No. 13-317

IN THE

Supreme Court of the United States

HALLIBURTON CO. AND DAVID J. 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

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BRIEF OF THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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INTEREST OF *AMICUS CURIAE*

The Securities Industry and Financial Markets Association ("SIFMA") is a securities industry trade association representing the interests of hundreds of securities firms, banks, and asset managers.[1] SIFMA's mission is to support a strong financial industry, while promoting investor opportunity, capital formation, job creation, economic growth, and trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the United States regional member of the Global Financial Markets Association.

SIFMA regularly files *amicus curiae* briefs in cases that raise legal issues of vital concern to the participants in the securities industry. SIFMA appeared before this Court as *amicus curiae* in *Erica P. John Fund, Inc.* v. *Halliburton Co.*, 131 S. Ct. 2179 (2011), and regularly appears as *amicus curiae* in many cases involving issues arising under the federal securities laws, most recently in *Gabelli* v. *SEC*, 133 S. Ct. 1216 (2013) (accrual of 28 U.S.C. § 2462's five-year statute of limitations); *Credit Suisse Sec. (USA) LLC* v. *Simmonds*, 132 S. Ct. 1414 (2012) (accrual of 15 U.S.C. § 78p(b)'s two-year statute of limitations); and *Matrixx Initiatives, Inc.* v. *Siracusano*, 131 S. Ct. 1309 (2011) (pleading standard for materiality in private securities fraud action).

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[1] The parties have filed blanket letters of consent for *amicus* briefs. No counsel for a party authored this brief in whole or in part; and no such counsel or any party made a monetary contribution intended to fund the preparation or submission of this brief. No person or entity, other than *amicus* and its counsel, made a monetary contribution intended to fund its preparation or submission.

This case involves important issues regarding liability under the federal securities laws for misrepresentations in connection with public-market transactions and the standards governing adjudication of private securities class action claims. These issues are directly relevant to SIFMA's mission of promoting fair and efficient markets and a strong financial services industry. Resolution of these issues will have a profound effect on SIFMA's members.

SUMMARY OF ARGUMENT

In *Basic Inc.* v. *Levinson*, 485 U.S. 224 (1988), a four-Justice majority endorsed a "fraud-on-the-market" presumption of reliance to permit securities class action plaintiffs to certify classes that otherwise would fail because individual issues of reliance would predominate. In the 25 years since that decision, many of the criticisms and fears articulated by Justice White in his prescient dissent have been realized: the economic theories underpinning the presumption have been debunked, *see id*. at 254 (White, J., dissenting); the expansion of the securities fraud class action has led to "large judgments payable in the last analysis by innocent investors, for the benefit of speculators and their lawyers," *id*. at 262; and there is continued confusion among lower courts with respect to how, if at all, the presumption may be rebutted, *id.* at 251. In short, the "bitter harvest" of the "seeds sown" by *Basic* has been reaped. The negative consequences of excessive and all-too-often meritless securities class actions have been well chronicled. Defendants, faced with massive potential exposures and the distraction of lengthy and costly litigation, frequently are constrained to submit to *in terrorem* settlements. Moreover, there is little evidence that providing securities plaintiffs with a virtual free pass to certify

a class has had a deterrent effect on misconduct by publicly traded companies, improved the quality of corporate disclosure, or resulted in meaningful recoveries that actually benefit investors in the aggregate, as opposed to their lawyers. "[F]rom a compensatory perspective . . . the securities class action performs poorly."[2]

Compounding these concerns is the fact that *Basic* drastically expanded a judge-made private right of action—one that finds no support in either the text or legislative history of the Securities Exchange Act of 1934 (the "Exchange Act") and has in recent years required repeated narrowing by Congress and this Court. In fact, the most analogous express right of action—§ 18, which does require actual reliance—compels the conclusion that if Congress had considered the issue in 1934, it would have required actual reliance for § 10(b) plaintiffs.

To redress the lack of empirical support for the fraud-on-the-market theory, the practical difficulties defendants face to rebut it, and the huge burdens it has imposed unfairly on countless companies, the Court should overrule *Basic*. One of the alternatives before the Court is to modify *Basic*'s presumption to require § 10(b) plaintiffs to demonstrate an actual price impact caused by a defendant's alleged misrepresentation. Although this would be better than leaving *Basic* unchanged, it lacks a sound economic basis. Even assuming the validity of the presumption that all investors rely on the integrity of market prices, that proposed modification would not

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[2] John C. Coffee, Jr., *Reforming the Securities Class Action: an Essay on Deterrence and Its Implementation*, 106 Colum. L. Rev. 1534, 1545 (2006).

reliably establish that any plaintiff relied on a distorted price *at the time* of the transaction. Plaintiffs commonly argue that price deflation in response to a purported corrective disclosure is circumstantial evidence that the alleged misrepresentation previously inflated price. However, a variety of market factors render it nearly impossible to prove earlier price inflation through later price declines, particularly given the complex market dynamics that have developed since *Basic* was decided. Nor is price impact itself necessarily probative of class-wide reliance: such impact would need to be shown to have occurred in a market that is efficient with respect to the particular information alleged to have been misrepresented in order for plaintiffs to demonstrate that they relied on the integrity of the market price to convey that information.

Rather than perpetuate the problems and burdens created by *Basic*, the Court should overrule the fraud-on-the-market presumption entirely. It should leave to Congress the task of analyzing global markets and evaluating economic theory to determine whether and to what extent§ 10(b) plaintiffs should be relieved of the burden of proving actual reliance in a class setting.

