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PERSPECTIVES

A MAJOR VICTORY FOR INVESTORS: THE US SUPREME COURT'S DECISION IN *HALLIBURTON* PRESERVES THE STATUS QUO IN US SECURITIES LITIGATION

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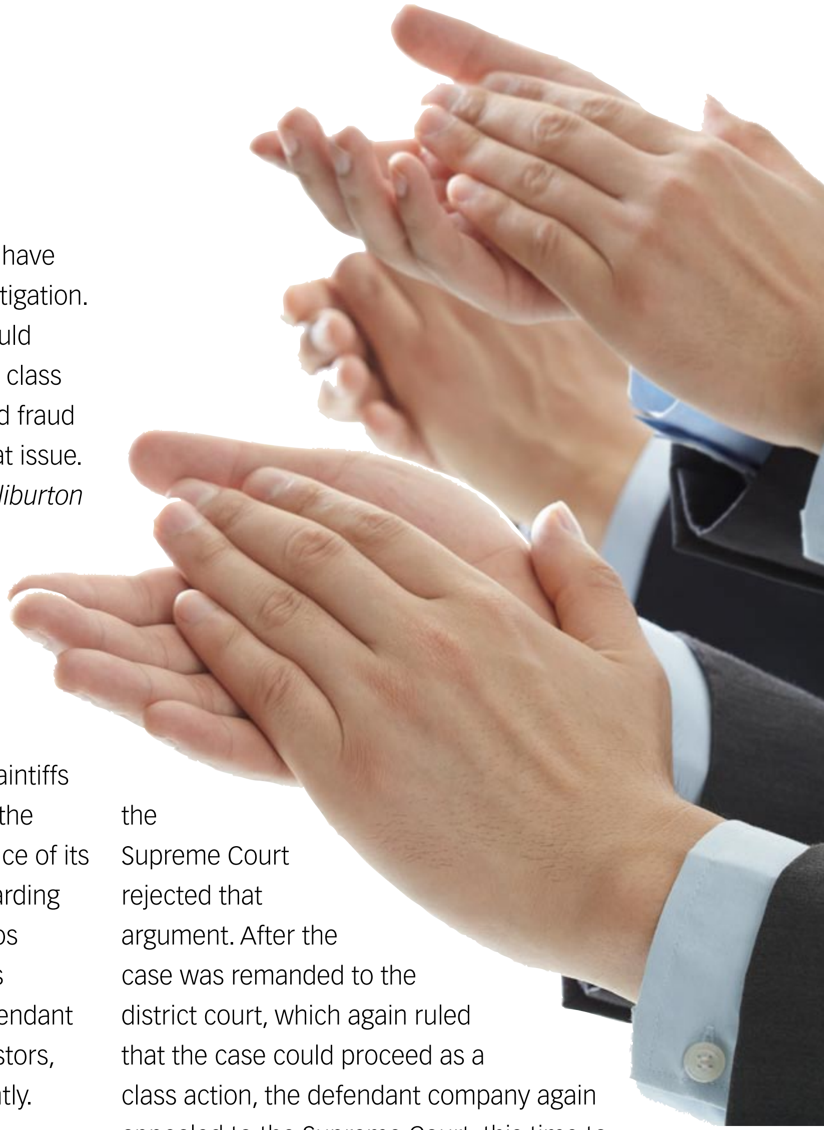
On 23 June 2014, the US Supreme Court issued an important decision in *Halliburton Co. v. Erica P. John Fund*, a case that tested the continuing vitality of the 'fraud on the market' presumption of reliance, one of the cornerstones of class action litigation under the US securities laws. The fraud on the market presumption is a legal presumption that all investors who buy or sell securities on public exchanges rely on the fact that the prices of those securities accurately reflect material public information about the company that issued those securities. In *Halliburton*, the Supreme Court rejected the defendant company's attack on the presumption. This was a major victory for



investors because a contrary decision would have drastically limited US securities class action litigation. However, the Court held that defendants should be permitted to rebut the presumption at the class certification stage by showing that the alleged fraud had no impact on the price of the securities at issue. Because the Supreme Court's decision in *Halliburton* is largely consistent with precedent from the Supreme Court and certain of the lower US federal courts, the decision will not have a significant impact on the US securities litigation landscape.

The relevant factual and procedural background of Halliburton. The *Halliburton* plaintiffs alleged that, in violation of US securities law, the defendant company artificially inflated the price of its stock by making material misstatements regarding certain costs and liabilities relating to asbestos exposure, and the purported benefits from its merger with another company. When the defendant company finally revealed the truth to its investors, the company's stock price dropped significantly.

