No. 13-317

IN THE

Supreme Court of the United States

HALLIBURTON CO. AND DAVID LESAR,

Petitioners,

v.

ERICA P. JOHN FUND, INC., FKA ARCHDIOCESE OF MILWAUKEE SUPPORTING FUND, INC.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AND NATIONAL ASSOCIATION OF MANUFACTURERS AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

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INTEREST OF *AMICI CURIAE*[1]

Amici curiae are the Chamber of Commerce of the United States of America (the "Chamber") and the National Association of Manufacturers (the "NAM"). Both have a significant interest in the interpretation and enforcement of the federal securities laws and in the rules governing class actions in private securities litigation.

The Chamber is the world's largest business federation. It represents approximately 300,000 direct members and indirectly represents the interests of more than three million companies and professional organizations of every size, in every industry sector, and from every region of the United States. The Chamber's members transact business in countries around the world. An important function of the Chamber is representing its members' interests in matters before Congress, the Executive Branch, and the courts. The Chamber actively participates as *amicus curiae* in various class-action appeals, including recently in this Court.

The NAM is the preeminent association of U.S. manufacturers and the largest industrial trade association in the country. Its members include more than 12,000 manufacturing companies, and it represents the interests of small and large manufacturers in every industrial sector and in all 50 States. The NAM regularly participates as

1. All parties were timely notified of *amici*'s intent to file this brief and have consented to this filing in letters on file with the Clerk of the Court. No counsel for a party has authored this brief in whole or in part, and no person other than *amici*, their members, and their counsel has made a monetary contribution to the preparation or submission of this brief. *See* Sup. Ct. R. 37.

amicus curiae in cases raising issues that affect the ability of U.S. manufacturers to stay competitive, promote economic growth, and create jobs.

The Chamber and the NAM have a keen interest in this case because private securities class action litigation puts a significant burden on American businesses and adversely affects access to capital markets. Experience with the application of *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), in the lower courts shows that the fraud-on-the-market theory approved in *Basic* has inflicted tremendous costs on public companies and their shareholders without producing corresponding benefits to investors. Recognizing the economic drag engendered by frivolous securities fraud litigation, Congress passed the Private Securities Litigation Reform Act of 1995 ("PSLRA"), Pub. L. 104-67, 109 Stat. 737, "to curb abusive securities-fraud lawsuits." *See Amgen Inc. v. Conn. Ret. Plans & Trust Funds*, 133 S. Ct. 1184, 1201 (2013). However, Congress in the PSLRA did not address the relationship between Rule 23 of the Federal Rules of Civil Procedure and the judicially created presumption of reliance endorsed in *Basic*. *See* 133 S. Ct. at 1212 n.9 (Thomas, J., dissenting). The present case offers a timely and well-suited opportunity for this Court to revisit the basis for the presumption and its interaction with the class certification procedure.

SUMMARY OF ARGUMENT

The Court should grant the petition for a writ of certiorari and reconsider the fraud-on-the-market theory endorsed in *Basic Inc. v Levinson*. The Court should also grant review on the second question presented in the

Petition and resolve the division that exists in the courts of appeals over whether a defendant in a securities fraud suit may rebut *Basic*'s presumption of reliance at the class certification stage and defeat class treatment with evidence that the alleged misrepresentation did not impact the market price of the stock at issue.

Basic endorsed the use of the fraud-on-the-market theory as a means of establishing the reliance element in a securities fraud class action, but, as the dissent feared, *Basic*'s approach has generated doctrinal confusion as courts struggle to apply the framework consistently. Moreover, the approach courts have taken to the fraud-on-the-market theory has provided securities fraud plaintiffs with a free pass to class certification in many cases, leading to excessive litigation and *in terrorem* settlements. This excess of securities class action litigation has inflicted a tremendous drain on U.S. public companies and their investors, both through the costs of litigation and settlements and through insurance costs associated with carrying securities fraud insurance. For all these costs, the securities fraud framework employed following *Basic* has not brought material benefits to investors; it has simply resulted in the shift of money from one set of investors to another.