ARGUMENT

I. THE "FRAUD-ON-THE-MARKET" THEORY OF INDIRECT RELIANCE HAS IMPOSED SIGNIFICANT BURDENS ON THE ECONOMY AND NEGATIVELY IMPACTED THE FINANCIAL MARKETS

The "fraud-on-the-market" theory of indirect reliance, endorsed by the four-justice majority in *Basic*, permits plaintiffs asserting claims under § 10(b) of the Exchange Act to pursue fraud claims on a class basis. To certify a class of plaintiffs seeking damages

under Rule 23 of the Federal Rules of Civil Procedure, a district court must first find that issues common to the class predominate over individualized issues. Under traditional principles of fraud and Rule 23, a securities fraud plaintiff could rarely, if ever, satisfy this requirement because the reliance element of fraud at common law is a classic individual inquiry, involving the facts and circumstances of each plaintiff's decision to engage in a particular transaction.[3] As the *Basic* Court put it, "[r]equiring proof of individualized reliance from each member of the proposed plaintiff class effectively would have prevented respondents from proceeding with a class action, since individual issues then would have overwhelmed the common ones." 485 U.S. at 242. By "presuming," first, that all public information about a company in an efficient market is known to the market and reflected in its stock price and, second, that investors "rel[y] on the integrity of [the market] price," *id*. at 246–47, *Basic* unleashed the most potent, and abuse-prone, form of securities litigation—the Rule 10b-5 class action.

A decision to certify a class exerts enormous and undue settlement pressure on a defendant, even one with a meritorious defense.[4] This problem is

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[3] The federal courts have looked to rules governing common-law fraud to define the Rule 10b-5 cause of action. *See Dura Pharms., Inc.* v. *Broudo*, 544 U.S. 336, 343 (2005) ("Judicially implied private securities-fraud actions resemble in many (but not all) respects common-law deceit and misrepresentation actions.").

[4] *See, e.g.*, *Coopers & Lybrand* v. *Livesay*, 437 U.S. 463, 476 (1978) ("Certification of a large class may so increase the defendant's potential damages liability and litigation costs that he may find it economically prudent to settle and abandon a meritorious defense."); Fed. R. Civ. P. 23(f) 1998 Advisory

especially acute in the context of private securities litigation. Between 2000 and 2012, 75 percent of decided certification motions in securities litigation resulted in the 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 2000–2012). And research shows that if putative class securities lawsuits survive dismissal and a large class is certified, even weak cases will result in "blackmail settlements" induced by a small probability of an immense judgment.[5] *Cf.* Henry J. Friendly, *Federal Jurisdiction: A General View* 120 (1973). The consequences of proceeding to summary judgment or

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Committee Note ("An order granting certification . . . may force a defendant to settle rather than incur the costs of defending a class action and run the risk of potentially ruinous liability."); *Newton* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 259 F.3d 154, 165 (3d Cir. 2001) ("[C]ertifying the class may place unwarranted or hydraulic pressure to settle on defendants.").

[5] *See* Tom J. Baker & Sean J. Griffith, *How the Merits Matter: Directors' and Officers' Insurance and Securities Settlements*, U. Pa. L. Rev. 755, 757–58 (2009) (observing that the merits of securities fraud claims are essentially irrelevant to settlement of securities class actions); Geoffrey Rapp, *Rewiring the DNA of Securities Fraud Litigation:* Amgen*'s Missed Opportunity*, 44 Loy. U. Chi. L.J. 1475, 1478 (2013) ("[B]ecause securities litigation is so high risk for defendants, these cases—should they survive motions to dismiss and obtain class certification—will almost always settle."); Denise N. Martin, *et al.*, *Recent Trends IV: What Explains Filings and Settlements in Shareholder Class Actions*, 5 Stan. J.L. Bus. & Fin. 121, 156 (1999) ("Generally, we find that the merits do not have much, if any, explanatory power on settlement size."); Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 Stan. L. Rev. 497, 523 (1991) (study of securities class action settlements concluding that "the merits did not affect the settlement amounts").

trial include a risk of massive, if not ruinous, monetary liability even if the likelihood of loss is small, as well as heavy costs to conduct document and deposition discovery and to engage experts. Indeed, the punitive costs of such class actions have prompted repeated legislative efforts to curtail meritless private securities fraud cases,[6] and call into question the continued validity of *Basic*.[7]

The costs of overbroad class action litigation burden not only defendants, but the economy as a whole. "No one sophisticated about markets believes that multiplying liability is free of cost." *SEC* v. *Tambone*, 597 F.3d 436, 452 (1st Cir. 2010) (Boudin, J., concurring). Instead, it is well recognized that the costs of abusive class actions inevitably "get passed along to the public." *Id.* These costs also affect markets: the average securities class action reduces a defendant company's equity value by 3.5 percent. *See* Anjan V. Thakor, *The Unintended Consequences of Securities Litigation* 14 (U.S. Chamber Inst. for Legal

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[6] *See, e.g.*, Class Action Fairness Act of 2005, Pub. L. No. 109-2, 119 Stat. 4; Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227; Private Securities Litigation Reform Act of 1995 (PSLRA), Pub. L. No. 104-67, 109 Stat. 737.

[7] Among other concerns, the fraud-on-the-market presumption creates significant procedural advantages for plaintiffs, which are difficult to justify if, in fact, investors do not rely on the integrity of the market when deciding whether to sell or buy securities. Indeed, in one of the few instances where the question has been actually litigated at the merits stage, the plaintiff was found not to have relied on the market price. *See GAMCO Investors, Inc.* v. *Vivendi, S.A.*, 927 F. Supp. 2d 88, 104 (S.D.N.Y. 2013) (defendant successfully rebutted presumption of institutional investors' reliance on misstatements, created pursuant to fraud-on-the-market theory).

Reform 2005). As this Court has observed, the costs associated with class actions often are "payable in the last analysis . . . for the benefit of speculators and their lawyers." *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 739 (1975) (quoting *SEC* v. *Tex. Gulf Sulphur Co*., 401 F.2d 833, 867 (2d Cir. 1968) (Friendly, C.J., concurring)). Particularly in securities class actions, the result often is a transfer of wealth from current to former shareholders, with the plaintiffs' lawyers collecting a sizable tax on the transfer.[8] *See, e.g*., Janet Cooper Alexander, *Rethinking Damages in*

