JUDGMENT DAY FOR FRAUD-ON-THE-MARKET: REFLECTIONS ON *AMGEN* AND THE SECOND COMING OF *HALLIBURTON*

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*Through two recent decisions, the Supreme Court has both reaffirmed and revised the so-called fraud-on-the-market presumption of reliance—the mechanism that allows securities-fraud class actions to go forward. Members of the Court split on the mechanics of the presumption in the first of these cases (*Amgen*), leading to a call to reconsider the entire presumption as outmoded and mistaken. The second case (*Halliburton*) said that the presumption was still good law, though it did potentially increase the difficulty of getting the class certified. This Article compares and contrasts the two cases, explores the role of market efficiency post-*Halliburton*, *and digs into what it means for the issue of price distortion to be an appropriate subject for consideration at the class certification stage.*

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INTRODUCTION

In *Amgen Inc. v. Connecticut Retirement Plans and Trust Funds*,[1] a solid majority of the Supreme Court held that proof of the materiality of alleged misstatements or omissions was neither necessary nor appropriate to certify a class action on behalf of investors who bought or sold securities in the aftermath of the falsehoods.[2] At issue was the meaning—both substantively and procedurally—of the so-called "fraud-on-the-market" presumption that had been established by the Court 25 years earlier in *Basic Inc. v. Levinson*,[3] whereby all such investors are presumed to have relied on the alleged fraud if they traded in an "efficient" market for those securities and that market was allegedly distorted by fraud. The majority in *Amgen* said that the Rule 10b-5 class certification inquiry, in the face of such a presumption, is limited to issues not susceptible to class-wide proof.[4] Materiality, being a single objective inquiry, is a class-wide question and hence not directly relevant to certification. Justices Scalia, Thomas, and Kennedy disagreed in two separate dissents, asserting that proof of materiality is a condition precedent to earning the presumption of reliance, without which certification necessarily fails because commonality unravels.[5]

But this seemingly technical issue exposed something far more fundamental: the two dissents suggested that *Basic* may have been wrongly decided in 1988,[6] and while Justice Alito joined the majority, he wrote a cryptic concurrence indicating that the *Basic* presumption had a shaky foundation that warranted future reconsideration.[7] The defense bar wasted no time in taking up the four Justices' invitation and sought review in a case that had already been up once to the Court, *Erica P. John Fund v. Halliburton Co.* (*Halliburton I*).[8] Shortly thereafter, the Court granted certiorari, which generated substantial buzz as to what would happen next.

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1. 133 S. Ct. 1184 (2013). The majority opinion was written by Justice Ginsburg.
2. *Id.* at 1197.
3. 485 U.S. 224 (1988). I have explored *Basic* extensively in prior work. *See* Donald C. Langevoort, Basic *at Twenty: Rethinking Fraud on the Market*, 2009 WISC. L. REV. 151 [hereinafter Langevoort, *Basic at Twenty*]; *see also* Donald C. Langevoort, *Theories, Assumptions and Securities Regulation: Market Efficiency Revisited*, 140 U. PA. L. REV. 851, 886–96 (1992); Donald C. Langevoort, *Taming the Animal Spirits of the Stock Markets: A Behavioral Approach to Securities Regulation*, 97 NW. U. L. REV. 135, 182–86 (2002) [hereinafter Langevoort, *Animal Spirits*].
4. 133 S. Ct. at 1196.
5. *Id.* at 1206 (Scalia, J., dissenting), 1213 (Thomas, J., dissenting).
6. *See id.*
7. *Id.* at 1204 (Alito, J., concurring).
8. 718 F.3d 423 (5th Cir. 2013). Shortly after *Amgen*, the Fifth Circuit held that *Amgen* and the Court's earlier *Halliburton* decision together are properly read to foreclose any price distortion argument as part of the class certification decision. *Id.* The earlier decision before the Court, discussed *infra*, was *Erica P. John Fund v. Halliburton Co.*, 131 S. Ct. 2179 (2011) (*Halliburton I*), rejecting defendants' argument that a showing of loss causation was an essential predicate to class certification.

This surely was portentous—the possible death of a cause of action that has been the centerpiece of private securities litigation for the last 40 years.[9] Just in the last 15 years alone, private securities class actions, the vast majority of which are fraud-on-the-market actions, produced more than $70 billion in settlements for investors—and in that same period, plaintiffs' attorneys' fees alone totaled more than $14 billion.[10] On the defense side, these cases are just as big a revenue source for lawyers if not bigger, and it is not hard to imagine that many large law firm securities litigators were fearing for their practices, and privately praying that securities class actions would somehow survive, even as their clients were anxiously hoping otherwise.

The Court gave its answer in *Halliburton Co. v. Erica P. John Fund*, *Inc.* (*Halliburton II*): *Basic* does survive, if largely as a matter of stare decisis.[11] Whatever doubts were raised about the fraud-on-the-market theory were not enough to overcome the strong presumption that precedent need not be revised simply because the now-sitting Justices would have decided the case differently. The Court did hold, however, that defendants can defeat class certification by showing that an issuer's stock price was not impacted by the alleged fraud, even though price impact is no different from materiality in terms of class wide applicability.[12]

This Article compares and contrasts *Amgen* and *Halliburton II*. Although *Halliburton II* is technically a unanimous decision, in that all the Justices favored reversing and remanding the lower court's decision, the reality was a stark 6-3 split. Chief Justice Roberts wrote the Court's opinion to uphold *Basic*. Justices Thomas, Scalia, and Alito vehemently disagreed with this ruling, concurring only because of the reversal and remand on the secondary issue of price distortion. The surprise switch here was Justice Kennedy, who had joined the dissent in *Amgen* but then voted with the Chief Justice to allow *Basic* to live on.

For obvious reasons, *Halliburton II* is the more important of these two cases. But *Amgen* is still worth a close look, because it framed the issues on which the two sides in the fraud-on-the-market debate have been battling for more than 25 years. As we shall see, there is a strong jurisprudential connection between the two decisions, and yet on the matter of what is at issue at the class certification stage there are also subtle inconsistencies. My Article explores the road from *Amgen* to *Halliburton II*, and more importantly what has now changed about fraud-on-the-market litigation.

I. CONGRESS AND THE COURTS: SETTING POLICY FOR SECURITIES CLASS ACTIONS

The road begins with *Amgen*'s seemingly technical issue: whether plaintiffs had to establish the materiality of the alleged lies at the class certification stage. As the majority and dissenting Justices conceded in their debate about who exactly was

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9. *See* John C.P. Goldberg & Benjamin Zipursky, *The Fraud on the Market Tort*, 66 VAND. L. REV. 1755 (2013).

10. *See* Joseph A. Grundfest, *Damages and Reliance Under Section 10(b) of the Exchange Act*, 67 BUS. LAW. 307, 308–09 (2014).

11. 134 S. Ct. 2398, 2407–13 (2014).

12. *Id.* at 2414–17.

putting the cart before the horse,[13] plaintiffs surely bear the burden of proving materiality. The question was *when* this burden must be met—specifically, whether it should occur pre-discovery.[14] The *Amgen* dissenters' main argument was that where the misstatements are likely to be immaterial, it is more efficient to dismiss those cases earlier rather than later, and that it is not unfair to do so given the generous gift that *Basic*'s presumption affords the plaintiff class when materiality can be established.[15]

But of course there is much more to the issue of considering the merits at class certification than just timing. Leaving materiality to trial means, in all likelihood, that a jury makes that determination instead of the judge. Materiality debates often turn on a mix of qualitative and quantitative evidence, the latter not likely to be understood particularly well by lay jurors. Defendants may reasonably suspect that they will fare better before a judge than a jury for this reason alone. Moreover, at trial there may be little to control for the trumping effect of hindsight bias: the inflated inference that, because something bad happened later on, those on the inside must have suspected it all along and so bear responsibility for it.[16] Given the large sums of money at stake plus the high litigation costs just to get to trial, this fear supposedly contributes to settlement pressure, which happens almost inevitably if a class is certified and survives a defendants' motion to dismiss or motion for summary judgment. Thus, there is a fundamental conflict between plaintiffs' strong desire to defer as many contestable issues as possible to trial and defendants' desire to fight vigorously for pre-discovery resolution of those same contestable issues. *Amgen* was just one of many cases where defendants had pushed for such an acceleration of a merits issue, and the Court's rejection was, for the moment, a significant strategic win for plaintiffs in countering these moves.

Given the Supreme Court's recent pro-defendant inclinations in class actions generally,[17] this settlement-bolstering win for plaintiffs was surprising to

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13. *Compare* Amgen Inc. v. Conn. Ret. Plans & Trust, 133 S. Ct. 1184, 1191 (2013), *with Halliburton II*, 134 S. Ct. at 1211 (Thomas, J., dissenting).

