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 Writ of Certiorari to the
United States Court of Appeals for the Fifth Circuit

BRIEF FOR VIVENDI S.A. AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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QUESTION ADDRESSED BY *AMICUS*

Whether this Court should abrogate the fraud-on-the-market presumption of reliance recognized in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988).

CORPORATE DISCLOSURE STATEMENT

Vivendi, S.A. has no parent corporation, and no publicly held corporation owns 10% or more of its stock.

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INTEREST OF *AMICUS* AND SUMMARY OF ARGUMENT[1]

Amicus curiae Vivendi, S.A. is an international entertainment and media company based in Paris, France, whose common stock (ordinary shares) trade on the Paris Bourse; Vivendi also has had American Depository Receipts that traded on the New York Stock Exchange. For more than a decade, Vivendi has been litigating the unforeseen consequences of this Court's decision in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988). Vivendi has a strong interest in ensuring that the securities laws are properly interpreted to reflect market realities for the protection of public companies and their investors alike.

Vivendi offers a unique perspective on the fraud-on-the-market presumption due to its position as a defendant in several related securities fraud lawsuits that present various aspects of the distortive effects of the fraud-on-the-market presumption, including a class action tried to judgment before a jury—a rarity in modern securities litigation.

In 2002 a group of investors sued Vivendi under § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), following a drop in the price of Vi-

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[1] Pursuant to Rule 37, counsel for *amicus* represent that they authored this brief in its entirety and that none of the parties or their counsel, nor any other person or entity other than the *amicus* or its counsel made a monetary contribution intended to fund the preparation or submission of this brief. All parties have consented to the filing of this brief, and letters reflecting their consent have been filed with the Clerk.

vendi's shares. The district court, invoking the fraud-on-the-market presumption, certified a class action; the named plaintiffs then tried their securities theories to a jury, and obtained a verdict—all without ever proving that a single investor has relied on any public statement made by Vivendi. Now in post-trial proceedings, Vivendi must try to *disprove* the element that plaintiffs failed to prove: that individual claimants who purchased shares more than a decade ago did so in reliance on Vivendi's public statements. Meanwhile, in a related case brought against Vivendi by a single investor the district court found that the reliance element was not satisfied. And in a third case arising out of the same events, the class action verdict was given collateral estoppel effect in a trial that resulted in a billion-dollar judgment against Vivendi.

Vivendi therefore offers a firsthand perspective into the failures of *Basic* at all stages of securities litigation. A class was certified against Vivendi on the basis of the *Basic* presumption. Vivendi also has experienced *Basic*'s unforeseen consequences during trial and post-trial proceedings—an exceedingly rare experience, given that issuers typically settle securities lawsuits before trial, and therefore do not experience, as Vivendi has, the full distorting effects of the presumption.

Vivendi submits this brief *amicus curiae* to provide the Court a real-world "test case" of how *Basic* plays out at each stage of trial level litigation—not just on class certification, but at trial and beyond. Vivendi's experiences over the course of this decade-long litigation should inform the Court's decision on whether to retain, modify, or abandon the *Basic* presumption of reliance. Vivendi urges total abrogation

of the fraud-on-the-market presumption, which has proven nearly unworkable in practice, manifestly unfair to defendants, and flatly at odds with market realities.

ARGUMENT

I. THE *BASIC* PRESUMPTION DISTORTS PRE-TRIAL PROCEEDINGS

The *Basic* presumption rests on the assumption that virtually all investors rely on the integrity of market price when buying or selling a security. That assumption, however, is demonstrably untrue: Many sophisticated traders, such as hedge funds, investment advisers, and other institutional investors do not believe that market price accurately reflects a company's value based upon publicly available information. And because, along with market efficiency, reliance on the integrity of market price is an essential premise of the *Basic* presumption, there is no basis to apply the presumption to a large class of sophisticated investors, who increasingly dominate the equity markets. This market reality is vividly illustrated by the *Vivendi* litigation.

Basic envisioned a plaintiff class made up almost exclusively of investors who trade securities "in reliance on the *integrity* of [market] price." *Basic*, 485 U.S. at 247 (emphasis added); *see also id*. at 246–47 ("it is hard to imagine that there ever is a buyer or seller who does not rely on market integrity") (internal quotation marks omitted). This supposition was critical to *Basic*'s conclusion that "an investor's reliance on any public material misrepresentations . . . may be presumed." *Id*. at 247. Market efficiency by itself, without investors' reliance on the integrity of market price, would not be enough to justify the

fraud-on-the-market presumption.[2] If investors did not believe or did not care whether the market correctly incorporated information relating to an alleged misrepresentation, there would be no reason to presume the investor had relied on the misrepresentation. *See Amgen Inc. v. Conn. Ret. Plans & Trust Funds*, 133 S. Ct. 1184, 1192 (2013) (courts may presume reliance because "most investors . . . will rely on the security's market price as an unbiased assessment of the security's value in light of all public information").