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[8] The enormous financial incentives to bring such cases have engendered illegal or questionable conduct on the part of the plaintiffs' bar. *See United States* v. *Lazar*, 05 Cr. 587 (C.D. Cal.) (in which named partners of Milberg Weiss, formerly one of the nation's leading plaintiffs' securities class action firms, pleaded guilty to paying kickbacks to lead plaintiffs); *United States* v. *Lerach*, 07 Cr. 964 (C.D. Cal.) (same); *see also* Stephen J. Choi, Drew T. Johnson-Skinner & A.C. Pritchard, *The Price of Pay to Play in Securities Class Actions*, 8 J. Empirical Legal Studies 650 (2011) (concluding that larger institutional investors serving as lead plaintiffs negotiate lower attorneys' fees, but that public pension funds whose officials receive political contributions from class counsel negotiate attorneys' fees that are statistically indistinguishable from those negotiated by individual investors serving as lead plaintiffs); Drew T. Johnson-Skinner, *Paying-to-Play in Securities Class Actions: A Look at Lawyers' Campaign Contributions*, 84 N.Y.U. L. Rev. 1725, 1750 (2009) (finding that, in the majority of cases in which a public pension fund served as a lead plaintiff, at least one appointed law firm made a political contribution to a relevant elected official); John C. Coffee, Jr., *"When Smoke Gets in Your Eyes": Myth and Reality About the Synthesis of Private Counsel and Public Client*, 51 De Paul L. Rev. 241, 244 (2001) (noting examples of plaintiffs' firms making political contributions to state treasurer candidates in "distant states" and questioning whether the firms' "desire to fund good government could have been satisfied closer to home").

Securities Class Actions, 48 Stan. L. Rev. 1487, 1503 (1996).

It is imperative that our markets remain attractive to outside investment and to companies considering where to list their securities, and that companies attract qualified individuals to serve on boards and in management positions. Yet it is widely perceived that the United States legal system imposes greater costs on businesses than the legal systems of other major capital markets. *See, e.g.*, Michael R. Bloomberg & Charles E. Schumer, *Sustaining New York's and the US' Global Financial Services Leadership* ii (2007). As a result, "foreign companies [are] staying away from US capital markets for fear that the potential costs of litigation will more than outweigh any incremental benefits of cheaper capital." *Id.* at 101. The perception of higher litigation costs frequently is cited as one reason for the decline in the competitiveness of American capital markets. *See, e.g.*, Fin. Servs. Forum, *2007 Global Capital Markets Survey* 8 (2007) (senior executives from nine of ten foreign companies that delisted from the United States between 2003 and 2007 cited litigation risk as a factor); Comm. on Capital Mkts. Regulation, *Interim Report of the Committee on Capital Markets Regulation* 5 (2006). *Cf. Stoneridge Inv. Partners, LLC* v. *Scientific-Atlanta, Inc.*, 552 U.S. 148, 164 (2008) ("Overseas firms with no other exposure to our securities laws could be deterred from doing business here. This, in turn, may raise the cost of being a publicly traded company under our law and shift securities offerings away from domestic capital markets." (internal citations omitted)).

As a policy matter, *Basic*—a policy-driven judicial intervention—has proved to be a paradigmatic example of the law of unintended consequences.

Justice White's fear that Rule 10b-5 would be converted into a "scheme of investor's insurance" has been realized. *Basic*, 485 U.S. at 252 (citation omitted) (White, J., dissenting).

II. NEITHER THE EXCHANGE ACT'S STATUTORY TEXT NOR LEGISLATIVE HISTORY SUPPORTS BASIC'S FRAUD-ON-THE-MARKET PRESUMPTION

As this Court recently noted, the fraud-on-the-market presumption of reliance is not the "traditional" or "most direct" way to prove reliance. *Halliburton I*, 131 S. Ct. at 2185. Conspicuously absent from *Basic*'s four-Justice opinion is any support in the text or legislative history of § 10(b) or Rule 10b-5 for this jettisoning of the traditional common-law reliance requirement. Rather, *Basic's* stated rationale for dispensing with actual reliance was the "problem of balancing" the substantive requirement of the statute with the procedural requisites of Rule 23. *Id*. at 243. But the Exchange Act did not authorize any such "balancing." To the contrary, the text and history of the Exchange Act confirm that, had Congress authorized a private cause of action under § 10(b), it would have insisted upon actual reliance.

Nor does *Basic*'s approach of redefining the elements of a judge-made § 10(b) action to permit plaintiffs easily to satisfy Rule 23 comport with this Court's more recent Exchange Act jurisprudence. This Court's subsequent § 10(b) cases have adopted the approach of Justice White's *Basic* dissent, and placed dispositive weight on the limits that Congress placed on analogous express rights of action. *See, e.g.*, *Central Bank*, 511 U.S. at 176; *Musick, Peeler & Garrett* v. *Emps. Ins. of Wassau*, 508 U.S. 286, 294 (1993). Even if *Basic* had engaged in *bona fide* statutory

interpretation affecting primary conduct (which it did not)—rather than creating a judge-made procedural rule (which it did)—overruling *Basic* would be warranted to "promote stability in the law" in light of the "virtually unbroken line of cases" adopting an incompatible interpretive approach. *Hubbard* v. *United States*, 514 U.S. 695, 713 (1995).

A. Congress Did Not Create a Private Right of Action Under § 10(b); Accordingly, the Judicially Implied Right of Action Should Be Narrowly Construed

The § 10(b) private action is a "judicial oak which has grown from little more than a legislative acorn." *Blue Chip Stamps*, 421 U.S. at 737. This analogy should not be "mistake[n] for praise rather than condemnation." *Morrison* v. *Nat'l Australia Bank, Ltd*., 130 S. Ct. 2869, 2880 n.4 (2010). Since *Basic*, this Court consistently has refused to expand the availability of the § 10(b) private action. *Basic* is now an outlier, rather than part of the "cohesive canopy." *Id*. It is a dangerous branch that should be removed.

1. *Congress Did Not Create a Private Right of Action Under* § 10(b). The existence of a § 10(b) private right of action has long been "assumed," but never properly considered, by this Court. *Aaron* v. *SEC*, 446 U.S. 680, 689 (1980). It was first recognized, as a fait accompli, in *Superintendent of Insurance* v. *Bankers Life & Casualty Co*., 404 U.S. 6 (1971), without briefing as to its existence, despite the Court having explicitly reserved the question of "who, if anyone, may bring private actions under § 10(b) and Rule 10b-5" just two years earlier. *SEC* v. *Nat'l Sec., Inc*., 393 U.S. 453, 572 n.9 (1969) (emphasis added); *see also Blue Chip Stamps*, 421 U.S. at 730 (noting that there

was "virtually no discussion" of the issue in *Superintendent of Insurance*).