14. Materiality determinations are aided by discovery to the extent that they deal with questions like the probability of an event's occurrence at the time of the public statements, or how seriously the issue was taken inside the company at the time. The lower courts that had made materiality an issue in class certification disagreed as to who had the burden of proof on the defendant to rebut materiality. *See In re* DVI Inc. Securities Litig., 639 F.3d 623 (3d Cir. 2011) (defendant may rebut); *In re* Salomon Analyst Metromedia Litig., 544 F.3d 474 (2d Cir. 2008).

15. 133 S. Ct. at 1206 (Scalia, J., dissenting).

16. *See* G. Mitu Gulati et al., *Fraud by Hindsight*, 98 NW. U. L. REV. 773 (2004). This is important because the approach to materiality with respect to speculative, future-oriented events is to ask the jury to balance the probability that the event would come to pass as of the time of the fraud against its likely magnitude—essentially an expected value calculation. This test was endorsed in a separate holding in *Basic*. On the somewhat surprising background to the Court's resolution of this issue, see Donald C. Langevoort, *Investor Protection and the Perils of Corporate Publicity:* Basic Inc. v. Levinson, *in* THE ICONIC CASES IN CORPORATE LAW 257 (Jonathan Macey ed., 2008).

17. Including another sizable win for the class action defense-side just a few weeks after *Amgen*. *See* Comcast Corp. v. Behrend, 133 S. Ct. 24 (2012).

many.[18] Indeed, in reading the briefs in *Amgen*, it is clear that the defense anticipated that the Court would bless this tough class certification stance because it was sound conservative policy to do so, and they expected a majority of the Justices to do so simply by adhering to that instinct.[19] But, with the Chief Justice as the defector from the conservative side of the Court, the defendants failed.

So why did the Chief Justice side with the majority in *Amgen*, given his defendant-friendly votes in other close fraud-on-the-market decisions like *Stoneridge Investment Partners v. Scientific-Atlanta Inc.*[20] and *Janus Capital Group v. First Derivative Traders*?[21] To me, there is a point in the opinion that was crucial to assembling that unexpected majority, one that also strongly hinted at what would happen later on in *Halliburton II*. As noted earlier, a strong thrust of the dissent was the *in terrorem* effect of class certification: impelling settlements, even when merits issues like materiality and scienter are questionable.[22] This debate has been raging for decades, and led Congress to substantially reform private securities litigation in 1995 with the enactment of the Private Securities Litigation Reform Act ("PSLRA").[23] Because Congress so thoroughly intervened in this debate, one could reasonably believe that it had implicitly "frozen" the outer limits of fraud-on-the-market class actions, precluding the judiciary from further expansion. This relates to the conservative critique of 10b-5 litigation generally, which despises that it originated as a judicially implied right rather than through explicit congressional action.[24] The Supreme Court's *Stoneridge* decision embraced the "frozen in 1995" idea explicitly.[25]

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18. I will leave to the civil procedure experts the task of reconciling *Amgen* with the noticeably contrary trend in class action litigation that is increasingly open to some degree of "merits" inquiry. *See* Linda Mullenix, *Class Action Cacophony at the Supreme Court*, NAT'L L.J., April 15, 2013, at 28. The majority and dissent in *Halliburton II* address this, with dramatically different conclusions.

19. The dissenters worked hard to find in the *Basic* opinion itself an implicit pre-certification materiality requirement in order to make this move seem not just a simple exercise of judicial policy making, the evidence for which did not impress the majority. In fact, the parties could not cite any instances where a court insisted on a materiality showing as crucial to class certification until the mid-2000s. If such a requirement was implicit in *Basic*, then, it lay undiscovered for a surprisingly long period of time. Unmentioned in *Amgen* is the Sixth Circuit's opinion on remand in *Basic*, which rejected the defendants' request for summary judgment on materiality and sent the case to the district court for trial, prior to which the case settled. *See* Levinson v. Basic Inc., 871 F.2d 562 (6th Cir. 1989). The court expressly affirmed the class certification even though materiality remained a live issue at trial.

20. 552 U.S. 148 (2008).

21. 131 S. Ct. 2296 (2011).

22. Amgen Inc. v. Conn. Ret. Plans & Trust, 133 S. Ct. 1184, 1206 (2013) (Scalia, J., dissenting), 1212 n.9 (Thomas, J., dissenting).

23. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (1995).

24. *See* Donald C. Langevoort, *Lies Without Liars?* Janus Capital *and Conservative Securities Jurisprudence*, 90 WASH. U. L. REV. 933, 934–36 (2013).

25. *Stoneridge*, 552 U.S. at 165–66 ("It is appropriate for us to assume that when [the PSLRA] was enacted, Congress accepted the §10(b) private cause of action as then defined but chose to extend it no further."). *Stoneridge* was addressing the extent of secondary liability in fraud-on-the-market suits.

But "frozen in 1995" is presumably a two-way street, indicating just as strongly that those doctrines that were firmly in place in 1995 are protected by that same logic. Albeit without an explicit citation to *Stoneridge*, the *Amgen* majority made much of the fact that Congress rejected efforts to overturn *Basic*, while at the same time making so many important substantive and procedural changes to counter settlement pressure and excessive liability.[26] Indeed, the structure of the PSLRA makes no sense unless read as a political compromise that preserves the foundation of the fraud-on-the-market class action while making it harder for plaintiffs to bring, plead, and prove a successful claim through a variety of reforms.[27] When this happens, a natural conservative judicial move is to defer to the legislative bargain.

Given the well-established status of materiality as a fact question in numerous Supreme Court decisions both pre- and post-1995,[28] the *Amgen* majority's point that Congress could have adjusted the law relating to materiality and class certification determinations if it had wanted, but chose other potent reforms instead, has considerable strength. This was the pointed message of *Schleicher v. Wendt*,[29] a Seventh Circuit decision authored by Judge Frank Easterbrook that rejected the role of materiality in class certification: "We do not think it appropriate for the judiciary to make its own further adjustments by reinterpreting Rule 23 to make likely success on the merits essential to class certification in securities-fraud suits."[30] It was a potent endorsement of deference to the PSLRA by a conservative scholar and judge who is an expert in both the theory and practice of private securities litigation,[31] and, in turn, the *Amgen* majority cited the case repeatedly.

Halliburton II, of course, involved this same separation of powers question on a much bigger scale—specifically, *Basic*'s very survival. In refusing to overturn *Basic*, the Chief Justice's opinion in *Halliburton II* comes back to what Congress did and did not do in 1995, albeit within the more limited framework of stare decisis. The opinion stops short of saying that the PSLRA formally endorsed or acquiesced in *Basic* as a matter of law. Instead, given the strong presumption of stare decisis, it is enough to say that ample opportunity was there for Congress to change the law if it wanted, but that Congress chose more narrow compromise solutions instead. This might be the point that also brought Justice Kennedy over to the majority—after all, he was the author of the *Stoneridge* opinion, where the "frozen in 1995" idea was

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26. 133 S. Ct. at 1200–01.

27. The legislative history of the PLSRA has been thoroughly explored and makes clear that the statute was *about* fraud-on-the-market litigation. *See, e.g.*, John W. Avery, *Securities Litigation Reform: The Long and Winding Road to the Private Securities Litigation Reform Act of 1995*, 51 BUS. LAW. 335 (1996). For a contrary view of the implications of the PSLRA, see Grundfest, *supra* note 10. One well-taken point made by petitioners and defense side amici in *Halliburton II* was that a minority in Congress (particularly the Senate) as well as the President (through a veto) can block legislation, so that a failure to act may not represent the preferred position of Congress as a whole.

28. *E.g.*, Matrixx Inc. v. Siricusano, 131 S. Ct. 1309 (2011); Basic Inc. v. Levinson, 485 U.S. 224 (1988); TSC Industries, Inc. v. Northway, 426 U.S. 438 (1976).

29. 618 F.3d 679 (7th Cir. 2010).

30. *Id.* at 686.

31. *See infra* note 41.

first expressed.[32] In any event, deference to the political process seems especially important to the outcomes in both cases.

II. MATERIALITY, PRICE DISTORTION, AND CORRECTIVE DISCLOSURE

The disagreement in *Amgen* was about whether an early showing of materiality in an evidentiary hearing should be the price plaintiffs have to pay for *Basic*'s generous presumption of reliance and the class certification that readily follows.[33] The majority said no, and largely restated that conclusion one year later in *Halliburton II*, ruling that plaintiffs did not have to show price distortion in order to gain the presumption.[34] But then—strangely, perhaps—the Court shifted ground in *Halliburton II* to say that defendants could raise a "no impact" defense in order to defeat class certification.[35] Logically, those two aspects of *Halliburton II* seem inconsistent. The latter holding is better seen as a pragmatic compromise to make the reaffirmance of *Basic* more palatable to securities class action critics and capture as large a majority of the Court as possible.