Basic acknowledged only one kind of investor who would trade stocks "without relying on the integrity of the market," as to whom, the Court held, the presumption of reliance would be rebutted: an investor who disbelieved the misrepresentation and therefore thought that the stock was wrongly priced at the time of the transaction. 485 U.S. at 249. But it is now clear there are many others who do not rely on the integrity of market price.

Some investors who defy *Basic*'s core assumption are individuals or institutions who employ trading strategies that are indifferent to the alleged misrepresentation, such as day traders who base trading decisions on a stock's intra-day volume and volatility,

[2] *See*, *e.g.*, *In re Am. Int'l Grp., Inc. Sec. Litig.*, 689 F.3d 229, 234 n.3 (2d Cir. 2012) ("The fraud-on-the-market theory involves *two* rebuttable presumptions that permit a finding of class-wide reliance . . . : that (1) misrepresentations by an issuer affect the price of securities traded in the open market, *and* (2) investors rely on the market price of securities as an accurate measure of their intrinsic value.") (internal quotation marks omitted) (emphasis added).

rather than price or underlying business fundamentals. Indeed, sophisticated, institutional investors may use a variety of complex trading strategies and techniques that drive trading irrespective of stock price or the underlying information the price supposedly reflects. Some institutional investors, like volatility arbitragers, can profit regardless of whether a stock's price moves up or down. Volatility arbitragers purchase a delta-neutral portfolio of both an option and its underlying asset (*e.g.*, a stock). They are indifferent to whether the underlying asset increases or decreases in price; instead they profit (or lose) according to whether the asset's volatility (*i.e.*, price fluctuation) differs from the volatility implied by the option price.

Other sophisticated "value" investors eschew market pricing in favor of private, and often proprietary, valuation models. One such investor, GAMCO Investors Inc., sought to recover millions of dollars from Vivendi for alleged securities fraud. Because GAMCO opted out of the plaintiff class, it was subject to extensive discovery and the reliance issue was tried individually while the class action claims administration process was still underway. The reliance trial showed why GAMCO and other, similar institutional investors have no legitimate claim to a presumption of reliance based on fraud on the market. GAMCO had no "non-public corrective information about Vivendi's misstatements." *GAMCO Investors, Inc. v. Vivendi, S.A.*, 927 F. Supp. 2d 88, 90 (S.D.N.Y. 2013), *appeal pending*, Nos. 13-1194, -1377 (2d Cir.). But, as the district court held after a bench trial, GAMCO did not rely on those alleged misstatements—even assuming market efficiency—because its trading decisions were based on its own,

private valuation of Vivendi's stock and not on the integrity of market pricing. *Id.* at 101–04.

An asset manager for institutional investors and high net-worth individuals, GAMCO seeks to identify companies "selling at substantial discounts to their intrinsic Private Market Values," or PMV, which is "the price that an informed industrialist would be willing to pay for [the company] if each of its segments were valued independently in a private market sale." *Id.* at 94–95. GAMCO views PMV as a more reliable measure of a company's value than public market capitalization, which "can be irrational and sentimental, thereby providing value-based investors an opportunity to make a profit." *Id.* at 95. GAMCO uses proprietary methods to determine a company's PMV and to assess whether a "catalyst" will eventually cause market price to align with PMV. *Id.*

It was undisputed that the market for Vivendi stock was "efficient" during the class period under the standard *Cammer* test. *Id.* at 90–91 & n.5 (citing *Cammer v. Bloom*, 711 F. Supp. 1264 (D.N.J. 1989)). Nonetheless, at the same time as Vivendi's stock price was found in the class action to be artificially inflated in this efficient market, GAMCO bought the stock because it determined that "Vivendi securities were trading at a substantial *discount* to Vivendi's PMV." *Id.* at 95 (emphasis added). Thus, GAMCO plainly did not rely on the integrity of the market price when purchasing Vivendi securities. It bought the securities because it believed the market was *under*valuing them. And price inflation resulting from alleged misrepresentations did not induce GAMCO to purchase the stock. On the contrary, if not for that "inflation," GAMCO "would have seen