The § 10(b) private right of action is "one of those so-called 'implied' causes of action that, for several decades, this Court was prone to discover in—or, more accurately, create in reliance upon—federal legislation." *Lampf, Pleva, Lipkind, Prupis & Petigrow* v. *Gilbertson*, 501 U.S. 350, 365 (1991) (Scalia, J., concurring). Were it a question of first impression, this Court undoubtedly would hold today that Congress did not create an implied § 10(b) private right of action in 1934.[9] Under current doctrine, congressional "intent to create not just a private right but also a private remedy" is the *sine qua non* of an implied cause of action. *Alexander* v. *Sandoval*, 532 U.S. 275, 286 (2001). "Without it, a cause of action does not exist and courts may not create one, no matter how desirable that might be as a policy matter, or how compatible with the statute." *Id.* at 286–87.[10]

This Court repeatedly has acknowledged that Congress did not have the requisite intent to create a § 10(b) private right of action in 1934.[11] This was not

[9] The Private Securities Litigation Reform Act of 1995 (PSLRA) placed limits on "any private action" arising under the Exchange Act. 15 U.S.C. § 78u-4(b). This was not a ringing endorsement of the § 10(b) private right of action, and this Court has properly followed the narrow construction rule since its enactment.

[10] Although policy concerns should not determine the scope of the implied private right of action, it of course "does not follow that the objectives of the statute are better served" by a "more far reaching" remedy. *Cent. Bank of Denver, N.A.* v. *First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 188 (1994).

[11] *See Stoneridge*, 552 U.S. at 164 ("The § 10(b) private cause of action is a judicial construct that Congress did not enact in the text of the relevant statutes."); *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 196 (1976) ("[T]here is no indication that Congress, or

an accidental omission, but rather stands in stark "contrast" to the "numerous carefully drawn express civil remedies provided in the Acts of both 1933 and 1934." *Blue Chip Stamps*, 421 U.S. at 730. In fact, the Exchange Act pared down some of the express private rights of action created by the Securities Act of 1933 (the "Securities Act"), due to "congressional concern over the impact of *even these limited remedies* on the new issues market." *Id*. at 754 (emphasis added). In light of these facts, the § 10(b) private right of action could not pass this Court's test for an implied right of action today.

It also is black-letter law that the Securities and Exchange Commission ("SEC") could not create a Rule 10b-5 private right of action beyond what Congress did (or did not) create under § 10(b). *See Alexander*, 532 U.S. at 285–86 (citing *Cent. Bank*, 511 U.S. at 173). In any case, the SEC did not intend to create a private right of action when it promulgated Rule 10b-5 in 1942. *See Blue Chip Stamps*, 421 U.S. at 730 ("Ther[e] is no indication that the Commission in adopting Rule 10b-5 considered the question of private civil remedies under this provision.").[12]

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the Commission when adopting Rule 10b-5, contemplated such a remedy."); *Blue Chip Stamps*, 421 U.S. at 729 ("Nor does the history of [§ 10(b)] provide any indication that Congress considered the problem of private suits under it at the time of its passage.").

[12] Milton V. Freeman, the Assistant Solicitor of the SEC who drafted Rule 10b-5 and was present when the Commissioners adopted it, put it bluntly: "It was intended to give the Commission power . . . . It had no relation in the Commission's contemplation to private proceedings." Remarks of Milton V. Freeman, Conference on Codification of the Federal Securities Laws, 22 Bus. Law. 793, 922 (1967).

2. *The § 10(b) Implied Private Right of Action Must Be Narrowly Construed*. Since *Basic*, this Court has recognized the "awkward task" of construing a "cause of action [Congress] really never knew existed." *Lampf*, 501 U.S. at 358, 359. The Court has held that it "must give 'narrow dimensions . . . to a right of action Congress did not authorize when it first enacted the statute and did not expand when it revisited the law.'" *Janus Capital Grp., Inc.* v. *First Derivative Traders*, 131 S. Ct. 2296, 2302 (2011) (quoting *Stoneridge*, 552 U.S. at 167).

Basic is not compatible with this principle of narrow construction. To the contrary, *Basic* stands alone in casting aside an essential element of common law fraud: reliance. In fact, since *Basic*, the Court has consistently construed the § 10(b) private right of action to be *as or more limited* than that for common law fraud. *See Stoneridge*, 559 U.S. at 162 (noting that § 10(b) "'must not be construed so broadly as to convert every common-law fraud that happens to involve securities into a violation'" (quoting *SEC* v. *Zanford*, 535 U.S. 813, 820 (2002)).

B. The Legislative History of § 18 Demonstrates that If Congress Intended to Permit a Private Right of Action Under § 10(b), It Would Have Required Proof of Reliance

Basic relied on the following clear misinterpretation of legislative history:[13] "In drafting [the Exchange] Act Congress expressly relied on the premise that

[13] There is, of course, no legislative history directly on point as to whether Congress might have enacted *Basic* in 1934 because Congress never contemplated any private right of action under § 10(b) at all. *See supra* Part II.A.1.

securities markets are affected by information, and enacted legislation to facilitate an investor's reliance on the integrity of those markets." 485 U.S. at 245–46 (citing H.R. Rep. No. 1383, at 11). The cited passage of the House Report, however, concerned § 13 of the Exchange Act, which required issuers to file periodic and other reports with the SEC. Exchange Act, § 13, 48 Stat. at 894–95.

The *Basic* opinion ignored evidence concerning the § 18 private right of action—cited in Justice White's dissent—that Congress anticipated meaningful proof of actual reliance before permitting civil recovery under the Exchange Act for misleading statements. *See* 485 U.S. at 257–58 (White, J., dissenting). In effect, the four-Justice majority in *Basic* elevated an extrapolation of a partial rationale for requiring SEC filings over the express limits that the statute placed on private actions concerning misstatements in those filings.