Here again, we start with *Amgen*. Materiality is a deceptively simple idea, describing that which reasonable investors likely consider important, or relevant to the value of the issuer's securities.[36] When plaintiffs bring a securities class action, the pleadings inevitably claim that the withheld truth was very important to investors. Apart from disputing what the truth was (a pure fact question) or whether it was fully appreciated by the defendant (a scienter inquiry) the most common response by the defense is a "truth-on-the-market" defense: that the market already knew the truth, so that whatever the defendant said was unimportant even if it was false.[37] This can be established qualitatively by calling market participants as witnesses and demonstrating, through contemporaneous publicity or published research, that there was an adequate understanding of the true state of affairs to

32. Justice Thomas's "concurrence" in *Halliburton II* questions whether stare decisis should play such a strong role when what is at issue is of the Court's own making (an implied private right of action) rather than a matter of statutory interpretation. As a result, he was unpersuaded that congressional inaction in 1995 was relevant. On the wholly inconsistent case law on legislative acquiescence, see William N. Eskridge, Jr., *Interpreting Legislative Inaction*, 87 MICH. L. REV. 67 (1988).

33. *Basic* permits a rebuttable presumption of reliance upon a showing that an investor traded during the relevant class period (i.e., after the misrepresentation but before correction), that the trading was on an "efficient" market, and that there was a material, public misstatement that distorted the market price. This presumption of reliance, in turn, has been seen as essential to a finding of commonality under Rule 23(b)(3) of the Federal Rules of Civil Procedure to justify class certification.

34. *Halliburton II*, 134 S. Ct. 2398, 2413–14 (2014).

35. *Id.* at 2414–17. John Coates's contribution to this volume sees a strategy on the part of the Chief Justice in this shift of direction. *See* John C. Coates IV, *Securities Litigation in the Roberts Court: An Early Assessment*, 57 ARIZ. L. REV. 1 (2015).

36. Matrixx Initiatives Inc. v. Siricusano, 131 S. Ct. 1309 (2011) (rejecting a claim that statistically insignificant instances of harmful effects from a new drug were necessarily immaterial).

37. *See* JAMES D. COX ET AL., SECURITIES REGULATION: CASES AND MATERIALS 637–39 (7th ed. 2013).

disregard management's supposed deception. The latter appears to be what defendants were anxious to do in *Amgen*.

However, as one can imagine, this kind of evidence is normally countered by plaintiffs' own experts and publicity survey. For some time now, the question of whether there is a noticeable stock price reaction to the alleged misstatement has been considered the best test to resolve contests between fraud-on-the-market and truth-on-the-market.[38] When a corporate lie is particularly dramatic and credible—false corporate "news"—we can expect a visible and prompt price reaction, usually on the upside. Indeed, that intuition is the basis of the fraud-on-the-market presumption. And that stock price distortion—often measurable via an event study—would tell us nearly everything necessary for plaintiffs to succeed or fail. The reaction itself suggests that the information is material, and that distortion triggers *Basic*'s presumption of reliance. The amount of the price distortion in turn might also be a good measure of damages. Indeed, it was this promise of a rigorous, unified, empirical approach to materiality,[39] reliance, and causation via the event-study tool that made the fraud-on-the-market theory appealing early on, even to fairly conservative judges and academics—a story I have explored in more depth elsewhere.[40]

But the simplicity was an illusion.[41] As was the case in *Amgen*, the typical fraud-on-the-market case does not involve a single dramatic lie. Rather, it involves a narrative that begins when the issuer is doing reasonably well. Gradually, however, things start turning bad and eventually the issuer is forced to reveal its troubles (or the market simply figures it out), at which point the stock price is much lower than it was during the good times. Plaintiffs will work to show that management knowingly or recklessly concealed those troubles. But concealment is not necessarily unlawful (another one of *Basic*'s fundamental lessons[42]) and so there will have to be a showing that particular misstatements or actionable omissions, usually half-truths, distorted the stock price. For a variety of reasons, finding

38. Jonathan Macey et al., *Lessons from Financial Economics: Materiality, Reliance and Extending the Reach of* Basic v. Levinson, 77 VA. L. REV. 1017, 1021 (1991).

39. *See* Roger Dennis, *Materiality and the Efficient Capital Market Model: A Recipe for the Total Mix*, 25 WM. & MARY L. REV. 373 (1984) (cited in *Basic*).

40. *See* Langevoort, Basic *at Twenty*, *supra* note 3, at 163–64. The seminal work here is Daniel R. Fischel, *Use of Modern Finance Theory in Securities-fraud Cases Involving Actively Traded Securities*, 38 BUS. LAW. 1 (1982); *see also* Frank H. Easterbrook & Daniel R. Fischel, *Optimal Damages in Securities Cases*, 58 U. CHI. L. REV. 611 (1985); Daniel R. Fischel, *Efficient Capital Markets, the Crash, and Fraud on the Market Theory*, 74 CORNELL L. REV. 907 (1989) [hereinafter Fischel, *Crash*]. Easterbrook and Fischel gather these ideas together in their classic book, THE ECONOMIC STRUCTURE OF CORPORATE LAW (1991). Credit for this law and economics vision is also due to Judge Patrick Higginbotham, who introduced this kind of analysis to the fraud-on-the-market case law, even before Easterbrook and Fischel, in *In re LTV Securities Litigation*, 88 F.R.D. 134 (N.D. Tex. 1980). Judge Higginbotham, who was later promoted to the Fifth Circuit, had a significant impact on the law since then as well.

41. *See* Jill E. Fisch, *The Trouble with* Basic: *Price Distortion after* Halliburton, 90 WASH. U. L. REV. 895 (2013) [hereinafter Fisch, *Trouble*].

42. *See* Jonathan Macey & Geoffrey Miller, *Good Finance, Bad Economics: An Analysis of the Fraud-on-the-Market Theory*, 42 STAN. L. REV. 1059, 1067–76 (1990).

measurable distortion is often hard. First, the alleged lies frequently come out in dribs and drabs, with incremental effect, and this allegedly prevents a decline in the stock price, not actually pumping it up. Second, these alleged lies are often coupled with lots of other information about the issuer, some of which may have been accurate. There is simply no way of measuring distortion with precision in settings like these. Often there is no visible change in stock price at all, on which defendants seize for their truth-on-the-market defense.[43]

Well before *Basic*, plaintiffs responded to this difficulty by turning attention not to the date of the alleged lie but rather the event of corrective disclosure—when the truth was later brought home to the market. When there was a big stock price drop after such disclosure, plaintiffs would argue by backwards induction that this drop was a good measure of the cumulative extent of the original distortion (and the right measure of damages as well).[44] But once the inquiry extends to a potentially lengthy period of time between the original lie and the corrective disclosure, it is likely that there will be many intervening or supervening events that also make their way into the correction, making it hard—if not impossible—to disentangle all the effects with any econometric rigor. The case law in this area exploded in the aftermath of the Supreme Court's *Dura Pharmaceuticals v. Broudo* decision,[45] with its insistence that plaintiffs put forth persuasive evidence of a price correction attributable to the fraud in order to establish "loss causation," their statutory burden after the PSLRA.[46]

Exploring how the courts have responded to all this is beyond the scope of this Article;[47] it is by all accounts a doctrinal and practical mess.[48] Courts vary considerably in how much they demand of plaintiffs, with many cases insistent that if plaintiffs cannot show with convincing evidence that there was either a price distortion at the time of the fraud or, afterwards, a deflation in price due to the revelation of the truth (not some separate causal event), they lose.[49] Of course, if this burden is imposed only at the trial on the merits, it may be largely illusory for the reasons discussed earlier—the case will be settled before then. In response, urged

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43. *See* Lucian Bebchuk & Allen Ferrell, *Revisiting* Basic, 69 BUS. LAW. 671 (2014) (providing a discussion of "confirmatory lies" and the proof problems they pose).

44. *See, e.g.*, Bradford Cornell & R. Gregory Morgan, *Using Finance Theory to Measure Damages in Fraud on the Market Cases*, 37 UCLA L. REV. 883 (1990).

45. 544 U.S. 336 (2005).

46. *Id.* at 345–36.

47. *See* Fisch, *Trouble*, *supra* note 41; Langevoort, Basic *at Twenty*, *supra* note 3, at 178–89.

