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CLASS ACTIONS

"The Law Professors' Brief": A New Middle Ground for the Fraud on the Market Presumption in Securities Class Actions After *Halliburton II*?

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On March 5, 2014, the U.S. Supreme Court heard oral argument in *Halliburton Co. v. Erica P. John Fund, Inc.*, No. 13-317 ("*Halliburton II*"). The primary question presented in the case is whether the Court should overrule or substantially modify the holding of *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988) ("*Basic*"), as it relates to the so-called "fraud on the market" doctrine.

I. Background of the *Basic* Decision

The fraud on the market doctrine provides the conceptual lynchpin for allowing securities claims implied as a private right of action under Section 10(b) of the Securities Exchange Act of 1934 ("Section 10(b)")[1] and Securities and Exchange Commission Rule 10b-5 ("Rule 10b-5")[2] to be brought as class actions. As set forth in *Basic*, the fraud on the market doctrine affords plaintiffs a rebuttable presumption of reliance on material misrepresentations published in relation to securities traded in an efficient market. Without such a presumption, the individual investors who purchased the securities in question would be required to prove that they each personally read (or heard) and relied on the alleged misrepresentations. The Supreme Court recognized in *Basic* that requiring individual plaintiffs to establish direct, "eyeball" reliance in this fashion would effectively preclude investors from proceeding with a class action, because individual issues related to reliance would overwhelm any common issues.[3]

Because the implied private right of action under Section 10(b) and Rule 10b-5 is a construct of the courts,[4] the Supreme Court's decision to adopt the fraud on the market doctrine in *Basic* was based on policy considerations, not on any form of statutory construction. As the Court has expressly moved away from such judicial law-making in recent years, and as questions have arisen about the economic theory underpinning the doctrine, commentators have suggested that *Basic* may have been wrongly decided. Last term, in *Amgen, Inc. v. Connecticut Retirement Plans & Trust Funds*, 133 S. Ct. 1184 (2013) ("*Amgen*"), at least four justices of the

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[1] 15 U.S.C. § 78j.
[2] 17 C.F.R. § 240.10b-5 (2014).
[3] *See Basic*, 485 U.S. at 242.
[4] *See, e.g.*, *Stoneridge Inv. Partners, LLC, v. Scientific–Atlanta, Inc.*, 552 U.S. 148, 164 (2008) (the private right of action under Section 10(b) is a "judicial construct that Congress did not enact"); *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 358-59 (1991) ("The text of § 10(b) does not provide for private claims. Such claims are of judicial creation.").

Supreme Court expressed an interest in revisiting *Basic*'s fraud on the market presumption.[5]

Thus, the Court granted the *certiorari* petition in *Halliburton II*. The Court will now decide whether the requirements for invoking the fraud on the market presumption of reliance should be overruled, reaffirmed, or substantially modified. Many commentators have suggested that if the Court were to overrule *Basic*, this could sound the death knell for securities class actions.

II. Oral Argument in *Halliburton II*: Is There a Workable "Middle Ground" to Be Found?

Given the stakes, the oral argument in *Halliburton II* played out before a packed courtroom. From the questions that the Court directed to counsel, it appears that the nine justices harbor a variety of opinions and concerns about the issues in the case. While it is perhaps perilous to predict what the Court might do, several of the justices indicated that they may be searching for what Justice Anthony Kennedy described as a "midway position," and appeared to be focusing on ideas expressed in an *amicus curiae* brief filed in support of Halliburton by law professors Adam C. Pritchard of the University of Michigan Law School and M. Todd Henderson of the University of Chicago Law School.

If the Court does indeed fashion some form of new rule or "midway position," perhaps based in whole or in part on what several justices repeatedly referred to at the argument as "the law professors' brief," *Halliburton II* may result in a substantial change in the way these cases are litigated, and produce a wave of litigation to test new boundaries for private claims under Section 10(b) and Rule 10b-5.