1. *The § 10(b) Implied Private Remedy Must Be Construed Consistently with the Most Analogous Express Remedy Under the Securities Acts*. Since *Basic*, the approach set forth in Justice White's Basic dissent has become the Court's "settled methodology in § 10(b) cases." *Cent. Bank*, 511 U.S. at 176. Under that now-settled methodology, the Court's "task is not to assess the relative merits of the competing rules," *Musick*, 508 U.S. at 294, but rather "'to infer how the 1934 Congress would have addressed the issue[s] had the 10b-5 action been included as an express provision in the 1934 Act,'" *Cent. Bank*, 511 U.S. at 173 (quoting *Musick*, 508 U.S. at 294). "For that inquiry, we use the express causes of action in the securities Acts as the primary model for the § 10(b) action." *Cent. Bank*, 511 U.S. at 178.

Applying this methodology, this Court consistently has placed limits on § 10(b) actions that are "symmetrical and consistent with" the limits Congress drafted in "those portions of the 1934 Act *most analogous*" to the § 10(b) private right of action. *Musick*, 508 U.S. at 294 (emphasis added). This is necessary "to ensure the [§ 10(b)] action does not conflict with Congress' own express rights of action." *Id*. at 295. Were it otherwise, the § 10(b) action would "nullify the effectiveness of the carefully drawn procedural restrictions on these express actions" in other sections of the Securities Acts. *Ernst & Ernst*, 425 U.S. at 210; *see also Blue Chip Stamps*, 421 U.S. at 736 n.8 (declining to "extend a [10b-5] private right of action . . . to those whom Congress excluded from the express civil remedies provided in the 1933 Act").

2. *The Express Private Remedy Under § 18 Is Most Analogous to § 10(b)*. The Securities Act and the Exchange Act created seven express private rights of action: §§ 11, 12, and 15 of the Securities Act and §§ 9, 16, 18, and 20 of the Exchange Act. *Musick*, 508 U.S. at 295–97.[14] Of those "seven candidates," the "easy answer" is that § 18 of the Exchange Act is the most analogous to § 10(b). Joseph A. Grundfest, *Damages and Reliance under Section 10(b) of the Exchange Act 21* (Stanford Law Sch. & the Rock Ctr. for Corporate Governance Working Paper No. 150 Aug. 28, 2013), http://www.law.stanford.edu/publications/damages-and-reliance-under-section-10b-of-the-exchange-act. Section 18 was the "[o]nly express private right of action in existence at the time of Section 10(b)'s

[14] In 1988, Congress added an express insider trading-related right of action for contemporaneous traders in § 20A of the Exchange Act, but that provision "was not an original liability provision in that Act." *Musick*, 508 U.S. at 296.

enactment [that] addresses misrepresentations or omissions that affect after-market prices." *Id*. at 29.[15]

The six private rights of action other than that created by § 18 are very different from § 10(b), and thus are not useful to this Court's inquiry into whether Congress would have required actual reliance had it created a § 10(b) private right of action. *Id*. at 19–32. Sections 9 and 16 of the Exchange Act do not address misstatements, but rather market manipulation and short-swing trading, respectively. 15 U.S.C. §§ 78i, 78p. Sections 11 and 12 of the Securities Act and § 16 of the Exchange Act do not require proof of scienter, and impose essentially strict liability (subject to "due diligence" and "negative causation" defenses for §§ 11 and 12). 15 U.S.C. §§ 77k, 77*l*, 78p. Section 12 does not apply to the aftermarket at all, while § 11's "tracing" requirement excludes nearly all aftermarket purchasers. And § 15 of the Securities Act and § 20 of the Exchange Act impose secondary liability on control persons of primary violators. 15 U.S.C. §§ 77o, 78t.

3. *Congress Required Reliance Under § 18 of the Exchange Act*. Section 18 of the Exchange Act, which provided a private right of action for misstatements in SEC filings, limited the action to persons that

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[15] In *Lampf* and *Musick*, the Court noted that §§ 9 and 18 of the Exchange Act are "of particular significance" because they "'target the precise dangers that are the focus of § 10(b).'" *Musick*, 508 U.S. at 295–96 (quoting *Lampf*, 501 U.S. at 360). The other express private remedies are of less significance because they "stand in marked contrast" to § 10(b). *Id*. at 296. While § 9 had relevance to the issues presented in those cases (the applicable statute of limitations and the availability of contribution), § 9 is not relevant to the elements of the § 10(b) private right of action because it addresses manipulation rather than misstatements.

purchased or sold "in reliance upon such statement." Exchange Act § 18(a), 48 Stat. 881, 897 (codified at 15 U.S.C. § 78r(a)). As Justice White's *Basic* dissent explained, Congress specifically considered the issue of reliance with respect to § 18. See 485 U.S. at 257–58 (White, J., dissenting). An initial draft of the Exchange Act would have created a private cause of action for plaintiffs who "purchased or sold a security the price of which *may have been affected* by such [misleading] statement" in an SEC filing. *Id*. at 257 (quoting S. 2693, 73d Cong., 2d Sess., § 17(a) (1934)) (emphasis added). The lack of a reliance element was widely criticized in the Congressional hearings. *Id.* at 257 & n.8 (citing hearings of the Senate Committee on Banking and Currency and the House Committee on Interstate and Foreign Commerce). Rep. Sam Rayburn, the Chairman of the House Committee, acknowledged that the draft was "very much challenged on the ground that reliance should be required" and that "[t]his objection has been met." *Id.* at 257 (quoting 78 Cong. Rec. 7701 (1934)). *A fortiori*, a Congress that required proof of actual reliance on SEC filings, which specifically were designed to provide information to investors, would not have endorsed a presumption of reliance on *all* publicly available information.

Consistent with this text and legislative history, a consistent line of lower court decisions has required actual, "eyeball" reliance under § 18. *See, e.g*., *Ross* v. *A.H. Robins Co., Inc*., 607 F.2d 545, 552 (2d Cir. 1979) ("Section 18 requires that a plaintiff establish knowledge of and reliance upon the alleged misstatements contained in any document filed with the S.E.C."); *Heit* v. *Weitzen*, 402 F.2d 909, 916 (2d Cir. 1968) ("[C]onstructive reliance is not sufficient."). Indeed, in *Blue Chip Stamps*, this Court appeared to

assume that "eyeball" reliance also would be required under § 10(b) when it restricted its parade of horribles to plaintiffs who actually read a misstatement.[16] For example, the Court worried that plaintiffs might recover based on false oral testimony of reliance.[17] *Basic* replaced that risk of false oral testimony reliance with the guarantee of a faulty presumption of reliance as a matter of law.