48. *See* Elizabeth Chamblee Burch, *Reassessing Damages in Securities Fraud Class Actions*, 66 MD. L. REV. 348 (2007); Allen Ferrell & Atanu Saha, *Loss Causation Requirement for Rule 10b-5 Causes of Action: The Implications of* Dura Pharmaceuticals v. Broudo, 63 BUS. LAW. 163 (2007); Jill E. Fisch, *Cause for Concern: Causation and Federal Securities Fraud*, 94 IOWA L. REV. 811 (2009); Merritt B. Fox, *After* Dura: *Causation in Fraud-on-the-Market Actions*, 31 J. CORP. L. 829 (2006); Michael J. Kaufman, *At a Loss: Congress, the Supreme Court and Causation under the Federal Securities Laws*, 2 N.Y.U. J. L. & BUS. 1 (2005); James C. Spindler, *Why Shareholders Want their CEO's to Lie More After* Dura Pharmaceuticals, 95 GEO. L.J. 653 (2007).

49. *E.g.*, Metzler Inv. GMBH v. Corinthian Colls., Inc., 540 F.3d 1049, 1062–65 (9th Cir. 2008).

on by defendants, more aggressive courts began finding ways to accelerate this inquiry, taking us to the present controversies.[50] As an effort to weed out these cases, class certification was appealing because it would permit an early evidentiary hearing, going well beyond the pleadings. The Supreme Court tried to shut the door on using class certification for this purpose, first holding that loss causation is not an appropriate certification inquiry in *Halliburton I*,[51] then holding the same with respect to materiality in *Amgen*.[52]

Even though plaintiffs won considerable (but again, perhaps momentary) strategic victories in these two cases, this kind of pre-discovery skirmishing resembled a game of whack-a-mole in that these issues continue to reappear under different labels.[53] For example, in a controversial series of Third Circuit opinions authored by then-Judge Alito,[54] he articulated that, where there is no stock-price reaction to a misrepresentation, omission, or corrective disclosure, the information is immaterial as a matter of law, and thus the case should be dismissed for that reason alone, on the merits as opposed to as part of class certification.[55]

If read strictly, this is a troubling doctrine.[56] The question of why there was no immediate stock-price reaction is factually complex. Sometimes reactions to information are delayed because of the subtlety or "buried" nature of the disclosure, even in well-developed markets. Sometimes there is no reaction because, as noted earlier, the alleged fraud diffuses a price reaction that would have occurred in the

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50. *E.g.*, Oscar Private Inv. v. Allegiance Telecom., Inc., 487 F.3d 261 (5th Cir. 2007).

51. 131 S. Ct. 2179 (2011); *see* Fisch, *Trouble*, *supra* note 41.

52. Technically, price distortion might be seen as different from both materiality and loss causation, though this did not persuade the Fifth Circuit in *Halliburton II*. *See supra* note 34 and accompanying text.

53. Still uncertain, for example, is the extent of plaintiffs' pleading burden with respect to price distortion and loss causation. Even summary judgment is a possibility, notwithstanding the highly disputed factual nature of these issues. *See In re* Williams Co. Sec. Litig., 558 F.3d 1130, 1143 (10th Cir. 2009). The court found a way to summary judgment via *Daubert*. The district court, properly in the Tenth Circuit's view, excluded the plaintiff's expert evidence entirely for failing to make the necessary scientific showing for admissibility; thus there was no factual contest any more. In sum, *Williams* concedes the likelihood of serious fraud closely connected with the reasons companies typically go bankrupt—hidden financial weakness—and yet dismissed the class action in its entirety.

54. *E.g.*, *In re* Burlington Coat Factory Sec. Litig., 114 F.3d 1410, 1425 (3d Cir. 1997). For perhaps the most notorious example, not by Alito, see *In re Merck & Co. Sec. Litig.*, 432 F.3d 261 (3d Cir. 2005), which uses immateriality as a matter of law even though there clearly was a later corrective reaction to the news once it became salient enough. *But see* Greenhouse v. MCG Capital Corp., 392 F.3d 650 (4th Cir. 2004). *See generally* Stefan J. Padfield, *Who Should Do the Math? Materiality Issues in Disclosure that Require Investors to Calculate the Bottom Line*, 34 PEPP. L. REV. 927 (2007).

55. That could be an explanation for Justice Alito's choice to concur rather than dissent in *Amgen*: he may have been convinced that class certification is not the right place to deal with these issues because there are other pre-discovery opportunities for dismissal when price distortion isn't obvious.

56. *See* James D. Cox, *Understanding Causation in Private Securities Lawsuits: Building on* Amgen, 66 VAND. L. REV. 1719 (2013); Langevoort, Basic *at Twenty*, *supra* note 3, at 189–91.

absence of the fraud. When this occurs, there is no obvious corresponding correction event because either the information has already leaked into the market or the correction has been bundled with other good news about the issuer. While there will be some cases where the mix of quantitative and qualitative evidence of truth-on-the-market is strong enough to justify pre-discovery dismissal,[57] most are likely to involve substantial ambiguity.

So what this is really all about is the burden of palpable uncertainty,[58] which takes us to *Halliburton II*. The majority in *Halliburton II*, having determined that requiring plaintiffs to show price impact at the class certification stage would be too large a burden, then went on to allow defendants to raise the issue as a defense to certification.[59] Why? The Court concedes that this is a class-wide issue, but (1) finds it the true predicate for the presumption of reliance for which the agreed-upon certification prerequisites, efficiency and publicity, are just indirect proxies; and (2) the issue tends to come up anyway in the course of assessing market efficiency.[60] The first of these claims surely frustrates defendants because it suggests that plaintiffs' affirmative burden should be fundamental to earning the presumption. The second is curious because only some cases—and as we shall see, perhaps even fewer in the future—seriously contest efficiency.

The reality is that *Halliburton II* is choosing a middle-ground policy: price distortion as an early-stage, judge-made determination, but with the burden on the defendants. In this sense, the Court is clearly backtracking on both *Amgen* and *Halliburton I*. How much this matters will depend on how lower courts structure and manage the inquiry into price distortion. If the approach to loss causation is any indication—which it should be because the proof of loss causation tends to be the same as proof of distortion—this could turn out to be defendant-friendly. This is because the simple absence of statistically significant price movement at the key points in time is sufficient to shift the burden of explanation to plaintiffs. On the other hand, we have to remember, as Justice Ginsburg's concurring opinion stresses,[61] that the Court solidly rejected putting the burden on plaintiffs, suggesting that it would be inappropriate to draw an inference of non-impact too easily. Also, importantly, we have to keep in mind that this *is* a binary question: simply "was there impact," not "how large was the distortion"—which is inevitably the much harder inquiry. We will dig more deeply into all of this shortly.

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57. *E.g.*, Smith v. Circuit City Stores, 286 F. Supp. 2d 707, 721 (E.D. Va. 2003).

58. *See* John C. Coffee, Jr., *Causation by Presumption? Why the Supreme Court Should Reject Phantom Losses and Reject* Broudo, 60 BUS. LAW. 533 (2005).

59. *Halliburton II*, 134 S. Ct. 2398, 2412–17 (2014).

60. After *Halliburton I* and *Amgen*, this was clearly a defense-side strategy of choice. *See* Lassaad Turki & Mark Allen, Amgen*—What Has Not Been Said So Far!*, 45 SEC. REG. & L. REP. (BNA) 1046 (June 3, 2013); *see also* Mukesh Bajaj & Sumon C. Mazumdar, *Assessing Market Efficiency for Reliance on the Fraud-on-the-Market Doctrine After Wal-Mart and Amgen*, 26 RES. IN L. & ECON. 161 (2014). My sense is that this kind of argument has to be evaluated very skeptically, especially after *Halliburton II*. *See infra* pp. 53–54.

61. *Halliburton II*, 134 S. Ct. at 2417 (Ginsburg, J., concurring). For a district court decision picking up on this, see Aranaz v. Catalyst Pharmacy Partners, 302 F.R.D. 657, 673 (S.D. Fla. 2014).

III. ON WHAT? EFFICIENCY, RELIANCE, AND REBUTTABILITY

I have written at length elsewhere about the confusion *Basic* created in trying to explain the precise nature of the presumed reliance, as well as how and why this relates to market efficiency.[62] So have others.[63] Neither *Amgen* nor *Halliburton II* blows away the fog, though the latter is a welcome step forward on the efficiency issue.

Market efficiency is the idea that, as a result of competitive research by market professionals and other mechanisms, "news"—or indeed any other material public information—about an issuer will be promptly incorporated into the issuer's stock price, so that traders thereafter cannot reasonably expect to profit on the stock as a result of such news.[64] It follows that most traders should not even try to beat the market—they can and should "free ride" on the professionals' work by simply assuming that the consensus price is the best publicly available estimate of the security's value. Index funds are commonly given as a good example of a rational, low-cost investment strategy in response to market efficiency.[65]

Basic's muddle was this: there are plenty of free riders in the market who can reasonably say that they buy or sell without researching the company because they are relying on the market—the investor's "unpaid agent"[66]—to do the work for them. But there are just as many investors, if not more, who try to identify mispricing opportunities—stocks that seem undervalued or overvalued—and hence, those investors do not trust that the market has gotten the valuation right. Of course some of these investors do the research and actually rely on the misinformation, but not all. Any presumption based simply on the assumption of passive freeriding will be necessarily overinclusive,[67] which, as a result, raises disturbing questions about excessive liability because each and every class member is entitled to damages.