Vivendi as a *more* attractive investment" because the discount to PMV would have been even larger. *Id*. at 102. Indeed, when Vivendi's stock price dropped after alleged corrective disclosures, GAMCO "doubled or tripled" its Vivendi position. *Id.*

The fraud-on-the-market presumption rests on the premise that "most investors . . . know[] that they have little hope of outperforming the market in the long run based solely on their analysis of publicly available information." *Amgen*, 133 S. Ct. at 1192. This premise is false when it comes to GAMCO and many other sophisticated, institutional investors, who receive an outsized share of securities class action recoveries. They *do* believe that they can outperform the "irrational and sentimental" market in the long run. *GAMCO*, 927 F. Supp. 2d at 95.[3] In many cases, their business models depend on that belief. And, most important for purposes of reliance, their trading decisions depend on it too. GAMCO, for example, bought more Vivendi stock after purported corrective disclosures because it viewed the disclosures as "a short-term concern, which would not trouble a longer-term investor." *Id.* at 96.

GAMCO, of course, was not the only institutional investor that traded Vivendi securities during the class period. Quite the contrary, institutional investors like GAMCO have become the rule, and not (as

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[3] *See also Basic*, 485 U.S. at 256 ("many investors purchase or sell stock because they believe the price *inaccurately* reflects the corporation's worth") (White, J., concurring in part and dissenting in part) (internal quotation marks omitted).

the majority in *Basic* imagined) the exception.[4] There are many sophisticated, institutional traders among the *Vivendi* plaintiff class members. And, not surprisingly given the large positions they ordinarily trade, institutions are claiming the lion's share of the damages sought to be recovered in the class action. For example, according to data provided by the claims administrator, although only 270 of the more than 10,400 filed claims are seeking $20,000 or more in damages, those 270 claims account for 96.2% of all claimed damages in the *Vivendi* class action. The vast majority of these 270 larger claims were submitted by institutions. No factual record about these institutional claimants has been developed yet, but at least some of them—claiming tens of millions of dollars in recoveries—appear to be "value" investors. Others may apply different, sophisticated trading strategies that are not dependent on the integrity of market price.

The concentration of institutional investors among the *Vivendi* plaintiff class reflects the predominant role now played by institutions in the equity markets. In 1980, not long before *Basic* was decided, institutions owned 34% of all stocks, according

[4] Recognizing the prevalent role of institutional investors in securities class actions, the Private Securities Litigation Reform Act of 1995 creates a rebuttable presumption that the lead plaintiff should be the one with "the largest financial interest in the relief sought by the class." 15 U.S.C. § 78u-4(a)(3)(B)(iii)(I)(bb) (2012). The intent of this provision is "to increase the likelihood that institutional investors will serve as lead plaintiffs." S. Rep. No. 104-98, at 11 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 690.

to one recent analysis.[5] By 2010, institutional ownership had nearly doubled to 67%, and the value of U.S. common stocks had increased from $1.4 trillion to $17.1 trillion.[6] And because institutions trade stocks far more often than individuals, institutions are more likely to have purchased a stock within any given class period. This gives rise to an unintended consequence of securities class actions: They tend to transfer wealth from individuals to institutions. Liability incurred in a securities class action reduces the wealth of shareholders of the defendant company who bought stock outside the class period and increases the wealth of those who bought within the class period. "Ironically, the clear winner under such a system is the more rapidly trading, undiversified investor—which is the profile of the contemporary hedge fund. The clearest loser is the small investor who buys and holds for retirement—exactly the profile of the American retail investor." John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 Colum. L. Rev. 1534, 1560 (2006).

When the district court held that GAMCO had not relied on Vivendi's alleged misrepresentations, it admonished that its ruling "should not be taken to suggest that sophisticated institutional investors or value-based investors are not entitled to the fraud on

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[5] *See* Marshall E. Blume & Donald B. Keim, *Institutional Investors and Stock Market Liquidity: Trends and Relationships* 5, The Wharton School, University of Pennsylvania (Aug. 21, 2012) (unpublished working paper), *available at* http://finance.wharton.upenn.edu/~keim/research/ChangingInstitutionPreferences_21Aug2012.pdf.