A. Halliburton Urges the Court to Overrule *Basic* or at Least Require Plaintiffs to Establish "Price Impact" at Class Certification. In the briefing and commentary leading up to the *Halliburton II* argument, much attention focused on Halliburton's contention that the economic theory underlying the *Basic* decision is obsolete. In *Basic*, the Supreme Court justified the adoption of a presumption of reliance by reference to the "efficient capital market theory."[6] According to the efficient market hypothesis, the trading activity of buyers and sellers in an efficient market will generally cause the market price of a security to incorporate all material public information about the security, such that the resulting price reflects the market's estimate of the fundamental value of the security based on that information. As expressed in *Basic*, the reasoning behind the fraud on the market doctrine is that, if this is true, then investors who purchase securities in reliance on the integrity of the market price may be deemed to have indirectly relied on misinformation that is "transmitted" to them through its incorporation into that market price.[7]

At the time *Basic* was decided, the efficient market hypothesis was gaining acceptance within the economics community, and for a number of years the "efficient market" foundation of the fraud on the market doctrine was effectively taken as a given in securities cases. But cracks eventually started to show in the economic foundation of this theory. In particular, economists started to question whether investors really act rationally in making investment decisions, and identified numerous examples where markets failed to price securities in a manner consistent with the efficient market hypothesis.

The boom and bust of the "dot-com" bubble, in particular, helped focus attention on the issue. Last year, Yale's Robert Schiller won the Nobel Prize for work that includes his book about that bubble, aptly titled *Irrational Exuberance*. Courts have also taken notice, and in recent years have more frequently denied class certification because of plaintiffs' inability to show that the securities in question traded in efficient markets.

In *Halliburton II*, the defendants are urging the Supreme Court to overturn *Basic*, in part, because "*Basic's* naïve understanding of market efficiency and its simplistic view that market prices rationally convey information are at war with economic reality."[8] In particular, Halliburton takes issue with the concept that market efficiency may properly be considered a binary, "yes or no" proposition. Citing recent scholarship, Halliburton contends that asking whether or not a stock trades on an efficient market has almost no real meaning, because efficiency is rarely uniform even for a single stock.[9] For example, a stock might trade efficiently some of the time, for some information types, but then trade inefficiently at other times, for other information types.[10] Furthermore, Halliburton asserts that "market realities now show that investors do not simply invest 'in reliance on the integrity of [the market] price.' "[11] Thus, Halliburton urges, *Basic*'s presumption of reliance should no longer be regarded as an adequate proxy for the actual reliance that fraud claims traditionally require. Given the "manifold flaws" in the policy-making behind the fraud on the market doctrine and in the economics of the efficient market hypothesis on which it is based, Halliburton posits that "the simplest and best solution is to overrule *Basic* altogether."[12]

In the alternative, Halliburton asks that the Court at least refashion the existing fraud on the market test to require affirmative proof that the market price was distorted by the particular misrepresentations at issue in a given case, "because the *Basic* presumption cannot spring to life until such a showing is made."[13] By making this argument, then, Halliburton itself suggests to

[5] *See Amgen*, 133 S. Ct. at 1204 (Alito, J., concurring); *id.* at 1208 n.4 (Thomas, J., joined by Scalia and Kennedy, JJ., dissenting).

[6] *See Basic*, 485 U.S. at 246.

[7] *See id.* at 244-48.

[8] *Halliburton II*, Petition for Writ of Certiorari (the "Cert. Petition"), 2013 WL 48559724, at *3 (Sept. 9, 2013).

[9] *Halliburton II*, Brief for Petitioners (the "Petitioners' Brief"), 2013 WL 6907610, at *20-*22 (Dec. 30, 2013).

[10] *Id.* at *20-*21 (citing Geoffrey C. Rapp, *Rewiring the DNA of Securities Fraud Litigation: Amgen's Missed Opportunity*, 44 Loy. U. Chi. L.J. 1475, 1484 (2013)).

[11] *Halliburton II*, Reply for Petitioners (the "Petitioners' Reply"), 2014 WL 689551, at *14 (Feb. 21, 2014) (quoting *Basic*, 485 U.S. at 247). In contrast to the "Norman Rockwell image of newspaper stock-quote pages spread across the [investor's] kitchen table" underlying *Basic*, Halliburton asserts that "price integrity (much less information conveyed by price) often is marginal or irrelevant to investors' trading decisions; indeed, some investors are indifferent to prices or their fluctuations because their investment strategies do not depend on those features." *Id.*

[12] *Halliburton II*, Petitioners' Brief, 2013 WL 6907610, at *11.