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62. *See* Langevoort, Basic *at Twenty*, *supra* note 3, at 166–78.

63. *E.g.*, Cox, *supra* note 56 (though seeing in both the majority opinion in *Amgen* and Justice Scalia's dissent a route toward a more coherent theory).

64. Actually, it starts simply from the empirical observation that after a prompt period of adjustment to news, there are no significant cumulative abnormal returns—the price is as likely to go up as down—so that we can fairly say that the information has been impounded in the stock price. The precise mechanisms of market efficiency remain contested. *See* Ronald J. Gilson & Reinier Kraakman, *The Mechanisms of Market Efficiency Twenty Years Later: The Hindsight Bias*, 28 J. CORP. L. 715 (2003). This is the notion of "informational" efficiency. "Fundamental" efficiency is an inference—that as a result of the forces that produce informational efficiency, it is more likely that the price reflects the stock's intrinsic value. Because there is no way of determining with precision what the intrinsic value is, fundamental efficiency is not directly testable.

65. *See* Burton G. Malkiel, *The Efficient Market Hypothesis and its Critics*, 17 J. ECON. PERSP. 59, 59–60, 76 (2003).

66. 485 U.S. 224, 244 (1988) (quoting *In re* LTV Sec. Litig., 88 F.R.D. 134, 143 (N.D. Tex. 1980)).

67. *See* Grigori Erenburg et al., *The Paradox of "Fraud-on-the-Market Theory": Who Relies on the Efficiency of Market Prices?*, 8 J. EMPIRICAL LEG. STUDS. 260, 267, 300 (2011).

But this is not the only, or even the standard, justification for a presumption of reliance. Midway through *Basic*—and again in both *Amgen*[68] and *Halliburton II*[69]—the Court subtly shifts to the idea of reliance on "price integrity" for what is being presumed.[70] An investor assumes that the market price is undistorted by fraud, even if he or she thinks the stock may be under or overvalued. Here, active as well as passive investors would be entitled to the presumption, even in the absence of actual reliance, which is how *Basic* had generally been understood by commentators[71] and applied by the courts.[72] In *Halliburton II*, Chief Justice Roberts asserts that "value investors" may think they can beat the market, but are still assuming that the price will eventually adjust in the direction of their prediction because of the forces of market efficiency.[73]

Yet, *Basic*'s muddle doesn't end here because a rational investor would never *assume* that prices have integrity. Sadly, corporate fraud is not uncommon—one recent estimate suggests that the probability of any given public company engaging in fraud in a particular year is as much as 14.5%.[74] In an efficient market, the residual fraud risk is priced, not assumed away.[75]

What *Basic* did, as much as anything, is create an *entitlement* to an undistorted stock price through, as I have described it, an act of juristic grace.[76] The most straightforward way of articulating this—advocated by Easterbrook and Fischel, for example—would be to jettison reliance entirely and give investors a right to recover whenever they show price distortion that harmed them.[77] This is a pure causation approach, and there is a fascinating backstory to *Basic* here. Private correspondence between Justices Blackmun and Brennan while *Basic* was being drafted shows Blackmun stubbornly insisted that "transactional reliance" had to be preserved and a simple causation approach rejected.[78] Their main point of

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68. 133 S. Ct. 1184, 1192–93 (2013).

69. 134 S. Ct. 2398, 2410 (2014).

70. *Basic*, 485 U.S. at 247.

71. *See, e.g.*, Fischel, *Crash*, *supra* note 40, at 919–20.

72. *See, e.g.*, Black v. Finantra Capital, Inc., 418 F.3d 203, 209 (2d Cir. 2005); *In re* Worldcom Inc. Sec. Litig., 219 F.R.D. 267, 282 (S.D.N.Y. 2003).

73. 134 S. Ct. at 2410.

74. *See* Alexander Dyck et al., *How Pervasive is Corporate Fraud?* 4 (Rotman Sch. of Mgmt. Working Paper No. 2222608, 2013), *available at* www.ssrn.com/abstract=2222608.

75. But because diversified traders can gain as well as lose from fraud (if they are sellers at an inflated price), this market risk may not be all that great. *See* sources cited *infra* note 110.

76. Langevoort, Basic *at Twenty*, *supra* note 3, at 161. A pre-*Basic* recognition of this is Lipton v. Documation Inc., 734 F.2d 740, 748 (11th Cir. 1984) ("The theory . . . actually facilitates Congress' intent . . . by enabling a purchaser to rely on an expectation that the securities markets are free from fraud.") *Basic* cites *Lipton*, with a page cite to this quote but not the quote itself. 485 U.S. 224, 246 (1988).

77. *See supra* note 40; *see also* Fisch, *Trouble*, *supra* note 41, at 928–31.

78. The phrase "transactional reliance," referring to Blackmun's insistence that actual reliance is essential, seems to be Brennan's. He distinguishes this from his preferred idea of "price reliance." Letter from William Brennan, U.S. Supreme Court Justice, to Harry Blackmun, U.S. Supreme Court Justice 1 (Jan. 22, 1988) (on file with author) ("I fear that the

disagreement centered on whether a trader who is committed to selling without regard to the price is harmed by fraud-induced price distortion: Brennan's causation approach says yes, while Blackmun's transactional approach says no. Their hypothetical trader is someone who decides to divest immediately the shares of a company doing business in South Africa. Blackmun edited the opinion to accommodate Brennan's preferred locution of "price reliance," though he was still unconvinced that there was much substance to the distinction.[79] Brennan disagreed, and was not sure that Blackmun yet understood his point, but finally gave up and willingly concurred because he realized that, once the presumption is invoked, the possibility that anyone will try to rebut it and challenge individualized reliance is rare.[80] Largely, he was right. But Blackmun's insistence on maintaining transactional reliance as the basis for the presumption leaves the decision incoherent and unsatisfying.[81]

Consider the important case of the index fund.[82] Index funds are the poster children for passive low-cost investment, the funds are compelled to buy or sell stocks solely to maintain a weighted average of the chosen market index. They thus seem to fit perfectly within the freeriding vision.[83] But these investors are entirely insensitive to information insofar as their entire methodology is just to mirror the

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Court's opinion may be read as approving transactional reliance rather than price reliance."). Adam Pritchard uncovered this correspondence in the course of his historical research, and I am grateful to him for copies. For previous use of this correspondence, see Langevoort, Basic *at Twenty*, *supra* note 3, at 153 n.9, 157 n.25, 160 n.38; Goldberg & Zipursky, *supra* note 9; *see also* STEPHEN CHOI & A.C. PRITCHARD, SECURITIES REGULATION: CASES AND ANALYSIS 281–82 (3d ed. 2012).

79. *See* Letter from William Blackmun, U.S. Supreme Court Justice, to Harry Brennan, U.S. Supreme Court Justice 1–2 (Jan. 25, 1988) (on file with author). I suspect that these edits and additions were the reason *Basic* is so hard to understand with regard to reliance—it tries to reconcile the price and transactional ideas while clearly preserving the latter, without recognizing the underlying tension.

80. *See* Letter from Justice Brennan, U.S. Supreme Court, to Justice Blackmun, U.S. Supreme Court (Jan. 27, 1988) (on file with author) ("The difference between us is now clear. In my view, the market relies on the defendant's misstatement, and plaintiffs are defrauded because they are forced to act through the market. Your view requires that in addition plaintiffs specifically depend on the integrity of the market, that is, that the market is fair."). Whether he was aware of it or not, Brennan was channeling Easterbrook and Fischel in these comments.

81. My point here goes solely to the effort to describe the presumption in reliance terms. To me, *Basic* would make a great deal of sense in terms of conferring an entitlement to rely on the integrity of the market, which I think was what Brennan (and Easterbrook and Fischel) were reaching for. For an elaboration of the economic justification for protecting reliance of this sort, see Zohar Goshen & Gideon Parchomovsky, *The Essential Role of Securities Regulation*, 55 DUKE L.J. 711, 771–80 (2006). Brennan does use the term "price reliance," but it is clear from the analysis in his letters that what he really meant was "price dependency," since traders in an organized market have no choice but to accept the prevailing market price.

82. *See* Cox, *supra* note 56; *see also* Richard A. Booth, *Index Funds and Securities Fraud Litigation* (Villanova Law, Pub. Policy Research Paper No. 2013-3046, 2012), *available at* http://papers.ssrn.com=1996587.

83. For cases including index investors within the presumption of reliance, see, e.g., *In re* Lehman Bros. Sec. Litig., 2013 WL 440622 (S.D.N.Y. 2013).

index. Even if told the truth about a particular issuer, they would still have to buy or sell to conform to the index. So why aren't they just like the investor who committed to divest from South Africa?