The Court should revisit *Basic* and reconsider the fraud-on-the-market doctrine, which has bred confusion in the courts and resulted in significant costs to investors and businesses. The rebuttable presumption of reliance endorsed in *Basic* is a judicially created procedural device designed to facilitate class-wide proof of an element of a claim that itself arises from a judicially inferred private right of action. The policy considerations on which this

procedural device is based are subject to the Court's reconsideration, and the inconsistent application of the doctrine in the lower courts ensures that no significant reliance interests will be at stake in this reconsideration. Further, *Basic* arose out of a judicial interpretation of economic theory (the efficient-market hypothesis) that has been called into serious doubt by subsequent economic studies. By granting certiorari, the Court can consider whether and, if so, to what extent *Basic*'s presumption should survive in light of the significant developments that have occurred since 1988 in our understanding of how markets operate.

The Court should also grant certiorari to resolve the circuit split regarding the use of price impact evidence to defeat class certification in securities fraud cases. The Fifth Circuit below, in contrast to the approach taken by the Second and Third Circuits, prohibited the use of price impact evidence at the class certification stage to rebut the fraud-on-the-market presumption of reliance. Rebutting the presumption with a showing that the alleged misrepresentation did not actually impact the stock's trading price would establish that reliance cannot be proven on a class-wide or common basis for all plaintiffs and would therefore mean that individual questions of reliance will predominate, thus defeating class treatment. Prohibiting the defendant from making that showing can effectively determine the outcome of securities litigation by giving plaintiffs a ready-made path to class certification and settlement. In concluding that price impact evidence could not be presented, the Fifth Circuit applied logic that would lead to inconsistent results if applied to other types of evidence—for example, evidence regarding publicity of disclosures. The Fifth Circuit's approach also stands

at odds with the approach the Second Circuit has used successfully for years. This Court should grant review to resolve the split and determine whether the Fifth Circuit erred in concluding that petitioners could not introduce price impact evidence at the class certification stage.

ARGUMENT

I. The Court Should Grant Certiorari to Overrule or Modify the Presumption of Reliance Endorsed in *Basic Inc. v. Levinson*

As Congress recognized with the passage of the PSLRA, the presumption of reliance endorsed in *Basic* has enabled a wave of frivolous class action litigation that bears little relation to any underlying culpability and that is all-too-often aimed only at extracting large settlements from insured businesses by the threat of class-wide damages. Despite the Court's assurance in *Basic* that the presumption of reliance is supposed to be "rebuttable," and notwithstanding the securities fraud pleading reforms enacted in the PSLRA, many lower courts continue to apply *Basic* in a manner that allows plaintiffs to make what is effectively an *irrebutable* showing of fraud-on-the-market to obtain class certification under Rule 23. With easy, virtually guaranteed class certification, strike suits continue, bringing more harm than benefit to the shareholders whose interests the securities laws were intended to serve.

The Court should therefore revisit *Basic* and reconsider whether plaintiffs may satisfy Rule 23(b)(3) with respect to the reliance element of a securities fraud claim based merely on a showing that they traded stock

in a "well-developed" market around the time of the alleged public misrepresentations. In its opinion below, the Fifth Circuit applied this Court's decision in *Amgen Inc. v. Connecticut Retirement Plans & Trust Funds*, 133 S. Ct. 1184 (2013), to hold that the *Basic* presumption is effectively irrefutable for class certification purposes. This case exemplifies how *Basic* has spawned wasteful litigation founded on unquestioned adherence to a court-sanctioned efficient-market theory that today's economists increasingly reject.

A. *Basic*'s fraud-on-the-market presumption has generated excessive costs for businesses and harmed capital markets.

Basic permits plaintiffs a rebuttable presumption to establish the reliance element of a securities fraud lawsuit brought under the implied private right of action of section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and SEC Rule 10b-5, 17 C.F.R. § 240.10b-5.[2] While plaintiffs were traditionally required to prove reliance in fraud cases with evidence that they were personally aware of the alleged material misrepresentation and specifically acted on it, *Basic* substituted for the traditional showing of reliance the presumption that the market price of any stock that is traded in "an impersonal, well-developed market for securities" "reflects all publicly available information," including "any material misrepresentations," and that

2. A Rule 10b-5 claim requires proof of: (1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance by the plaintiff on the misrepresentation or omission; (5) economic loss; and (6) loss causation. *Amgen*, 133 S. Ct. at 1192.

investors who buy or sell the stock in such a market intrinsically do so "in reliance on the integrity" of the stock's market price. *Basic*, 485 U.S. at 246-47; *see Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179, 2186 (2011). To gain the benefit of this rebuttable presumption on the merits of a securities fraud claim, a plaintiff must show that: (1) the defendant's alleged misrepresentation was made publicly; (2) the alleged misrepresentation was material; (3) the relevant security traded in an efficient market;[3] and (4) the plaintiff traded in the security between the time when the alleged misrepresentation was made and the time when the truth was revealed. *See* 485 U.S. at 248 & n.27. Essentially, the *Basic* doctrine entitles plaintiffs to rely on the market price of any security traded in a market that a court determines was "efficient." *See* Donald C. Langevoort, Basic *at Twenty: Rethinking Fraud on the Market*, 2009 Wis. L. Rev. 151, 160, 171 (2009).