4. *The 1934 Congress Could Not Have Shared* Basic*'s Solicitude for Class Actions, Which Did Not Exist*. This Court does not assume that Congress's express (much less implied) remedies are intended to be amenable to class treatment. Rather, Rule 23 "imposes stringent requirements for certification that in practice exclude most claims." *Am. Express Co.* v. *Italian Colors Restaurant*, 133 S. Ct. 2304, 2310 (2013). This observation applies *a fortiori* to statutes like the Exchange Act that were enacted "before adoption of class-action procedures." *Id*. at 2311.[18]

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[16] *See Blue Chip Stamps*, 421 U.S. at 745 (noting the dramatic expansion of liability for misstatements that reach the "subscribers to financial journals" and the "readership of the Nation's daily newspapers"); *id*. at 746 (noting again that a large number of plaintiffs could show reliance by "reading of a prospectus" or "reading of information contained in the financial pages of a local newspaper"); *id*. at 754 (noting that the "potential plaintiffs" would be those who "read" the misstatement "in the financial pages of their local newspaper").

[17] *See Blue Chip Stamps*, 421 U.S. at 746 (noting the "very real risk" of recovery by a plaintiff who "offers only his own testimony to prove that he ever consulted a prospectus of the issuer, that he paid any attention to it, or that the representations contained in it damaged him").

[18] Rule 23 was first adopted in 1938, but "modern class action practice emerged in the 1966 revision of Rule 23." *Ortiz* v. *Fibreboard Corp.*, 527 U.S. 815, 833 (1999).

Because § 10(b) was adopted at a time when individual actions were the sole form of private money-damages litigation, Congress could not have been concerned with imposing an "unrealistic evidentiary burden" on class action plaintiffs. *Basic*, 485 U.S. at 245.

C. Courts Applying State Law Have Rejected or Declined to Adopt Basic's Fraud-on-the-Market Presumption

In the years since *Basic* was decided, state courts—which developed the common law principles to which this Court has looked in fleshing out § 10(b), *see Dura*, 544 U.S. at 344—have had the opportunity to reconsider the fraud-on-the-market doctrine, and have "cast a jaundiced eye on [its] worth." *Kaufman* v. *i-Stat Corp*., 754 A.2d 1188, 1190 (N.J. 2000). Where courts have interpreted a state statute or cause of action that requires a showing of reliance, they have overwhelmingly rejected *Basic*'s approach. Indeed, nearly every court to consider the fraud-on-the-market presumption in an analogous state law fraud context has either rejected or declined to apply it. *Aubrey* v. *Sanders*, 346 F. App'x 847, 849–50 (3d Cir. 2009); *Gunnells* v. *Healthplan Servs., Inc*., 348 F.3d 417, 435–36 (4th Cir. 2003) (applying South Carolina law); *Basham* v. *Gen. Shale Prods. Corp.,* Nos. 92-1608, 02-1607, 1993 WL 65086, at *4 n. 4 (4th Cir. Mar. 10, 1993) (applying West Virginia law); *Gerstein* v. *Micron Tech.*, Civ. No. 89-1262, 1993 WL 735031, at *9 (D. Idaho Jan. 9, 1993); *In re Metro. Sec. Litig*., No. CV-04-25-FVS, 2009 WL 36776, at *4–5 (E.D. Wash. Jan. 6, 2009); *In re Enron Corp. Sec., Derivative & ERISA Litig*., 284 F. Supp. 2d 511, 644 (S.D. Tex. 2003); *Freedman* v. *Value Health, Inc*., Nos. 3:95CV2038 JCH, 3:97CV2711, 2000 WL 630916, at *9 (D. Conn. Mar. 24, 2000) (applying New Mexico law); *In re Digi*

Int'l, Inc. Sec. Litig., 6 F. Supp. 2d 1089, 1104 (D. Minn. 1998); *In re Stratosphere Corp. Sec. Litig.*, 1 F. Supp. 2d 1096, 1123 (D. Nev. 1998); *In re Medimmune, Inc. Sec. Litig.*, 873 F. Supp. 953, 968 (D. Md. 1995); *Borow* v. *nVIEW Corp.*, No. 93-2142, 1994 WL 285458, at *2 n* (4th Cir. June 29, 1994) (applying Virginia law); *Simpson*v. *Specialty Retail Concepts*, 149 F.R.D. 94, 102 (M.D.N.C. 1993); *Anderson* v. *Daniel*, 724 S.E.2d 401, 404 (Ga. App. 2012); *Contreras* v. *Host Am. Corp.*, 453 F. Supp. 2d 416, 420 (D. Conn. 2006); *Krieger* v. *Gast*, 197 F.R.D. 310, 320 (W.D. Mich. 2000); *Constantine* v. *Miller Indus., Inc.*, 33 S.W.3d 809, 814 (Tenn. App. 2000); *Kaufman*, 754 A.2d at 1190; *In re First Merchants Acceptance Corp. Sec. Litig.*, No. 97 C 2715, 1998 WL 781118, at *13 (N.D. Ill. Nov. 4, 1998); *Malone* v. *Brincat*, 722 A.2d 5, 13 (Del. 1998); *Rosenthal* v. *Dean Witter Reynolds, Inc.*, 908 P.2d 1095 (Colo. 1995); *Bunch* v. *Kmart Corp.*, 898 P.2d 170, 171–72 (Okla. App. 1995); *Mirkin* v. *Wasserman*, 858 P.2d 568, 580 (Cal. 1993); *Kahler* v. *E.F. Hutton Co.*, 558 So.2d 144, 145 (Fla. App. 1990).