While there is no self-evident answer to this question, one possible response would be to interpret an investor's right to undistorted stock prices as a right conferred on to the market generally—in other words, a right to an undistorted market, not just undistorted prices for each company in the market. When framing the entitlement this way, it is clear that there are a number of different ways for the investor to rely on the market that would qualify for protection. One is through passivity, or assuming that the market is doing the best possible job of valuing in light of the entitlement—this might include index funds, even if their actual decisions are automatic.[84] Another is through active investing, either through actual reliance on the misinformation in question or an investment strategy that seeks to beat the market, but nonetheless utilizes the prevailing market price as an informational component of the investment decision. In other words, the presumption is properly given to any active or passive purchaser or seller during the class period to whom the integrity of the stock price could be relevant—i.e., those who would not have necessarily made the same investment decision had the truth been revealed. This is essentially the approach used in *Gamco Investors v. Vivendi S.A.*,[85] where the plaintiff was disqualified from taking advantage of *Basic*'s presumption where plaintiff was a sophisticated, active investor whose valuation model incorporated a set of factors entirely separate from what the issuer concealed from the market.[86] However, the *Gamco* court suggested that this was an extremely rare holding, in no way suggesting that active traders are normally disqualified from the presumption of reliance.[87]

All of that is background now, given *Halliburton II*'s endorsement of *Basic*'s presumption. Chief Justice Roberts gets caught up in much the same muddle that Justice Blackmun did 26 years earlier: the inability to articulate exactly what the uninformed investor is reasonably relying upon without simply reverting to pure causation—the system of "investor insurance" that everyone wants to avoid.[88] This is the focus of Justice Thomas' concurring opinion,[89] and there is some force to his critique.

Halliburton II's most helpful conceptual contribution is with regard to market efficiency. The Court granted certiorari largely in response to the question Justice Alito posed in *Amgen*: do developments in our contemporary understanding of stock market efficiency—particularly skepticism about how efficient they really are—call into question *Basic*'s fundamental assumptions?[90] The Chief Justice's

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84. Index investing relies more heavily on portfolio diversification than any strong assumption of market efficiency to deal with issuer-specific risk.

85. 927 F. Supp. 2d 88 (S.D.N.Y. 2013).

86. *See id.*

87. *Id.* at 102.

88. *See* text accompanying *supra* note 79.

89. *Halliburton II*, 34 S. Ct. 2398, 2420–23 (2014) (Thomas, J., concurring in judgment).

90. Amgen Inc. v. Conn. Ret. Plans & Trust, 133 S. Ct. 1184, 1204 (2013) (Alito, J., concurring).

answer in *Halliburton II* is no, or at least not enough to overcome the stare decisis presumption.[91] Chief Justice Roberts came to this determination by stressing that the efficiency question is not meant to be particularly rigorous—that "generalized" efficiency, not some idealized vision of hyper-efficiency, is sufficient.[92] He is clearly right on this.[93]

I have explored the reasons for why this generalized efficiency determination is right in depth elsewhere,[94] and so will be relatively brief. The contemporary understanding of financial markets makes clear that perfect efficiency is just an ideal; all markets fall short, some more than others.[95] Informational efficiency—that is, how quickly information is impounded in price so that subsequent price moves return to random—varies based on how widely followed the issuer is, as well as the nature of the information. Obscure information is impounded more slowly than salient information, even for blue-chip issuers. And sentiment-based investors (noise traders) can sometimes move prices away from fundamental value for sustained periods of time, producing both underreaction and overreaction to both news and pseudo-news before the forces of efficiency correct the distorted price.[96]

None of this, however, undermines a presumption of reliance that is based either on the relative wisdom of passivity or an entitlement to assume stock price integrity. Finance experts have hardly backed off of the suggestion that index investing and other passive strategies are wise for most investors, even in the face of market imperfections.[97] Index strategies remain popular, and profits from active trading strategies as elusive as ever.[98] Stock price integrity is a worthy policy goal despite inevitably imperfect efficiency. The key question in assessing the presumption of reliance is whether the market segment that the securities are traded in has *sufficient* efficiency properties to make us reasonably confident that misinformation is likely to distort the stock price.[99] Most well-organized markets

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91. 134 S. Ct. at 2409–11.

92. *Id.* at 2410.

93. Indeed, one might reasonably jettison the entire efficiency inquiry. *See* Bebchuk & Ferrell, *supra* note 43. This the Court does not do, though perhaps it comes close.

94. *See* sources cited *supra* note 3. Ironically, my work was cited extensively by Justice Thomas for the opposite conclusion.

95. On legal and regulatory manifestations of this contemporary understanding, see Henry T.C. Hu, *Efficient Markets and the Law: A Predictable Past and an Uncertain Future*, 4 ANN. REV. FIN. ECON. 179 (2012).

96. For citations and elaboration, see Langevoort, *Animal Spirits*, *supra* note 3. *See also* William O. Fisher, *Does the Efficient Market Hypothesis Help Us Do Justice in a Time of Madness?*, 54 EMORY L.J. 843 (2005); Lynn Stout, *The Mechanisms of Market Inefficiency: An Introduction to the New Finance*, 28 J. CORP. L. 635 (2003).

97. *See* Malkiel, *supra* note 65, at 76–80.

98. *See* Gilson & Kraakman, *supra* note 64.

99. *See* Bradford Cornell & James C. Rutten, *Market Efficiency, Crashes and Securities Litigation*, 81 TUL. L. REV. 443, 456 (2006) (efficiency inquiry with respect to the presumption of reliance should be a relative one, and not overly demanding); Fischel, *Crash*, *supra* note 40 (discussing efficiency implications of market volatility for *Basic*'s presumption); Langevoort, Basic *at Twenty, supra* note 3, at 161–62; Macey et al., *supra* note 38 ("The legal system should not withhold redress from an injured plaintiff simply because

meet this condition. Efficiency, in other words, should just be a proxy for those markets in which passive investing is reasonable.

In recent years, unfortunately, defendants have had a fair amount of success in persuading courts that the efficiency inquiry should be much more demanding than this. Perhaps the best-known case along these lines is *In re PolyMedica Securities Litigation*,[100] which insists that plaintiffs show that the market price for the company's stock is very fast in impounding new information.[101] Building on this, particularly after *Amgen*, the defense-side continued the class certification battle as to price distortion by using the apparent absence of evidence of distortion as proof that, for the issuer in question, its market must thus not be efficient.[102] The Chief Justice recognized this strategy in *Halliburton II*, where he said that price distortion is usually before the trial judge in class certification anyway.[103]

Hopefully *Halliburton II* will take the steam out of the defense-side's effort through its emphasis on "general" market efficiency rather than hyper-efficiency. The *PolyMedica* court justified its more-demanding standard by claiming that *Basic* was ambiguous on the subject—explicitly disregarding a footnote in *Basic* that seemed to say that the inquiry should not be overly demanding.[104] *Halliburton II*, on the other hand, quotes and highlights that very same footnote.[105] There is a consensus in *Halliburton II* to reject any "binary" vision of market efficiency—i.e., that markets are either efficient or not, as opposed to a continuum of relative efficiency. That is all well and good, but this strongly cautions against overemphasizing the efficiency determination for class certification, because the judge must inevitably answer the question of sufficient efficiency with a clear yes or no. The factors that courts have used previously (the so-called *Cammer* factors[106]) create the illusion that there is a scientific way to answer that question, when there really is not.[107] The risk here is that the courts will defer too much to the econometricians.

From here on out, all that should be necessary to establish efficiency is a showing that a company's stock price generally responds to new information within

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he owns the security of a corporation traded in a market considered by some court to be 'inefficient.'").

100. 432 F.3d 1 (1st Cir. 2005).

101. *Id.* at 14.

102. *See* Langevoort, Basic *at Twenty*, *supra* note 3, at 168–77; *see also* Meyer v. Greene, 710 F.3d 1189 (11th Cir. 2013); sources cited *supra* note 60.

103. There is some irony here because if the efficiency inquiry should be less demanding, as the opinion suggests, we should see less of an effort to prove non-efficiency.

104. 432 F.3d at 10–12.

105. 134 S. Ct. 2398, 2410 (2014) (quoting Basic Inc. v. Levinson, 485 U.S. 224, 247 n.24 (1988)).