Establishing the predicate for application of the fraud-on-the-market theory is the ticket to class certification for most plaintiffs in securities fraud suits because it enables common, class-wide proof of reliance, an element of the securities fraud claim that would otherwise require individualized proof inconsistent with class treatment. *See Basic*, 485 U.S. at 242. However, as a result of this Court's recent holding in *Amgen* that plaintiffs need not prove materiality at the class certification stage, plaintiffs

3. Under *Basic*, there are multiple factors courts consider in determining whether the relevant stock was traded in an "efficient market," with one typical factor being whether information about the stock was both widely available and rapidly and accurately reflected in the stock price. *See Cammer v. Bloom*, 711 F. Supp. 1264, 1276 n.17, 1281 (D.N.J. 1989) (citing *Basic*, 108 S. Ct. at 991 & n.24).

now may obtain class certification based on the *Basic* presumption of reliance by establishing only three of the four requirements for fraud-on-the-market: (1) publicity, (2) market efficiency, and (3) trade timing. *See Amgen*, 133 S. Ct. at 1199.

The direct result of *Basic* (now compounded by *Amgen*) is that plaintiffs claiming securities fraud obtain class certification as a matter of course in nearly any case where the relevant security was traded in large volumes on an established exchange—requirements that are easily met for the stock of most large companies. *See, e.g.*, *In re Merck & Co., Inc. Sec., Derivative & ERISA Litig.*, MDL No. 1658, 2013 WL 396117, at *11 (D.N.J. Jan. 30, 2013) (declining to consider defendant's challenge to market efficiency because Merck stock trades on the NYSE and is one of the stocks in the Dow Jones Industrial Average). Even before this Court's decisions in *Amgen* and *Erica P. John Fund*, when courts at times permitted defendants to contest materiality or loss causation at the class certification stage, 75 percent of decided certification motions in securities litigation resulted in certification of a class. *See* Renzo Comolli et al., NERA Economic Consulting, *Recent Trends in Securities Class Action Litigation: 2012 Full-Year Review* 20 (2013) (examining 2000 to 2012), http://www.nera.com/nera-files/PUB_Year_End_Trends_1.2013(2).pdf; *see also Schleicher v. Wendt*, 618 F.3d 679, 682 (7th Cir. 2010) (noting that plaintiffs need not establish loss causation or materiality at class certification and describing the process as "routine" when a suitable class representative comes forward).

Basic's presumption therefore subjects businesses to the serious prospect of frivolous strike suits using

easily obtained class certification as a threat to extract settlement. This Court has recently noted the extent to which improper class certification perversely pressures defendants to settle even meritless lawsuits. *See AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1752 (2011) (class actions create risk of *in terrorem* settlement); *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta*, 552 U.S. 148, 164 (2008) ("[E]xtensive discovery and the potential for uncertainty and disruption in a lawsuit allow plaintiffs with weak claims to extort settlements from innocent companies.").

Indeed, when the Second Circuit in 2008 rejected a defendant's concern that "any person who posts material misstatements about a company on the internet could end up a [securities fraud] defendant," it did so based on the belief that "the law guards against a flood of frivolous or vexatious lawsuits," because, prior to class certification, (1) plaintiffs must show materiality, (2) defendants may rebut the presumption of fraud-on-the-market by showing absence of price impact, and (3) forward-looking statements of prediction or opinion are not actionable under the securities laws. *See In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474, 484 (2d Cir. 2008). The first safeguard identified by the Second Circuit has since been eliminated by the holding in *Amgen*, and the second is now threatened by opinions like the Fifth Circuit's in this case.

Without the safeguards at class certification of inquiry into materiality or price impact, settlement is the only reasonable option for many securities fraud defendants. As is true in other class action settings, virtually no securities fraud cases are tried to verdict, with more than

50 percent of filed cases leading to settlement in recent years and almost all the rest resolved by motions before trial.[4] Indeed, studies have found that settlements often have more to do with the defendant's insurance limits than with the strength of plaintiffs' claims. *See Schleicher*, 618 F.3d at 686 (citing studies). The necessity, and therefore the prevalence, of insurance against securities fraud cases puts defendants in a position where settlement is their only reasonable option.