After both a US district court and a federal appellate court agreed that the case should be certified as a class action, the defendant company made two appeals to the Supreme Court. In its first such appeal, the defendant company argued that securities plaintiffs are required to establish the substantive element of 'loss causation' at the class certification stage of the case in order to invoke the fraud on the market presumption. In a 2011 decision, the Supreme Court rejected that argument. After the case was remanded to the district court, which again ruled that the case could proceed as a class action, the defendant company again appealed to the Supreme Court, this time to challenge the fraud on the market presumption.

The fraud on the market presumption of reliance. As with common law fraud claims, in order to prevail on US statutory securities fraud claims (i.e., claims under the US Securities Exchange Act of 1934), a plaintiff must establish that it relied on the alleged misstatements. However, as the Supreme Court recognised in its seminal 1988 decision in *Basic* *v. Levinson*, requiring securities plaintiffs to prove direct reliance on a class-wide basis is an unrealistic burden in practice because what investors consider when investing in a company's securities can be argued to be quite specific as to each individual investor. Therefore, in *Basic*, the Supreme Court held that securities plaintiffs could invoke a rebuttable presumption of reliance, rather than proving direct reliance as to each class member.

The Court reasoned that it should be presumed that securities plaintiffs relied on the alleged misstatements where the plaintiffs are able to show that the market where the relevant securities traded reflected material public information about the issuer.

While the fraud on the market presumption was the subject of frequent attack, it was consistently upheld by the lower US federal courts and ratified by the US Congress. Specifically, in 1995, when the US Congress revamped the US federal securities laws by enacting the Private Securities Litigation Reform Act to rein in frivolous securities claims and curb abusive practices in securities litigation, it implicitly adopted the presumption by leaving it undisturbed.

The arguments of the parties and others in Halliburton. In the defendant company's argument to the Supreme Court, it urged the Court to overrule the fraud on the market presumption in its entirety. It argued in the alternative that the Court should modify the presumption to require securities plaintiffs to show that the alleged misstatementshad an impact on the company's stock price in order to invoke the presumption. This argument in favour of modifying the presumption of reliance was supported by several academics in submissions to the Supreme Court.

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However, there was also strong support for the Supreme Court to leave the fraud on the market presumption alone. In addition to the plaintiffs, the Justice Department, two former Chairmen of the Securities and Exchange Commission, 11 current and former members of Congress, a number of public pension schemes and several prominent academics made separate submissions to the Supreme Court urging that the presumption be left untouched. They argued that the Supreme Court would be ignoring the intent of Congress, undermining the regulation and enforcement of US securities laws and overreaching their judicial power if they were to reverse their own precedent and undermine the presumption.

The Supreme Court's decision in Halliburton. Fortunately, the Supreme Court stopped short of eliminating the fraud on the market presumption. The Court refused to overrule 24 years of precedent following *Basic*, especially in view of the fact that Congress had the opportunity to eliminate the presumption and chose not to do so. The Court also rejected the defendant company's invitation to modify the presumption to require plaintiffs to show that the alleged misstatements had a price impact on the securities at issue. However, the Court held that defendants should have the opportunity to rebut the presumption at the class certification stage by showing that the alleged misstatements did *not* have any price impact.

The effects of Halliburton. The Supreme Court's decision in *Halliburton* is consistent with the Court's 2013 decision in *Amgen Inc. v. Connecticut Retirement Plans & Trust Funds*. In *Amgen*, the Court held that at the class certification stage, securities plaintiffs do not need to prove whether an alleged misstatement was material to investors. In the years prior to *Amgen*, the Supreme Court handed down a spate of decisions that imposed additional burdens on securities plaintiffs, thereby limiting their access to the courts. However, in *Amgen* and *Halliburton*, the Court reversed that trend and ruled in favour of securities plaintiffs.

As noted, the *Halliburton* decision will not significantly impact the US securities class action landscape. Defendants always had a chance to rebut the fraud on the market presumption, either at the merits stage or (in certain US federal courts) at the class certification stage of the litigation. Therefore, the only impact of *Halliburton* is that defendants in certain cases will have the opportunity to rebut the presumption at an earlier procedural stage in the case. That opportunity will *not* impose any additional burdens on securities plaintiffs with viable claims. In fact, Justice Ginsberg's concurring opinion, joined by Justice Breyer and Justice Sotomayor, stated that she concurred with the majority's opinion with the understanding that the decision would not impose any additional burdens on plaintiffs with viable claims. Indeed, where defendants unsuccessfully attempt to rebut the fraud on the market presumption at the class certification stage, securities plaintiffs might actually benefit by gaining more leverage in settlement negotiations. CD

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