106. Cammer v. Bloom, 711 F. Supp. 1264, 1285–87 (D. N.J. 1989).

107. *See* Langevoort, Basic *at Twenty*, *supra* note 3, at 169–73; *see also* Bebchuk & Ferrell, *supra* note 43. One of the first post-*Halliburton II* cases to address efficiency continued to rely on *Cammer* and similar factors, without seeing that there was anything new in the Supreme Court's approach. That said, the court of appeals did find sufficient efficiency in a way that was consonant with a more relaxed approach. *See* Local 703 I.B. of T. Grocery & Food Emps. Welfare Fund v. Regions Fin. Corp., 762 F.3d 1248, 1255–58 (11th Cir. 2014).

a reasonable period of time—even if not immediately or fully. This standard should not be all that hard. In the course of this inquiry, it is important to avoid allowing defendants to cherry-pick instances of no price reaction. There can be many reasons for no reaction or underreaction in generally efficient markets, including that the market had figured out the essential truth on its own without waiting for corrective disclosure from the issuer, or that the significance of the information was hard to glean from the particular disclosure in question. Both common sense and economic theory suggest that it will be the rare, well-organized market that is not generally efficient.

IV. PRICE DISTORTION: DIGGING MORE DEEPLY

The fraud-on-the-market theory was devised to create a form of corrective justice—compensating investors for real losses.[108] It might also have beneficial effects in terms of deterring fraud, but that has always been secondary. Justice Blackmun's stubborn insistence to preserve the reliance requirement by making the presumption rebuttable underscores this, and neither *Amgen* nor *Halliburton II* lets go of that obsession.

Much contemporary legal scholarship has been critical of fraud-on-the-market as a compensatory device, however.[109] The arguments are by now familiar enough that we can summarize here, too. First, fraud produces windfall gains for many investors along with losses—indeed, putting aside insider trading in its various forms, the marketplace losses and gains are roughly equal. Active traders are as likely to be winners as losers. Compensating for the losses while ignoring the gains, even for the same investor, leads to systematic overcompensation over time.[110] Second, because payments in judgment or settlement come from either a liability insurance policy or the company itself, investors themselves are funding these payouts, directly or indirectly—the so-called "circularity" argument.[111] We have known for some time that payouts by individual wrongdoers, i.e., senior company managers, are extremely uncommon.[112] Together, these points argue that the fraud-on-the-market system is a very costly, and somewhat unnecessary, pocket-shifting mechanism that resembles an insurance policy for the investor.

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108. *See* Goldberg & Zipursky, *supra* note 9.

109. There is now a large literature on this debate. The critique is thoroughly described in, e.g., William Bratton & Michael Wachter, *The Political Economy of Fraud on the Market*, 160 U. PA. L. REV. 69 (2011) and John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and its Implications*, 106 COLUM. L. REV. 1534 (2006). For a particularly helpful exploration of the arguments and empirical evidence, pushing back on some of the critiques, see James D. Cox & Randall Thomas, *Mapping the American Shareholder Litigation Experience: A Survey of the Empirical Evidence of the Enforcement of U.S Securities Laws*, 6 EUR. COMP. & FIN. L. REV. 164 (2009).

110. See Jill E. Fisch, *Confronting the Circularity Problem in Private Securities Litigation*, 2009 WISC. L. REV. 333 [hereinafter Fisch, *Circularity Problem*].

111. *See* TOM BAKER & SEAN GRIFFITH, ENSURING CORPORATE MISCONDUCT 134–36 (2010); *see also* James J. Park, *Shareholder Compensation as Dividend*, 108 MICH. L. REV. 323 (2009).

112. *See* Michael Klausner et al., *How Protective is D&O Insurance in Securities Class Actions—An Update*, 26 PLUS J., May 2013.

While this argument has substantial traction, the main counterpoint is that the injuries are real when investors trade at distorted prices, and the injuries simply cannot be assumed away by hoping that the victims will make up their losses elsewhere.[113] Fraud causes injury to everyone who trades at a distorted price regardless of whether there was psychologically meaningful reliance—this is essentially the idea that Justice Brennan was pushing on Justice Blackmun. One can then add on the deterrence argument: price distortion is a social harm with many serious externalities,[114] and it must be policed. The fraud-on-the-market class action is put forth by its proponents as practically necessary, if not conceptually clean, for achieving both of these objectives.[115] I tend to agree.

In this debate, two less familiar points are worth making about price distortion. In theory, plaintiffs should only recover the amount the price was distorted by at the time of the fraud (the conventional out-of-pocket measure), so long as the truth was revealed before a plaintiff unwound its position. But for a variety of reasons, litigants and courts long ago shifted focus from price distortion to corrective disclosure as the key to damages.[116] *Dura Pharmaceuticals v. Broudo* solidified this by stressing loss causation, making corrective disclosure even more central to the assessment of plaintiffs' injuries.[117] As we have seen, this has made a mess of loss causation and damage measurements, and has inspired the procedural moves designed to weed out the speculative cases early on.

Ironically, in the aforementioned Blackmun–Brennan correspondence, Blackmun said that, while he wanted to avoid any discussion of damages in the *Basic* opinion, he agreed that the strict out-of-pocket measure (which Brennan saw as the necessary corollary to his "price reliance" approach[118]) made more sense than a

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113. *See* Thomas A. Dubbs, *A Scotch Verdict on "Circularity" and Other Issues*, 2009 WIS. L. REV. 455; *see also* Goldberg & Zipursky, *supra* note 9; Fisch, *Circularity Problem*, *supra* note 110; Cox & Thomas, *supra* note 109.

114. *See* Urska Velikonja, *The Costs of Securities Fraud*, 54 WM. & MARY L. REV. 1887 (2013).

115. For a critique on the value-added deterrence from private litigation, see Amanda Rose, *The Multienforcer Approach to Securities Fraud Deterrence: A Critical Analysis*, 158 U. PA. L. REV. 2173 (2010). For evidence of a deterrence effect, see Jared Jennings et al., The Deterrence Effect of SEC Enforcement and Class Action Litigation (Aug. 10, 2011) (unpublished manuscript), *available at* http://www3.nd.edu/~carecob/Workshops/11-12Workshops/Rajgopal%20Paper.PDF (class actions cause more compliant behavior by peer firms of those targeted); *see also* Brian McTier & John Wald, *The Causes and Consequences of Securities Class Actions*, 17 J. CORP. FIN. 649 (2011).

116. The key step here came when courts abandoned a strict out-of-pocket measure in favor of a modified one that used the corrective disclosure date as a baseline for computing damages, thereby making it closer to a rescission remedy. *E.g.*, Harris v. Am. Inv. Co., 523 F.2d 220, 226 (8th Cir. 1975), *cert. denied*, 423 U.S. 1054 (1976).

117. 544 U.S. 336, 345–46 (2005).

118. Letter from Harry Blackmun, U.S. Supreme Court Justice, to William Brennan, U.S. Supreme Court Justice 2 (Jan. 25, 1988) (on file with author) ("I had not thought the opinion supported an argument for receiving the merger price . . . an argument we both agree is largely implausible, but because it has not been briefed or discussed, we should not presume to reject it out of hand here"); *see also* Letter from William Brennan, U.S. Supreme Court Justice, to Harry Blackmun, U.S. Supreme Court Justice (Jan. 27, 1988) (on

recessionary one that would give the full-merger value to the former Basic shareholders.[119] Had this impression made its way into the *Basic* opinion, the history of loss causation and the emphasis on corrective disclosure under Rule 10b-5 might have taken a completely different turn. Only price distortion would have been important.

Halliburton II now makes proof, or absence of, price impact a key step in the litigation process; this step occurs early on and before a judge. But what is this inquiry, really? My sense from the oral argument is that the Justices seemed to think that event studies are a clean and simple way to answer the narrow and specific distortion question.[120] Sadly, that is far from so. We have already seen the challenge when an alleged lie effectively lulls investors into thinking that nothing has changed about the company's fundamentals, when change is indeed occurring.[121] We will see how courts approach this and other conceptual challenges, hopefully remembering that the burden is clearly on the defendants and that the task is simply to estimate whether there was price impact or not, not to quantify the extent of the distortion (which is usually a much harder task). Event studies may help, but there is no reason in the class certification inquiry to limit evidence to those, especially in "confirmatory lie" cases. Courts should be open to all probative evidence on that question—qualitative as well as quantitative—aided by a good dose of common sense.[122] If the facts at issue appear to be material, one can fairly presume that their misrepresentation or omission would necessarily distort the market price unless the market somehow already knew the truth.[123] The latter is entirely possible under the right circumstances, but it is the defendants' burden to show.

No doubt defendants will push against this, trying to fit into the evidentiary hearing on impact nearly the entirety of their merits defenses. After all, price distortion is the difference between the price that prevailed and the price had there been no fraud (that is, had the truth been told). So is it open to defendants at class certification to argue that the company told what it believed to be the truth, so that therefore there was no price distortion?[124] That, of course, is the heart of the merits,

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file with author) ("[I]f [there is no rebuttal and] the measure of damages is ultimately resolved as the difference between the price actually received and the price that would have been received had the market been fair, my view and your view will lead to identical results, although by somewhat different routes.").