Plaintiffs' choices of defendants likewise often have little to do with the merits. While the Court inferred a private right of action from SEC Rule 10b-5 based on the perceived need for securities fraud suits to provide a remedy for investors who were victims of fraud, securities class actions have been filed generally following almost any kind of negative announcement by a company that corresponds to a decline in the stock price. Statistics on the filing of class action securities fraud lawsuits from the Stanford Law School Securities Class Action Clearinghouse ("Stanford Clearinghouse") demonstrate that class action suits often target particular industry sectors, in many cases ensnaring a large portion of the publicly traded companies in a given industry.[5] For example, in 2010, new securities fraud class actions were

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4. *See* Stanford Law School Securities Class Action Clearinghouse & Cornerstone Research, *Securities Class Action Filings: 2013 Mid-Year Assessment* 15-17 (2013) ("Stanford Clearinghouse") (demonstrating resolution statistics by case lifecycle, showing that in 2006, the most recent year for which all cases are completed, 57% of filed cases settled), http://securities.stanford.edu/clearinghouse_research/2013_YIR/Cornerstone-Research-Securities-Class-Action-Filings-2013-MYA.pdf.

5. *See* Stanford Clearinghouse at 8.

filed against 5.4 percent of S&P 500 companies, but the figures were 15.4 percent for health care companies, 10.3 percent for financial companies, and 7.7 percent for energy companies. *Id.*[6] These lawsuits do not only target the largest companies; securities suits increasingly target companies with smaller market capitalizations, including companies that are not traded on the major exchanges. *See id.* at 14.

These suits impose a tremendous cost on American business. For example, per the Stanford Clearinghouse, securities fraud class actions led to $2.9 billion in settlements in 2012, with the average settlement at $54.7 million.[7] As they drag on, these cases generate tremendous litigation expenses as well, with a median time to settlement of 3.3 years and approximately 19 percent of cases taking more than 5 years. *Id.* at 6 (examining cases settled from 2007-2011). Defense costs in these cases have been estimated to range from 25 to 35 percent of the settlement value. *See* John C. Coffee, *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 Colum. L. Rev. 1534, 1546 (2006). Costs are borne not only by those companies sued but by public companies in general, as the prevalence of insurance spreads costs through companies that access capital

6. Because securities fraud cases can take multiple years to resolve, the filing of a significant number of cases against an industry in one year can mire that industry in litigation for years to come.

7. Stanford Clearinghouse & Cornerstone Research, *Securities Class Action Settlements: 2012 Review and Analysis* 3 (2013), http://securities.stanford.edu/Settlements/REVIEW_1995-2012/Settlements_Through_12_2012.pdf.

markets, hampering the competitiveness of American public companies against their rivals. Ultimately, investors themselves pay the costs of securities fraud litigation through lower returns on their investments.

These costs come without corresponding benefits. The *Basic* approach to securities fraud lawsuits was originally designed to give investors protection from fraud beyond that provided at common law, *see Basic*, 485 U.S. at 244 n.22, and to deter fraud. Yet, class actions built on the fraud-on-the-market presumption have brought neither protection for investors nor meaningful deterrence benefits. *See generally* William M. Bratton & Michael Wachter, *The Political Economy of Fraud on the Market*, 160 U. Pa. L. Rev. 69, 72-73 (2011). While the securities laws were not intended "to provide investors with broad insurance against market losses," *Dura*, 544 U.S. at 345 (citing *Basic*, 485 U.S. at 252 (White, J., dissenting)), they have in fact become an entitlement to a partial recovery of losses through settlement of class actions after stock declines.