[6] Blume & Keim, *supra*, at 5.

the market presumption in general." *GAMCO*, 927 F. Supp. 2d at 102. But why should plaintiffs of that stripe be permitted to obtain massive recoveries without offering any proof whatsoever on an essential element of their claim? "[R]equiring proof of direct reliance" might place an "unrealistic evidentiary burden" on *retail* investors. *Amgen*, 133 S. Ct. at 1192 (internal quotation marks omitted). But hedge funds, institutional asset managers, and other sophisticated traders stand on very different footing. They rely on highly compensated research analysts and portfolio managers to make trading decisions. Unlike many retail investors, they know why they determined that a security was a good investment when they purchased it. And if they did, in fact, rely on a particular public statement, they would be in a position to prove it.

II. THE *BASIC* PRESUMPTION DISTORTS TRIAL PROCEEDINGS

The fraud-on-the-market presumption's unfair effect on Vivendi did not terminate when the class was certified. At trial, the presumption continued to prejudice Vivendi by altering the loss causation element of the plaintiffs' claim. In a private action for securities fraud, the plaintiff bears the burden of proving "a causal connection between the material misrepresentation and the loss." *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 342 (2005). Congress underscored the loss causation element in 1995, mandating that "the plaintiff shall have the burden of proving that the act or omission of the defendant … caused the loss for which the plaintiff seeks to recover damages." 15 U.S.C. § 78u-4(b)(4). Although loss causation and reliance are distinct elements of a claim for securities fraud, the fraud-on-the-market

presumption has blurred the distinction and distorted the loss causation element in practice.

If a stock's price on a given date is presumed to reflect the market's reliance on an issuer's alleged material misstatements, then those misstatements must cause an immediate effect on price. *See Basic*, 485 U.S. at 243 ("Reliance provides the requisite causal connection between a defendant's misrepresentation and a plaintiff's injury."); *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1425 (3d Cir. 1997) (Alito, J.) ("[E]fficient markets are those in which information important to reasonable investors … is immediately incorporated into stock prices."). Conversely, the absence of a price effect in an efficient market signals the absence of materiality and causation. Thus, to satisfy the statutory burden of proving loss causation, a plaintiff who invokes the presumption of reliance must show that any allegedly material misstatement, and any revelation of a previously undisclosed material fact, produced an immediate and measureable effect on stock price.

In practice, however, courts have allowed plaintiffs to employ the fraud-on-the-market theory *and* avoid showing any causal nexus between material misstatements and price. To justify use of the presumption in these cases, courts have indulged in a variety of fictions in an attempt to reconcile the fraud-on-the-market presumption with plaintiffs' burden of proving that each material misstatement "affected the integrity of the market price." *Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179, 2186 (2011). These fictions lack any empirical basis and, as we explain below, have elided the element of loss causation in securities fraud actions.

"*Unitary Omission.*" Some courts have entertained the fiction that an issuer's public statements need not have any immediate effect on stock price if they can be deemed to merge into a "unitary omission" that causes price inflation over time. In this way, the plaintiff is excused from proving that *each* alleged misstatement has a discernible and immediate effect on stock price, as would be required if the court were faithfully to apply the fraud-on-the-market presumption. *See*, *e.g.*, *In re Vivendi Universal, S.A. Sec. Litig.*, No. 02-cv-05571, D.E. 929, at 4–5 (S.D.N.Y. Aug. 18, 2009) (allowing plaintiffs to prove inflation by choosing "'anchor points' for the beginning of stock price inflation and the date of maximum inflation" and using a "proxy" to "allocate inflation over time"); *In re Vivendi Universal, S.A. Sec. Litig.*, 765 F. Supp. 2d 512, 561–62 & n.36 (S.D.N.Y. 2011) (holding that plaintiffs need not show that any alleged misstatement corresponds to a change in stock price inflation).

"*Maintenance Theory.*" Similarly, some courts have imagined that issuers' public statements that have no effect on stock price over time can nonetheless be deemed to "cause" investor losses under a "maintenance" theory. As this theory goes, an issuer's allegedly false or misleading statements or omissions serve to "maintain" stock at a constant price, thereby exactly counteracting the price declines that would otherwise have occurred. *See*, *e.g.*, *FindWhat Investor Grp. v. FindWhat.com*, 658 F.3d 1282, 1314–15 (11th Cir. 2011) (holding that an alleged misstatement need not affect price inflation to cause investor losses), *cert. denied*, 133 S. Ct. 109 (2012); *In re Bristol-Myers Squibb Sec. Litig.*, No. 00-cv-1990, 2005 WL 2007004, at *17 (D.N.J. Aug. 17, 2005) ("[A] misstatement could serve to maintain the stock price

at an artificially inflated level without also causing the price to increase further."). Courts deploying this theory have thus attempted to maintain the pretense that the fraud-on-the-market theory, on which the class was certified and the case tried, has some basis in fact.