119. *Id.*

120. Oral Argument, Halliburton Co. v. Erica P. John Fund, Inc., 134 S. Ct. 2398, 2407–13 (2014), *available at* http://www.supremecourt.gov/oral_arguments/audio/2013/13-317.

121. *See supra* note 44 and accompanying text.

122. For a description of the modern quantitative toolkit, which is by no means limited to event studies, see Bebchuk & Ferrell, *supra* note 43. *See also* Esther Bruegger & Frederick Dunbar, *Estimating Financial Fraud Damages with Response Coefficients*, 35 J. CORP. L. 11 (2009).

123. This would resemble the separate presumption created to address reliance in *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972).

124. Imagine, for example, that plaintiffs allege two confirmatory lies that prevented the market from reflecting the truth about the issuer's prospects. Defendants' merits defense is that at the time those disclosures were made, there was no corporate scienter (i.e., the disclosures, even if inaccurate, were made in good faith). A stock price drop occurs later

and something no econometrician could possibly address. There is no indication that the Court contemplates this, but given the centrality of price distortion, defendants will presumably seek as capacious a scope to it as possible.

Indeed, this may well expose an underappreciated counterfactual difficulty about the nature of securities fraud in the first place.[125] Securities regulation imposes only a limited duty on issuers and their managers to reveal the truth—much can lawfully be concealed if the issuer prefers, especially with respect to forward-looking information. That is a central point made in *Basic*. However, *if* the issuer chooses to comment on a matter, it must do so truthfully.[126] Hence there is a large category of cases where it is ambiguous what is meant by comparing the price that prevailed at the time of the fraud with the price that would have prevailed in the absence of the fraud. Is it the world where there simply was no lie or half-truth (but in which the issuer could have kept quiet about the truth) or are we assuming a (legally non-existent) duty to reveal everything? This is a very tricky inquiry, but note that investors deserve little or no recovery for reliance on price integrity when the former is the right way of posing the question.

Imagine, for example, a company that falsely states that things are going smoothly for its flagship product when they really are not. If the market price was $20 per share at the time, such an announcement would have little effect on the price to the extent that the information just confirms prior market expectations. Had the truth been told, assume that the price would have dropped to $15. Should post-fraud purchasers receive $5 per share? Only if we are confident that the right counterfactual is revelation of the truth. If the more plausible counterfactual is instead that the issuer chose (lawfully) to stay silent, those purchasers would presumably have paid $20 for the stock even absent the fraud, and thus suffered no real economic harm. In other words, the assumption that there are causal losses to purchasers or sellers whenever there are material lies or omissions is not necessarily true. Whenever the issuer had no legal duty to reveal the truth, harm follows only when the effect of the lie or half-truth was to prevent discovery of the truth. As tricky and important as this inquiry is,[127] it is ignored entirely by contemporary doctrine, which simply assumes the truth-telling counterfactual by focusing solely on the market effects associated with discovering the truth later on. In sum, we cannot say as confidently as we do that fraud necessarily means investor injury in a setting that presumes reliance on "price integrity."[128]

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on, but defendants claim that this was a result of a prompt revelation of the truth when company officials learned it. Perhaps that is what Justice Ginsburg was getting at in her concurring opinion, which raised the possibility of the need for limited discovery in sorting through all the relevant price impact issues at class certification.

125. *See* Donald C. Langevoort, *Compared to What? Econometric Evidence and the Counterfactual Difficulty*, 35 J. CORP. L. 183 (2009).

126. Basic Inc. v. Levinson, 485 U.S. 224, 240 n.17 (1988).

127. It is of course hard to think through whether the company would have been able to stay silent on a matter in the face of shareholder, analyst, and financial press scrutiny. Typically, the half-truth is designed to throw these groups off their guard.

128. This, of course, is in addition to any doubts that we may have based on the possibility of sentiment-driven overreactions to disclosures. *See* Langevoort, *Animal Spirits*, *supra* note 3; Cornell & Rutten, *supra* note 99, at 463–68.

CONCLUSION

In his dissent in the *Amgen* case, which very much foreshadowed his dissenting concurrence in *Halliburton II*, Justice Thomas traced the history of the fraud-on-the-market theory prior to *Basic* by reference to two "signposts,"[129] one of which was the seminal Ninth Circuit case of *Blackie v. Barrack* in 1975.[130] This was a fruitless effort in terms of reading *Blackie* to say that materiality was crucial to class certification—it holds no such thing—but also ironic. *Blackie* justified the fraud-on-the-market presumption entirely in pragmatic terms. While it expresses an intuition about organized markets and the importance of price integrity, the main idea is simple: without class certification there will be no practicable mechanism to address demonstrable harm from securities-fraud.[131] Candidly admitting that its approach risked overinclusion in the plaintiff class, the court reminded its readers that the securities statutes were to "be liberally construed to effectuate its remedial purposes, and that that purpose may be served only by allowing an overinclusive recovery to a defrauded class if the unavailability of the class device renders the alternative a grossly underinclusive recovery."[132]

Basic starts out saying much the same thing, stressing that presumptions exist mainly to do justice, but then wanders into the efficient markets discussion as if it offers a better way of understanding reliance in modern financial markets. It doesn't, generating the uncertainty about class certification that eventually led to *Amgen* and *Halliburton I* & *II*. *Blackie*'s argument was always the better one, and the fraud-on-the-market theory would have been on more solid ground (if no less controversial) had that reasoning prevailed.

Today the Supreme Court is no longer enamored with the "liberally construed" rhetoric,[133] which naturally invites those dissatisfied with how things have turned out to question the premises on which the fraud-on-the-market presumption rests. Still, as a result of *Halliburton II*, *Basic* lives on. To the Chief Justice and his majority, fundamental changes to the availability of class action relief for alleged securities fraud should be legislative (and hence political), not judicially wrought. By situating the issue as one of stare decisis—and thus triggering something of a light-touch rational basis review of *Basic*—the Court's opinion will hardly satisfy those who, like the dissenters, find *Basic*'s reasoning contrived and its failure to take on the hard policy issues underlying securities class actions frustrating.

Along with others,[134] my work was cited repeatedly in Justice Thomas's concurring dissent in *Halliburton II*, and I concede that I still find the reliance narrative in both *Basic* and *Halliburton II* puzzling and not particularly persuasive, for many of the reasons Thomas points out. Yet I think Thomas's ultimate

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129. 133 S. Ct. 1184, 1213–14 (2013).

130. 524 F.2d 891 (9th Cir. 1975).

131. *Id.* at 907.

132. *Id.* at 906 n.22.

133. *See* A.C. Pritchard, *Launching the Insider Trading Revolution:* SEC v. Capital Gains Research Bureau, *in* RESEARCH HANDBOOK ON INSIDER TRADING 33, 50–51 (Stephen M. Bainbridge ed., 2013).

134. Particularly work by Jim Cox and Lynn Stout.

conclusion is wrong, and that keeping *Basic* in place was the right thing to do, both legally and conceptually. My view is ultimately much closer to Justice Brennan's, who worked hard behind the scenes many years ago to articulate an approach to fraud-on-the-market that had little or nothing to do with reliance (for more conservative readers, substitute Easterbrook and Fischel). We would be better off had he succeeded. As Brennan, Easterbrook, and Fischel saw, however, the expansive approach to who can recover needs to be balanced with caution about the total size of the recovery, to avoid the bias toward overcompensation that characterizes the current doctrinal framework. All of this has long suggested that Congress should revisit the entire remedial approach in the fraud-on-the-market setting, enabling private litigation but making it more clearly a deterrence-based mechanism.[135] Whether Congress is inclined toward a sensible, balanced approach to the serious problem of securities fraud is in doubt, however.

In the meantime, we will have to wait and see how lower courts react to the many possible implications of *Amgen* and *Halliburton II*. While it need not (and probably should not) be, the price distortion inquiry may well turn to be another thicket where polarized views about the desirability of fraud-on-the-market continue to affect outcomes. The game of whack-a-mole plays on.

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135. *See* Donald C. Langevoort, *Capping Damages for Open Market Securities Fraud*, 38 ARIZ. L. REV. 639 (1996); Donald C. Langevoort, *Reading* Stoneridge *Carefully: A Duty Based Approach to Reliance and Third Party Liability Under Rule 10b-5*, 158 U. PA. L. REV. 2125 (2010); *see also* Janet Cooper Alexander, *Rethinking Damages in Securities Class Actions*, 48 STAN. L. REV. 501 (1996). There are many possible approaches, from damage caps or disgorgement measures to what is effectively a *qui tam* procedure. As suggested earlier, much judicial misunderstanding could have been avoided had *Basic* endorsed a strict price distortion approach to damages, as both Justices Blackmun and Brennan seemed to want. But unwinding the post-*Dura* loss causation to get to that simple approach would, at this point, be very hard.