III. A MIDDLE GROUND APPROACH MODIFYING *BASIC*'S PRESUMPTION WILL NOT REDRESS THE NEGATIVE EFFECTS OF SECURITIES CLASS ACTIONS ON THE FINANCIAL MARKETS

One of the alternatives before this Court is to modify *Basic*'s presumption to bring it more in line with the reality of the financial markets and current economic theory. While this approach would be preferable to leaving the presumption as it currently stands, the core flaw of *Basic* is not merely that it got the economic analysis wrong, but that it arrogated to the judiciary a task that properly belongs to the legislature. "[T]he Congress, with its superior resources and expertise, is

far better equipped than the federal courts for the task of determining how modern economic theory and global financial markets require that established legal notions of fraud be modified." *Basic*, 485 U.S. at 254 (White, J., dissenting).

For the reasons set forth below, requiring proof of price impact—though a logical prerequisite to the *Basic* presumption—is insufficient to correct *Basic*'s error. Requiring such proof would not provide an effective method of establishing class-wide reliance, or redress the negative effects of fraud-on-the-market class actions on the financial markets. Thus, rather than attempting, with the limited resources and expertise available to assist it, to select among economic theories and develop rules or modify presumptions to implement them, this Court should overturn *Basic*'s presumption entirely.

1. *Proof of Price Movement Upon Corrective Disclosure Does Not Necessarily Demonstrate that the Alleged Misrepresentation Affected the Market Price*. Traditionally, price impact has been demonstrated by showing either price inflation after the alleged misrepresentation or price deflation after a purportedly corrective disclosure. *See, e.g.*, *Greenberg* v. *Crossroads Sys., Inc*., 364 F.3d 657, 662 (5th Cir. 2004). In practice, plaintiffs overwhelmingly take the latter approach because it is far easier to establish a "lie-truth-drop" pattern of price movement to argue that the stock price was previously inflated by a prior misrepresentation. See Michael J. Kaufman & John M. Wunderlich, *The Judicial Access Barriers to Remedies for Securities Fraud*, 75 L. & Contemp. Probs. 55, 86 (2012).

Price movement in response to a corrective disclosure, however, does not prove that prices were

distorted, *ex ante*, as a result of fraud. *First*, the two reflect temporally distinct—even disparate—market reactions to different information. *See* Jill E. Fisch, *The Trouble With* Basic: *Price Distortion After Halliburton*, 90 Wash. U. L. Rev. 895, 922 (2013). There simply is no "systematic relationship" between *ex ante* and *ex post* price distortion. *Id*.

Second, multiple factors may affect the market's reaction to a corrective disclosure, such as other corporate disclosures preceding or accompanying the correction or uncertainty about possible future developments. *See* Jay W. Eisenhofer, *et al.*, *Securities Fraud, Stock Price Valuation, and Loss Causation: Toward a Corporate Finance-Based Theory of Loss Causation*, 59 Bus. Law. 1419, 1420 (2004). Indeed, speculation about the possibility of future adverse disclosures or even concerns about costly securities litigation might affect the market's reaction to a corrective disclosure, causing the market to overreact beyond what the disclosure itself would otherwise warrant.[19] *Third*, intervening market developments may distort the impact of the fraudulent statements when they are subsequently disclosed, rendering the corrective disclosure more or less important to market

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[19] This type of market overreaction was the driving force behind congressional enactment of the 90-day "bounce-back" (or "look-back") provision as part of the PSLRA. *See* S. Rep. No. 104-98, at 19–20 & n.58 (1995); *see also* Robert A. Fumerton, *Market Overreaction and Loss Causation*, 62 Bus. Law. 89, 90 (Nov. 2006). The 90-day provision places a ceiling on recoverable damages by limiting a plaintiff's potential recovery to the difference between the price paid for a security and the "mean trading price of that security during the 90-day period beginning on the date on which the information correcting the misstatement or omission that is the basis for the action is disseminated to the market." 15 U.S.C. § 78u-4(e)(1).

price than it would have been at the time of the alleged misrepresentation. *See* Fisch, 90 Wash. U. L. Rev. at 922 (citing extreme example where an intervening event so damages the issuer company as to render corrective disclosure irrelevant). Permitting plaintiffs to demonstrate price impact merely by showing evidence of price movement after a corrective disclosure improperly conflates the required showing of reliance, which focuses on price impact *at the time of the transaction*, with that of loss causation, which focuses on *subsequent economic loss* as a result of the corrective disclosure. *See* Fisch, 90 Wash. U. L. Rev. at 923; *Halliburton I*, 131 S. Ct. at 2186 ("Loss causation addresses a matter different from whether an investor relied on a misrepresentation, presumptively or otherwise, when buying or selling a stock."). The conflation of these temporally distinct concepts—*ex ante* price distortion, which is part of the reliance inquiry, and *ex post* price distortion, which is a component of loss causation—was expressly rejected by this Court in *Halliburton I*. *See* 131 S. Ct. at 2186–87 (rejecting the Fifth Circuit's confusion of loss causation showing with price impact, but leaving for future cases the examination of whether plaintiffs must prove price impact to invoke the fraud-on-the-market presumption).

Further, as an evidentiary matter, price movement in response to a purportedly corrective disclosure is a poor measure of the price impact of an alleged misrepresentation. *See* Kaufman & Wunderlich, 75 L. & Contemp. Probs. at 88. In part, this is because plaintiffs widely rely upon event studies to address the loss causation analysis required by *Dura*, but such studies are ill-suited to show *ex ante* price distortion. Not every misrepresentation moves stock prices at the time it is conveyed to the market (for example, a

misrepresentation that falsely portrays a deteriorating business as unchanged may prevent, rather than cause, price movement), and thus the amount of price distortion cannot consistently be demonstrated with an event study. *See* Esther Bruegger & Frederick C. Dunbar, *Estimating Financial Fraud Damages with Response Coefficients*, 35 J. Corp. L. 11, 25–26 (2009).