"*Materialization*"/"*Leakage*." Still other courts have held that stock price declines need not be tied to any specific disclosure of fraud if a class of plaintiffs can simply argue that the price declines resulted from a "materialization" or "leakage" of some previously hidden risk. *See*, *e.g.*, *In re Flag Telecom Holdings, Ltd. Sec. Litig.*, 574 F.3d 29, 40 n.5 (2d Cir. 2009) ("We do not take issue with the plausibility of Plaintiffs' 'leakage' theory."); *Lawrence E. Jaffe Pension Plan v. Household Int'l, Inc.*, No. 02-civ-5893, 2012 WL 4343223, at *2 (N.D. Ill. Sept. 21, 2012) (jury was free to adopt plaintiffs' "Leakage Model" that "did not isolate as to any given day the inflation caused by a misstatement or omission regarding each of the three subjects presented to the jury"). In its most extreme and controversial form, the "materialization of the [concealed] risk" theory posits the existence of loss causation "where a plaintiff shows that 'misstatements and omissions concealed the price-volatility risk (or some other risk) that materialized and played some part in diminishing the market value' of a security." *Nuveen Mun. High Income Opportunity Fund v. City of Alameda*, 730 F.3d 1111, 1120 (9th Cir. 2013); *see also id.* at 1122 n.5 (noting that "[t]he Ninth Circuit has not adopted the materialization of the risk approach"). Here again, courts have completely abandoned the teaching of the fraud-on-the-market theory that material misstatements in an efficient market must cause immediate and identifiable effects on stock price.

All of these fictions have sprung from the misguided efforts of some courts to explain how the fraud-on-the-market theory can be reconciled with allegedly material misstatements that have no demonstrable effect on stock price. And all of these fictions have been, and are currently being, applied to Vivendi in an erroneous attempt to conform the elements of an action for securities fraud to the fraud-on-the-market theory on which that action was tried. Vivendi's experience illustrates how the fraud-on-the-market presumption can distort the element of loss causation and radically alter securities plaintiffs' statutory burden of proof.

Despite invoking the fraud-on-the-market presumption and its underlying efficient-market hypothesis, the class plaintiffs in the Vivendi litigation admittedly could not prove at trial that any individual public statement made by Vivendi corresponds to a change in Vivendi's stock price. That failure of proof should have resulted in a judgment for Vivendi because an alleged misstatement that does not affect stock price in an efficient market is neither material nor the cause of investor losses. *See Amgen*, 133 S. Ct. at 1195 ("[I]mmaterial information, by definition, does not affect market price …."); *Dura*, 544 U.S. at 342 (loss causation is the "causal connection between the material misrepresentation and the loss"); *In re Burlington*, 114 F.3d at 1425 (where a public statement had no effect on price in an efficient market, "it follows that the information disclosed … was immaterial as a matter of law"). Instead, the plaintiffs sought to preserve the fraud-on-the-market presumption by altering the statutory elements of materiality, loss causation, and scienter. The plaintiffs argued that "[t]here is no legal or economic requirement that inflation must correspond to particular

misstatements or omissions," and that "inflation also reflects other factors, such as defendants' scienter, that do not necessarily correspond in any direct way to particular public statements." *In re Vivendi*, D.E. 1051, at 47 (citing no authority).

Therefore, the plaintiffs and their causation expert concocted the theory that all of Vivendi's public statements merged into a unitary omission spanning a two-year period from 2000 through 2002, and that this "omission"—not any specific public statement—was the efficient cause of the alleged price inflation. *See In re Vivendi*, D.E. 1051, at 47 (arguing that the alleged omission "*extended across* numerous public statements" and that inflation could be shown "using straight-line extrapolation") (emphasis added). And the district court accepted this theory, even going so far as to allow the plaintiffs to try their entire case without telling the jury—or Vivendi—exactly which public statements were allegedly false. *See In re Vivendi*, 765 F. Supp. 2d at 579 (holding that it was sufficient that plaintiffs had identified the allegedly actionable statements on the eve of summations). The plaintiffs thus avoided showing that *any* public statement made by Vivendi had an effect on Vivendi's stock price or corresponded to an increase in price inflation—in direct conflict with the fraud-on-the-market theory.