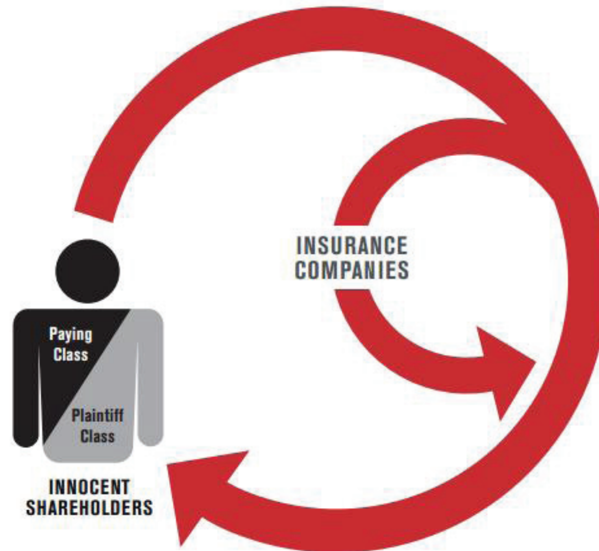
The *Basic* approach has failed to provide benefits to investors in part because of the circular nature of private securities fraud class actions. In the typical case, the putative class of investor plaintiffs purchased the defendant's stock during a period in which, they allege, the price was inflated due to the defendant company's misrepresentations. Thus, the class of purchasing shareholders seeks recovery from all current shareholders, whose equity interests in the defendant company are negatively affected by the company's cost of defending the litigation, as well as any resulting increase

in the company's insurance premiums. The shareholders who (innocently) benefited from the alleged fraud by selling their shares during the period of inflated price are out of the scene, so any costs incurred by the company will impact the shareholders who are not only innocent but also could not have benefited from any fraud.

Any recovery the class obtains from the company is just a transfer of wealth from one set of innocent shareholders to another, with significant litigation costs incurred in between. While individual executives are often named as defendants, they in fact pay virtually nothing when so included.[8] They are sued for their insurance coverage, the costs of which are then spread across public companies in general:

8. *See* Donald C. Langevoort, *Capping Damages for Open-Market Securities Fraud*, 38 Ariz. L. Rev. 639, 648 n.43 (1996) ("[I]n the average settlement, 68.2% comes from the insurer and 31.4% from the issuer, with only 0.4% coming from individual defendants.") (citing Frederick C. Dunbar et al., Nat'l Economic Research Assocs., *Recent Trends III: What Explains Settlements in Shareholder Class Actions?* v (1995)).

Securities Fraud Class Actions – A Circular System[9]



The system seems even odder when one considers that most investors rely on portfolios of securities. To the extent undiscovered fraud inflates a stock price, the average investor is just as likely to be a buyer of shares, and thus an unwitting victim of such fraud, as they are to be a seller, and thus an unwitting beneficiary. *See* Bratton, *Political Economy*, *supra*, at 94-95. Because investors often own stock in diversified portfolios, they should gain about as much from undiscovered fraud as they should lose from it. Thanks to this dynamic, only a narrow set of

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9. Source: U.S. Chamber Institute for Legal Reform, *Securities Class Action Litigation: The Problem, Its Impact, and the Path to Reform* 16 (2008), *available at* www.instituteforlegal reform.com/get_ilr_doc.php?docId=1213.

fortunate investors in fact receives any corrective justice at all from the system of securities class actions. *See id.* at 94-99.

The costs of securities class action litigation do not even benefit capital markets by significantly deterring fraud. Academic literature has recognized that the social costs of private securities class actions have overwhelmed the modest amount of fraud deterrence they offer. *See id.* at 111-12. Recognizing this reality, in times of elevated concern about financial fraud, Congress and the Executive Branch have consistently looked to the Department of Justice and the Securities and Exchange Commission, not private litigation, to increase deterrence.[10] In addition, unlike in many other contexts, such as consumer fraud, large institutional investors provide a separate deterrence for securities fraud by frequently bringing non-class claims under the securities laws.

B. The Court should revisit *Basic* and reconsider the role that efficient-market theory may properly play in class certification.

As four members of the Court suggested in *Amgen*, the Court should revisit *Basic* to reconsider the role of the efficient-market theory in class certification. The decision has produced confusion in the lower courts, and recent scholarship has been highly critical of the economic

10. Thus, after this Court in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994), refused to recognize the cause of action for aiding and abetting securities fraud that many lower courts had implied, Congress expressly authorized such a cause of action by statute, but only for the SEC. *See* 15 U.S.C. § 78t(e).

assumptions underlying *Basic* when it was decided 25 years ago. Reconsideration of *Basic* will allow the Court to address the extent to which now-rejected economic assumptions have led to the development of unnecessarily costly litigation. Finally, there are no reasonably settled reliance interests or *stare decisis* concerns that militate against reconsideration of *Basic*, particularly as *Basic*'s presumption is a judge-made, common law doctrine.

