if a plaintiff shows that the defendant's misrepresentation was public and material and that the stock traded in a generally efficient market," then the plaintiff "is entitled to a presumption that the misrepresentation affected the stock price." *Id*. The Court held that requiring a plaintiff to prove price impact as an initial matter would do away with this constituent presumption and would be an unnecessary change if the concern was that market efficiency standing alone is not sufficient proof of price impact. *Id*. at 18. This is so because, as the Court reasoned, defendants will be afforded "an opportunity to rebut the presumption by showing, among other things, that the particular misrepresentation at issue did not affect the stock's market price." *Id*.

19 *Id*. at 18.

20 *Id*. at 23.

21 *Id*. at 19.

22 *Id*.

23 *Id*.

The Court also quickly dispensed with plaintiff's argument that price impact evidence may be offered by defendants to refute market efficiency, but not to rebut the application of the presumption altogether. The Court held that any such distinction would lead to absurd results (i.e., certification of a class because the court finds that the market was generally efficient, even though there is no evidence the alleged misstatements had any impact on the stock price) and is also inconsistent with the logic of ***Basic***.[24] Under ***Basic***, the Court had previously explained that "'[a]ny showing that severs the link between the alleged misrepresentation and . . . the price received (or paid) by the plaintiff . . . will be sufficient to rebut the presumption of reliance'" because "'the basis for finding that the fraud had been transmitted to investors through market price would be gone.'"[25] Thus, "[w]hile ***Basic*** allows plaintiffs to establish th[e] precondition [of price impact] indirectly, it does not require courts to ignore a defendant's direct, more salient evidence showing that the alleged misrepresentation did not actually affect the stock's market price and, consequently, that the ***Basic*** presumption does not apply."[26]

Thus, while the Court declined to overrule ***Basic*** or modify the prerequisites for invoking the presumption of reliance, the Court held that affording defendants the opportunity to rebut the presumption "maintain[ed] the consistency of the presumption with the class certification requirements of Federal Rule of Civil Procedure 23[.]"[27] Because both courts below had denied Halliburton the opportunity to rebut the presumption of reliance based on price impact evidence, the judgment of the Fifth Circuit was vacated and the case remanded for further proceedings consistent with the opinion.[28]

Analysis and Impact of the Court's Decision. Defendants have consistently argued that ***Basic*** gives them the right to rebut the presumption of reliance at class certification and ***Halliburton II*** should finally put to rest any suggestion to the contrary. In this respect, the decision is a clear victory for defendants because district courts must now consider any price impact evidence offered by defendants prior to ruling on class certification. ***Halliburton II*** also clearly directs that, should the court find that there is no evidence of price impact from the alleged misstatements, then class certification must be denied because the presumption of reliance is not available to plaintiffs under those circumstances.

Halliburton II also cannot be read to suggest that the only means by which the presumption can be rebutted by defendants at class certification is through evidence of no price impact from the alleged misstatements. The Court at several points in ***Halliburton II*** makes clear that the failure to show price impact from the alleged misstatements is only one means by which a defendant may rebut the presumption under ***Basic***.

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24 *Id*. at 20.

25 *Id*.

26 *Id*. at 21. The Court also rejected plaintiff's argument that price impact is similar to materiality, which the Court in *Amgen* held plaintiffs do not have to prove at class certification because it is a question common to all class members. *Id*. The Court explained that price impact differed from materiality because materiality is "a discrete issue that can be resolved in isolation from the other prerequisites" and thus can be "confined to the merits stage." *Id*. at 22. Price impact, on the other hand, is "'***Basic***'s fundamental premise'" and "thus has everything to do with the issue of predominance at the class certification stage." *Id*.

27 *Id*. at 23.

28 *Id*.

Halliburton II is also consistent with the Court's prior directives that market efficiency (and all of the other requirements for invoking the presumption of reliance with the exception of materiality) must be proven by plaintiffs or class certification will be denied. In the past, plaintiffs sought to avoid any challenge as to whether they had carried their burden on these prerequisites by arguing, as the plaintiff did in ***Halliburton II***, that such matters go to the merits and can only be attacked by defendants later in the case. In light of ***Halliburton II***, it is hard to see how any court could properly refuse to consider evidence submitted by defendants for the purposes of refuting an express requirement for invoking the presumption of reliance, given that the Supreme Court has now made clear that defendants have the right to be heard at class certification on even those matters where plaintiffs do not bear the initial burden of proof.

Halliburton II is also expected to have a significant impact on how class certification issues are litigated in securities cases. The "battle of the experts" that often occurs at class certification in other types of cases will likely prove to be more common in securities cases than in years past. The favorable references in the Court's opinion and during oral argument to "event studies" offered by economic experts will create greater incentives for both sides to offer such studies at class certification. As a result, the amount of time and effort that the parties and the court will expend on certification is expected to increase due to, *inter alia*, the need for expert discovery, the possibility of challenges to the admissibility of expert opinions, and the increased likelihood of appeals from certification decisions under Rule 23(f). All these factors may create earlier incentives and opportunities to resolve cases through more modest settlements because of the increased burdens on plaintiffs to prevail at class certification.

Halliburton II also provides defendants in securities cases with yet another opportunity to end cases early via motion practice without being forced to incur costly discovery expenses related to the merits of the claims. A ruling from the court that the presumption of reliance cannot apply should, as a practical matter, terminate the case because no investor seeking to represent a class can overcome the fact that individualized reliance issues will overwhelm any issues that he or she may share in common with other class members. Moreover, any early ruling from the Court related to price impact or market efficiency will be based exclusively on publicly available information to which all parties and the court already have access. Thus, while some amount of expert discovery may be necessary, these issues will nevertheless be ripe for a ruling by the court well in advance of the completion of any fact discovery that would otherwise need to take place.

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