Moreover, to avoid tying any public statement to later price declines, the plaintiffs and their expert theorized that negative news in 2002 about Vivendi (and the media sector generally) was in fact a "materialization of the liquidity risk" that Vivendi had supposedly concealed in 2000 and 2001. *In re Vivendi*, D.E. 1051, at 44. With the trial court's imprimatur, a jury accepted this theory and returned a ver-

dict against Vivendi. *See In re Vivendi*, 765 F. Supp. 2d at 555 (noting that the "'materialization of risk' method" allowed the plaintiffs to rely on "revealing events that negatively affect stock price" and "do not identify prior company statements as misleading"). Thus, the plaintiffs again subverted the loss causation element in order to retain the benefits of the fraud-on-the-market theory.

Then, in a strained effort to conform the jury's verdict to the fraud-on-the-market theory, the district court felt compelled to adopt the additional fiction that, although Vivendi's public statements had no discernible effect on stock price or price inflation, they must have "maintained" Vivendi's shares at artificially high prices. *In re Vivendi*, 765 F. Supp. 2d at 579. In an efficient market, however, that conjecture works only if one shows that the stock price otherwise would have fallen by the *exact amount* of the inflation caused by the alleged misstatement. Suffice it to say, the plaintiffs put forth no evidence to support this bizarre, *ex post* theory.

Vivendi's experience graphically illustrates the lengths to which courts have gone to bridge the analytical gap between the fraud-on-the-market theory—and its necessary implications—and the requirement that securities plaintiffs must show that each material misstatement or omission has proximately caused investor losses. A district court that uses the fraud-on-the-market presumption to certify a class and relieve plaintiffs of their burden of proving actual reliance must also accept the legal and logical implications of that theory. Too often, however, courts have allowed securities plaintiffs to enjoy the presumption of reliance while advancing theories of materiality and loss causation that are fundamen-

tally at odds with the efficient-market hypothesis. The result is a degradation of the traditional elements of a cause of action under § 10(b). In extreme examples, as in Vivendi's case, plaintiffs are allowed effectively to dispense with the element of loss causation altogether.

Private plaintiffs under § 10(b) "must prove elements that are similar to those in actions for common-law fraud," including materiality, reliance, loss causation, and scienter. *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 376–77 (1991) (Kennedy, J., dissenting). Overturning the fraud-on-the-market presumption would correct an empirically untenable doctrine and restore to securities plaintiffs their burden of proving these elements in every case.

III. THE *BASIC* PRESUMPTION DISTORTS POST-TRIAL PROCEEDINGS

Although post-trial proceedings in the *Vivendi* class action are still underway, Vivendi's experience shows that the presumption of reliance distorts securities fraud actions after the verdict no less than before. Recognizing that the presumption adopted by *Basic* is supposed to be rebuttable, the district court rejected a motion by the class plaintiffs for immediate entry of final judgment after the verdict, and held that Vivendi must first have the opportunity to rebut the presumption of reliance as to particular class members. *In re Vivendi*, 765 F. Supp. 2d at 584–87. This "individualized inquiry," the court explained, could take place only after the trial because when the class action verdict was entered Vivendi did "not yet know the identity of most class members." *Id.* at 584–85. Class members have submitted claim forms and the process of challenging reliance

on an individualized basis will soon begin, as *Basic* allowed.

As it turns out, however, this process is fundamentally unfair. *Basic* invoked the presumption of reliance to resolve a *procedural* "problem," *i.e.*, to allow class actions to proceed without "individual issues . . . overwhelm[ing] the common ones." *Basic*, 485 U.S. at 242. But the effect of the presumption in the post-trial stage—as in the trial itself, see *supra* Point II—is decidedly *substantive*: It permits class members to recover without presenting any proof that they relied on alleged misrepresentations. *See Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 845 (1999) (holding that under the Rules Enabling Act "rules of procedure [including Rule 23] shall not abridge, enlarge or modify any substantive right") (internal quotation marks omitted).