1. Courts have struggled to apply the *Basic* framework in a consistent and coherent manner.

Just as Justice White predicted, *Basic*'s acceptance of the fraud-on-the-market theory has given rise to "[c]onfusion and contradiction in court rulings." *In re DVI Sec. Litig.*, 639 F.3d 623, 632-33 (3d Cir. 2011) (quoting *Basic*, 485 U.S. at 252 (White, J., concurring in part and dissenting in part)); *see also* Donald C. Langevoort, Basic *at Twenty*, *supra*, at 153-54 (discussing extent to which law following *Basic* "is confused, and in flux").

While the *Basic* Court did not "intend conclusively to adopt any particular theory of how quickly and completely publicly available information is reflected in market price," 485 U.S. at 249, most courts following *Basic* assume that once a market is labeled "efficient," all prices in that market will reflect all publicly available information at all times. *See, e.g.*, *In re DVI Sec. Litig.*, 639 F.3d at 631 ("The Supreme Court appears to have endorsed the semi-strong version of the efficient capital market hypothesis.") (citing *Schleicher v. Wendt*, 618 F.3d 679, 685 (7th Cir. 2010); *In re Polymedica Sec. Litig.*, 432 F.3d 1, 10 n.16 (1st Cir. 2005)). Courts applying *Basic* have exhibited a binary approach

to market efficiency by either deeming a market to be "efficient" as a matter of law—so that all information is treated as incorporated into the prices of the securities traded in the market—or concluding that the market at issue is "inefficient." The binary approach forces courts into awkward line-drawing, both in determining whether a market qualifies as efficient and in establishing the consequences of that determination. *See, e.g.*, *In re DVI Sec. Litig.*, 639 F.3d at 635 (holding that while "we have held that a market is inefficient when a price does not decrease within four days following an alleged corrective disclosure," a market can be efficient where the price took two days to move); Langevoort, Basic *at Twenty*, *supra*, at 174-75.

2. Subsequent economic studies of how markets function have called into question *Basic*'s binary approach to market efficiency.

Basic rested on an understanding of market efficiency that modern economic understanding has called into question. *See Amgen*, 133 S. Ct. at 1204 (Alito, J., concurring) (citing Langevoort, Basic *at Twenty*, *supra*, at 175-76), 1209 n.4 (Thomas, J., dissenting). *See generally* Donald C. Langevoort, *Taming the Animal Spirits of the Stock Markets: A Behavioral Approach to Securities Regulation*, 97 Nw. U. L. Rev. 135 (2002).

Basic assumed investors were justified in relying on market prices because "the market [acts] as the unpaid agent of the investor, informing him that given all information available to it, the value of the stock is worth the market price." *Basic*, 485 U.S. at 244 (quoting *In re*

LTV Sec. Litig., 88 F.R.D. 134, 143 (N.D. Tex. 1980)), 246 (stating that "[r]ecent empirical studies have tended to confirm" this premise). Not only has economic thought evolved such that we now understand that the relationship between stock prices and market information is far more complex than *Basic* assumed, *see, e.g.*, Bradford Cornell & James C. Rutton, *Market Efficiency, Crashes, and Securities Litigation*, 81 Tul. L. Rev. 443, 466 (2006), but we also now understand that real investors most definitely do not uniformly believe in market efficiency or integrity, *contra Basic*, 485 U.S. at 246-47 ("'[I]t is hard to imagine that there ever is a buyer or seller who does not rely on market integrity.'") (quoting *Schlanger v. Four-Phase Sys.*, 555 F. Supp. 535, 538 (S.D.N.Y. 1982)). In fact, Congress has taken an approach in the securities fraud context that is inconsistent with the simple approach to market efficiency that underlay *Basic*. Out of a concern that markets may overreact following disclosure of fraud, Congress enacted as part of the PSLRA a cap on damages, *see* 15 U.S.C. § 78u-4(e), that limits damages where the relevant security "bounces back" from its drop. Such an approach is not consistent with *Basic*'s assumption that stock prices in an efficient market properly reflect all available information. *See* Stefan J. Padfield, *Who Should Do the Math? Materiality Issues in Disclosures that Require Investors to Calculate the Bottom Line*, 34 Pepp. L. Rev. 927, 969 n.260 (2007).

The Court should reconsider *Basic* to determine whether it remains appropriate to apply the fraud-on-the-market theory in light of developments since 1988 in the understanding of how markets function and the significant criticism scholars have directed at *Basic*'s simplistic approach to market efficiency.