Compounding the difficulty of discerning price impact through evidence of ex post price distortion is the fact that the misrepresentations at issue in complex securities class action litigation often are multifaceted, comprising recurring or related statements made to the public over time. *See* Frank Torchio, *Proper Event Study Analysis in Securities Litigation*, 35 J. Corp. L. 159, 165 (2009). Depending on the nature of the alleged misrepresentations and the form of the disclosures, recurring or related alleged misrepresentations might result in dynamic price inflation throughout the class period, while corrective disclosures might not necessarily correct each distinct misrepresentation. As a result, certain economists have argued that event studies may overestimate or underestimate the price inflation per share if the corrective disclosure contains more or less information than was known during the class period. *See* Kaufman & Wunderlich, 75 L. & Contemp. Probs. at 88; Donald C. Langevoort, *Compared to What? Econometric Evidence and the Counterfactual Difficulty*, 35 J. Corp. L. 183, 184 (2009) ("Corrective disclosure often reveals either too much (information beyond that known or knowable at the time of the fraud, or extraneous information bundled together with the correction) or too little (excluding information already impounded into the market price through leakage or other informational mechanisms) to be a particularly precise baseline.").

Thus, the presence or absence of price movement—whether at the time of the alleged misstatement or of the corrective disclosure—is a poor measure of market transmission of a false or misleading statement. It sets an unduly low and too easily satisfied threshold for invoking the *Basic* presumption.

2. *Price Impact Is Not Probative of Class-Wide Reliance in an Efficient Market.* In an "efficient market," as the *Basic* Court understood that term, all publicly available information is transmitted to investors in the form of a market price. *See Basic*, 485 U.S. at 244. Therefore, the Court reasoned, if plaintiffs could show that the defendant's security traded in an efficient market, it would be highly likely that the defendant's alleged misrepresentation affected the stock price, and, as a result, the Court should presume class-wide reliance on that misrepresentation. *See id.* at 244–47; *see also* Jeffrey L. Oldham, *Taking "Efficient Markets" Out of the Fraud-on-the-Market Doctrine After the Private Securities Litigation Reform Act*, 97 Nw. U. L. Rev. 995, 1011 (2003); Donald C. Langevoort, *Theories, Assumptions, and Securities Regulation: Market Efficiency Revisited*, 140 U. Pa. L. Rev. 851, 890–91 (2003). If the market is efficient, the hypothesis posits, then stock prices should adjust quickly to reflect any new information. *See* Jonathan P. Macey & Geoffrey P. Miller, *Good Finance, Bad Economics: An Analysis of the Fraud-on-the-Market Theory*, 42 Stan. L. Rev. 1059, 1083 (1990). As a result, plaintiffs must show that they traded in an efficient market to invoke the presumption, a showing that by and large is presumed when the security at issue is traded on a large stock exchange. *See, e.g.*, Donald C. Langevoort, Basic *at Twenty: Rethinking Fraud on the Market*, 2009 Wis. L. Rev. 157, 173.

Since *Basic*, however, scholarship has demonstrated that market efficiency is not a "binary, yes or no question." *See* Langevoort, 2009 Wis. L. Rev. at 167; *see also Amgen Inc.* v. *Conn. Ret. Plans & Trust Funds*, 133 S. Ct. 1184, 1197–98 n.6 (2013) (acknowledging "modern economic research tending to show that market efficiency is not a 'binary, yes or no question,'" but instead that "differences in efficiency can exist within a single market"). Instead, scholars widely agree that whether a market operates efficiently ought to be determined with respect to the particular *type* of information alleged to have been misrepresented. This is because the market price of a security will not be uniformly efficient as to all types of information. *See* Macey & Miller, 42 Stan. L. Rev. at 1083. Market participants will find some types of information more costly to obtain and complex to assimilate than others; the more difficult it is for those participants to internalize a particular type of information, the less efficient the market is likely to be with respect to that information. *See* Ronald J. Gilson & Reiner H. Kraakman, *The Mechanisms of Market Efficiency*, 70 Va. L. Rev. 549, 612–13 (1984) (explaining differentiation of efficient responses occurs due to varying levels of information accessibility and diffusion). "Where the payoff from new information is very high or the costs of obtaining new information are very low, market prices will adjust quickly. But share prices will adjust more slowly to reflect information where high costs are involved in obtaining and analyzing the information." Macey & Miller, 42 Stan. L. Rev. at 1086.[20]

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[20] For example, some studies have shown that the prices of securities traded in high-volume markets tend to react more slowly to changes in quarterly earnings announcements. *See* Dan

As a result, evidence of price impact is far less valuable in establishing indirect reliance. Any indication of price impact—particularly one that relies on price movement following a corrective disclosure—would need to be shown to have occurred in a market that is efficient with respect to the particular information alleged to have been misrepresented. This is because while shareholders might reasonably rely on the efficiency of the market to price a certain security correctly with regard to certain easily processed information, it might be less reasonable for shareholders to rely on the efficiency of the market to price a security correctly for information that is more difficult to obtain and analyze. *See* Macey & Miller, 42 Stan. L. Rev. at 1083 (1990). Thus, before the fraud-on-the-market presumption may properly be invoked, plaintiffs would have to show the misrepresentation was of a type that the market digests quickly and accurately *and* affected the price. Both showings are necessary to warrant the presumption that the information at issue was transmitted to investors through the market price.

Attempting to salvage the flawed *Basic* presumption requires careful analysis of the operation of global financial markets, examination of the way in which those markets react to disclosure of information, and sensitive policy judgments regarding the costs and

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Givoly & Josef Lakonishok, *The Information Content of Financial Analysts' Forecasts of Earnings: Some Evidence on Semi-Strong Efficiency*, 1 J. Acct. & Econ. 165 (1979). Conversely, the same security traded in a thin market might adjust very quickly to an announcement regarding information in which that market's participants specialize. *See, e.g.*, Macey & Miller, 42 Stan. L. Rev. at 1085–86 ("[T]he prices of securities traded in very thin markets may adjust quickly to a takeover announcement, because many investors specialize in decoding takeover news.").

benefits of private litigation under § 10(b). These are tasks appropriate to the legislative branch, not the judiciary. The majority in *Basic* erred when it appropriated those tasks to itself. This Court should not repeat that error, even in service of an improved legal standard. It should overrule the fraud-on-the-market presumption.

CONCLUSION

The judgment of the Court of Appeals should be reversed.

Respectfully submitted,

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