The most obvious problem is that Vivendi bears the burden of *disproving* an element of each plaintiff's claim, as to which the plaintiffs themselves have not presented even a modicum of proof. This is the opposite of where the burdens in civil litigation are supposed to fall. *See Schaffer v. Weast*, 546 U.S. 49, 56 (2005) ("'Perhaps the broadest and most accepted idea is that the person who seeks court action should justify the request, which means that plaintiffs bear the burdens on the elements in their claims.'") (quoting Christopher B. Mueller & Laird C. Kirkpatrick, *Evidence* § 3.1 (3d ed. 2003)). And while burden-shifting presumptions are not uncommon, they ordinarily require the presentation of at least *some* evidence by the plaintiff that bears on the issue in dispute. *Basic*'s presumption, in contrast, is routinely applied whenever the defendant is a large company; indeed, many courts presume market effi-

ciency if the defendant's stock is traded on a national exchange.[7] Nothing (apart from trading during the class period) needs to be established *about the plaintiffs* to invoke a presumption of reliance, even though reliance is ultimately a question about the plaintiffs' behavior. Thus, in order to help plaintiffs meet the procedural requirements of Rule 23, the fraud-on-the-market presumption unjustifiably reduces the substantive elements of the plaintiffs' claim.

The unjust effects of this presumption, which are present even in an individual action, are compounded in a class action. It is simply not feasible for Vivendi to attempt to rebut the presumption of reliance in individualized proceedings for each of the more than 10,400 class members claiming recovery. And for all those Vivendi does not challenge, the reliance element of their cause of action has, in practice, simply disappeared. At no stage of the proceedings—class certification, trial, or post-trial—will they have presented any evidence suggesting that they relied on the purported misrepresentations or even that they assumed the integrity of the market price when purchasing the stock.

For those relatively few class members whose reliance Vivendi does challenge, the presumption con-

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[7] *See*, *e.g.*, *Teamsters Local 445 Freight Div. Pension Fund v. Bombardier, Inc*., No. 05-cv-1898, 2006 WL 2161887, at *8 (S.D.N.Y. Aug. 1, 2006) ("If . . . a security is listed on the NYSE, AMEX, NASDAQ, or a similar national market, the market for that security is presumed to be efficient."), *aff'd*, 546 F.3d 196 (2d Cir. 2008); *RMED Int'l, Inc. v. Sloan's Supermarkets, Inc*., 185 F. Supp. 2d 389, 404–05 (S.D.N.Y. 2002) ("[N]umerous courts have held that stocks trading on the AMEX are almost always entitled to the presumption.").

tinues to cause undue prejudice. The district court set out complex procedures for individualized reliance challenges. *See In re Vivendi Universal S.A. Sec. Litig.*, 284 F.R.D. 144, 155 (S.D.N.Y. 2012). Vivendi may propound discovery to a "limited number" of investors, after which a special master will make a "quasi-summary judgment determination" whether the discovery responses raise a triable issue as to reliance. *Id.*[8]

These procedures place Vivendi at a stark disadvantage when compared with those that *should* govern reliance proceedings: The plaintiffs—especially sophisticated institutions and hedge funds—should have been required to prove by a preponderance of the evidence that they, in fact, relied on the purported misrepresentations. Instead, Vivendi must disprove reliance and must overcome procedural hurdles at each stage of the post-trial process. All these procedural gateways will tend to reduce the number and the scope of reliance challenges by Vivendi. But reliance is an unproved element of the claimants' case, so the onus of establishing reliance should fall on them. Vivendi should not bear the burden of disproving reliance fourteen years after the trades in issue, especially since it is the claimants who solely

[8] The district court in *Household International*, another of the few securities fraud class actions to proceed through trial, adopted post-trial claims procedures that similarly disadvantaged the defendants' ability to challenge individual reliance. In that case, defendants were allowed to take discovery of only a limited number of institutional investors, and a special master would determine which reliance challenges could be resolved as a matter of law and which ones required a trial. *See Household Int'l*, 2012 WL 4343223, at *5–7.

possess (and may not have retained) evidence regarding the reasons for their trades.

In the few § 10(b) class actions that have gone through trial, the claims administration process often occurs, as here, long after the class period in which the trades were executed. Unlike GAMCO, which opted out of the class, absent class members are not named parties to litigation and probably do not implement controls to preserve relevant evidence.[9] This makes it highly likely that claimants have destroyed evidence such as emails and memos explaining their reasons for buying a security at a given time. For example, the class period during which Vivendi's stock price was supposedly inflated by fraud runs from October 30, 2000 – August 14, 2002. Vivendi did not learn the identities of the class claimants until more than ten years later, when they submitted proof of claim forms, due in August 2013. These class claimants were never notified that they may be subject to a proceeding in which their reliance would be disputed. Nor were prospective class members ever notified that they must preserve evidence regarding their decisions to trade Vivendi securities during the class period. Consequently, it is exceedingly likely that some records, documents or witnesses relevant to a claimant's trading decision