3. Reconsideration of *Basic*'s presumption will not impair reasonable reliance expectations or implicate principles of *stare decisis*.

Reconsideration of *Basic* will not threaten reliance interests. In fact, the public already anticipates reconsideration of *Basic* following the suggestion of four members of the Court in *Amgen* that reconsideration may be appropriate. *See, e.g.*, Sean T. Carnathan, *Fraud-on-the-Market Theory Questioned*, Litigation News (June 12, 2003), http://apps.americanbar.org/litigation/litigationnews/top_stories/061213-fraud-on-the-market.html. Even prior to *Amgen*, developments in the Court's class action jurisprudence generated expectations that *Basic* could be subject to revision. *See, e.g.*, John C. Coffee, *"You Can't Just Get There From Here": A Primer on* Wal-Mart v. Dukes, 141 BNA Daily Labor Report I-1, at 3 (2011), *available at* http://www.americanbar.org/content/dam/aba/administrative/labor_law/meetings/2011/annualmeeting/002.authcheckdam.pdf. Potential litigants can have no settled expectation that *Basic*'s fraud-on-the-market framework will continue into the future unmodified.

Further, *stare decisis* does not weigh against revisiting *Basic*. *Basic*'s fraud-on-the-market approach arises not from statute or rule but rather from this Court's understanding of how markets worked in 1988. *See Basic*, 485 U.S. at 245 (describing presumptions, such as the fraud-on-the-market presumption, as "[a]rising out of considerations of fairness, public policy, and probability, as well as judicial economy"). The Court described itself as not endorsing the validity of the fraud-on-the-market

theory but merely determining whether it was proper for courts to allow the use of the theory as a means of creating a rebuttable presumption that the reliance element was satisfied. *Id.* at 242.

It would be appropriate and prudent for the Court to revisit that determination. While the Court in *Basic* anticipated that the fraud-on-the-market theory could be rebutted—for example, by evidence that a plaintiff in fact believed that a given security's stock price was distorted, *see id.* at 249—the dissent's concern that *Basic* would eviscerate the reliance element in securities fraud claims, *see id.* at 257-58 (White, J., concurring in part and dissenting in part), has come to pass. The determination that class certification can be obtained on a mere showing of trading in an efficient market around public, alleged misstatements eliminates the opportunity for defendants to rebut the reliance element for individual defendants, creating an entitlement to rely on market prices through "an act of juristic grace." *See* Donald C. Langevoort, Basic *at Twenty*, *supra*, at 161. Revisiting the wisdom of that "act of grace" is within the Court's appropriate role to determine the "contours of a judicially implied cause of action with roots in the common law." *See Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 345 (2005).

II. The Court Should Grant Review to Resolve the Circuit Split Regarding the Use of Price Impact Evidence at Class Certification to Rebut the *Basic* Presumption of Reliance

The Court should also take up the second question presented in the Petition to address the significant disagreement among the circuits over whether defendants

may introduce evidence of lack of price impact at class certification to rebut the *Basic* presumption of reliance. This circuit split is pronounced and involves an issue of great importance to the conduct of securities fraud litigation.

Lack-of-price-impact evidence can be relevant on the merits of a securities fraud claim to rebut the elements of materiality, statement publicity, or loss causation. *See* Pet. App. 13a-14a, 17a-18a. If permitted at the class certification stage, the same evidence could defeat a motion for class certification because the plaintiffs would be required to prove the element of reliance on an individualized basis, rather than through evidence common to the class. *See* Fed. R. Civ. P. 23(b)(3) (requiring that common questions of fact or law predominate for class treatment).

The Fifth Circuit below, like the Seventh Circuit in *Schleicher v. Wendt*, 618 F.3d 679 (7th Cir. 2010), held price impact evidence inadmissible at class certification, and instead treated such evidence as "based upon common evidence" in the analytical process employed in *Amgen*, such that "later proof of price impact will not result in the possibility of individual claims continuing." Pet. App. 19a. The court interpreted such evidence as an effort to show that the stock price "did not actually transfer the effects of the alleged fraud to a stock purchaser," which the court believed was foreclosed by *Amgen*. *Id.* at 15a. The Second and Third Circuits, in contrast, have allowed evidence of price impact at class certification to defeat the fraud-on-the-market presumption and thereby foreclose class treatment. *See In re DVI Sec. Litig.*, 639 F.3d 623 (3d Cir. 2011); *In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474 (2d Cir. 2008).