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[9] As a named plaintiff, GAMCO was presumably well aware of its duty to preserve evidence relating to Vivendi and to its trading decisions. *Cf. Zubulake v. UBS Warburg LLC*, 220 F.R.D. 222, 217 (S.D.N.Y. 2003) ("[A]nyone who anticipates being a party or is a party to a lawsuit must not destroy unique, relevant evidence that might be useful to an adversary.").

have become unavailable in the intervening decade.[10]

Any loss of reliance evidence *should* count solely against the plaintiff, either because the failure to preserve evidence would give rise to an adverse inference or simply because a dearth of evidence would prevent the plaintiff from carrying *its* burden of proof. But in the current posture, it is Vivendi that bears the burden of disproving reliance by each claimant. Only the claimants themselves—not Vivendi—would possess evidence relevant to that proof. Yet in the decade or more that has elapsed since they made the subject trades, the claimants were not named parties to the litigation; were never apprised that they would need to produce evidence of reliance; and presumably did not institute litigation holds or

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[10] Documentary evidence, particularly emails and text messages, has featured prominently in insider trade cases brought by the government against hedge funds. *See*, *e.g.*, Verified Compl. ¶ 37, *United States v. S.A.C. Capital Advisors, L.P.*, No. 13-cv-5182 (S.D.N.Y. July 25, 2013) (discussing e-mails from traders confirming that their trading recommendations were based on non-public information); Compl. ¶ 37, *SEC v. Guttenberg*, No. 07-cv-1774 (S.D.N.Y. Mar. 1, 2007) (alleging that UBS executive director sent coded text messages to Wall Street trader containing upcoming UBS analyst recommendations, in insider trading scheme involving, *inter alia*, three hedge funds). Evidence of this kind reveals the *actual* reasons institutional investors make trading decisions, whether based on "inside" information, other non-public information, proprietary valuation models, or other factors. Yet, because of the fraud-on-the-market presumption, institutional claimants in securities class actions are not required to present this evidence in order to recover, and, at least in Vivendi's case, are not even told that they must preserve it.

other practices to preserve relevant evidence. Nor did Vivendi have an opportunity to take early depositions of portfolio managers or other persons with critical knowledge of the transactions, whose memories now may have faded or who may now be unavailable. Indeed, Vivendi did not even learn the claimants' identities until 2013, when claim forms were filed.

The evidentiary records regarding reliance by claimants in the *Vivendi* action have not yet been developed. When they are, if there has been any loss of relevant evidence, the only just outcome would be to assume that all missing evidence is adverse to the claimant. Otherwise, the presumption of reliance is rendered irrebuttable merely because the claimants—the only parties in a position to know why they traded the securities—have not held on to the evidence necessary to adjudicate the issue. No claimant should be permitted to recover on that basis, especially institutional claimants who, if they actually did rely on a misrepresentation, would be able to prove it.

* * *

As Vivendi's experience shows, in practice *Basic* has provided substantial substantive benefits to plaintiffs in securities cases, while distorting securities-fraud litigation at the pre-trial, trial, and post-trial stages. Many investors stand to recover without presenting any evidence of reliance whatsoever—even in the rare cases, like *Vivendi*, that are tried to verdict. The main beneficiaries of this arrangement are sophisticated, institutional investors, who claim the largest share of damage awards, yet who are least likely to have relied on the integrity of market price and who are in the best position to prove the

grounds they actually did rely upon. To put an end to these untoward results, the *Basic* presumption should be abrogated.[11]

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[11] If the Court does not abrogate the fraud-on-the-market presumption completely, it should, at a minimum, confine the presumption to class certification proceedings. Afterward, the named class representatives should bear the burden of establishing their own reliance at trial, without the benefit of the presumption. And, after trial, each claimant seeking to recover should bear the burden of establishing its own individual reliance. As a practical matter, a sophisticated institutional investor or hedge fund engaged in multi-million dollar trades in a fiduciary capacity, and which periodically informs its investors about its trading strategies and why its investments performed as they did, is more likely to have documentary evidence bearing on the question of reliance than a retail investor trading for his own account. Such evidence may be pivotal to the outcome of its claim, yet in the case of Vivendi, claimants were neither required to retain this evidence, nor did the plaintiff, an institutional investor, have the burden of testifying about its own alleged reliance.

CONCLUSION

The decision of Court of Appeals should be reversed.

Respectfully submitted,

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