In applying *Amgen*, the Fifth Circuit asked two questions regarding the introduction of price impact evidence: (1) whether price impact evidence is common to the class, and (2) whether there is any risk that a later failure of proof on price impact could result in individual questions predominating. Pet. App. 16a-17a. Finding that price impact evidence was common to the class and that the defendants' successful demonstration of no price impact would undermine the loss causation element, the Fifth Circuit found price impact to be, like materiality in *Amgen*, inappropriate for consideration at class certification. *Id.* at 17a-18a.

The same logic applied by the Fifth Circuit to conclude that price impact belonged at the merits stage would likewise apply to any element—such as the publicity element of the fraud-on-the-market theory—for which a failure of proof would undermine loss causation. Yet this Court in *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541 (2011), rejected the view that an issue can be removed from consideration on a motion for class certification just because it is subject to common evidence and is a component of or bears upon the plaintiffs' claim on the merits. *Id.* at 2552 n.6 (pointing to market efficiency in securities fraud cases as a paradigmatic example). The Fifth Circuit also ignored the potential that plaintiffs may establish loss causation notwithstanding uncertainty about price impact; plaintiffs would have to do so, for example, in any case involving a security traded in a market not shown to be "efficient" in the *Basic* sense, *see, e.g.*, *WPP Luxembourg Gamma Three Sarl v. Spot Runner, Inc.*, 655 F.3d 1039, 1053 (9th Cir. 2011) (noting plaintiffs in securities fraud cases involving private companies generally seek to prove loss causation without analysis of price impact), *cert.*

denied, 132 S. Ct. 2713 (2012), or in any case where the alleged misrepresentation was not public, *see, e.g.*, *EP Medsystems, Inc. v. EchoCath, Inc.*, 235 F.3d 865, 871 (3d Cir. 2000) (plaintiff sufficiently alleged 10b-5 claim against publicly traded company even though plaintiff "d[id] not base its claim on public misrepresentations or omissions that affected the price of the stock").

District courts have routinely and successfully resolved factual disputes about price impact at the class certification stage. For example, since *In re Salomon Analyst Metromedia Litigation*, district courts in the Second Circuit have examined expert testimony, event studies, and market reports in determining whether plaintiffs have shown that an alleged misrepresentation impacted a security's price. *See, e.g.*, *Berks Cnty. Emp. Ret. Fund v. First Am. Corp.*, 734 F. Supp. 2d 533, 541 (S.D.N.Y. 2010) (denying class certification); *In re Sadia, S.A. Sec. Litig.*, 269 F.R.D. 298, 310-15 (S.D.N.Y. 2010) (granting certification); *In re Credit Suisse First Boston Corp. (Lantronix, Inc.) Analyst Sec. Litig.*, 250 F.R.D. 137, 143 (S.D.N.Y. 2008) (denying certification); *In re Monster Worldwide, Inc. Sec. Litig.*, 251 F.R.D. 132, 138-39 (S.D.N.Y. 2008) (granting certification).

This approach has the benefit of eliminating unnecessary litigation by preventing class certification in precisely those cases where plaintiffs will be unable to prove reliance through common evidence at trial. Nothing is served by deferring consideration of price impact to the merits stage of the litigation, since evidence of price impact rarely requires extensive discovery.

In contrast, by precluding defendants from introducing evidence of lack of price impact to rebut the presumption of reliance at the class certification stage, the Fifth Circuit's decision will have the perverse result of producing routine class certifications (and thus virtually inevitable large-figure settlements) in many cases where plaintiffs' claims would otherwise fail on the merits. The Fifth Circuit's approach leaves defendants in the odd position of being able to introduce evidence to rebut fraud-on-the-market reliance at class certification only so long as that evidence does not also resolve plaintiffs' claims on the merits. Such a framework could force district courts to permit rebuttal evidence at class certification only where the court concludes that the plaintiffs' claims will survive introduction of the evidence.

Such was not *Amgen*'s intent. The Court should grant certiorari to address the circuit split and clarify that *Amgen*'s holding regarding the rebuttal of the fraud-on-the-market presumption was limited to rebuttal evidence on the issue of materiality and does not foreclose consideration at the class certification stage of all evidence that may threaten the merits of plaintiffs' claims.

CONCLUSION

For the foregoing reasons, *amici curiae* urge the Court to grant the petition for a writ of certiorari.

Respectfully submitted,

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October 11, 2013