[13] *Id.*

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the Court a possible middle ground between affirming and reversing *Basic*.

In *Amgen*, the Supreme Court explained that plaintiffs must establish at least two prerequisites in order to obtain the benefit of *Basic*'s fraud on the market presumption in a given case. First, the plaintiffs must demonstrate ''that the alleged misrepresentations were publicly known'' and, second, ''that the stock traded in an efficient market.''[14] This is consistent with the proposition that, ''[i]f a market is generally efficient in incorporating publicly available information into a security's market price, it is reasonable to presume that a particular public, material misrepresentation will be reflected in the security's price.''[15]

But according to Halliburton, in a world where market efficiency is not a binary, ''yes or no'' proposition, the two-part test articulated in *Amgen* cannot be enough. Halliburton is a large corporation, and its stock is vigorously traded on a daily basis over the New York Stock Exchange. Under the circumstances, the company chose not to contest the issue of general market efficiency.[16] However, in seeking to defeat class certification, Halliburton pointed to the fact that the specific alleged misstatements that are the basis of the plaintiffs' claims were not associated with an increase in the company's stock price. Citing *Basic*, Halliburton disputes that the fraud on the market presumption of reliance is appropriate where there is no ''price impact'' of the alleged fraud, *i.e.*, that the alleged misstatements did not result in an increase in market price.[17] Thus, Halliburton's alternative point is that, with no price impact, nothing about the alleged misstatements could be ''transmitted'' to investors through the price set by the market, so there is no basis for presuming that subsequent purchasers of the company's stock indirectly relied on the alleged misstatements by purchasing at the market price.[18] As Halliburton argues, ''[i]t makes scant sense to certify enormous 'fraud-on-the-market' class actions based on disproven notions of general efficiency without inquiring whether the market was actually defrauded by the alleged misrepresentations.''[19]

Facially, such a requirement could simply be grafted onto the existing *Basic* requirements as enumerated in *Amgen* and *Halliburton I*. Plaintiffs seeking to invoke the fraud on the market presumption could be required to show: (1) that the security at issue traded in an efficient market; (2) the alleged misstatement was publicly disseminated; and (3) ''price impact,'' *i.e.*, the alleged misstatement produced an uptick in market price after dissemination to the market. At the very least, the Supreme Court could expressly recognize the right of the defendant to raise a lack of price impact as a legitimate reason to deny class certification. Of course, as with *Basic* itself, this would essentially amount to a form of judicial policy-making, which the Court has eschewed in recent years.

B. The ''Law Professors' Brief.'' In support of Halliburton's position, Professors Pritchard and Henderson submitted an *amicus curiae* brief to the Supreme Court in which they proposed a different approach. They urge the Court to ''abandon *Basic*'s insistence upon a demonstration of [market] efficiency in favor of a showing that a particular misrepresentation caused a market distortion.''[20] In other words, rather than requiring a showing of general market efficiency and *adding* a test of whether a particular alleged misstatement had a market price impact, Pritchard and Henderson would *replace* the market efficiency requirement with a statement-by-statement price impact analysis. As with *Basic*, the law professors' reasoning is based on policy and economic theory, not statutory construction. They posit that ''[t]he efficient capital markets hypothesis is not necessary to the use of the fraud on the market theory—whenever the market incorporates fraudulent information into the price, a 'fraud on the market' has occurred, whether the market is efficient or not.''[21] In support of their position, Pritchard and Henderson posit that the price impact analysis can be performed relatively simply, by using a standard ''event study'' to measure the effect of the alleged misstatements on the stock price.[22]

C. SIFMA's View on the ''Middle Ground'' Proposal. In another *amicus curiae* brief filed in support of Halliburton, the Securities Industry and Financial Markets Association (''SIFMA'') argued against what it called the ''middle ground'' approach to modify *Basic* by allowing plaintiffs to obtain class certification by showing price impact. The primary point made by SIFMA is that the Supreme Court should not attempt ''to select among economic theories and develop rules or modify pre-

[14] *Amgen*, 133 S. Ct. at 1198 (citing *Erica P. John Fund, Inc. v. Halliburton Co.*, 563 U.S. ___, 131 S.Ct. 2179, 180 L.Ed.2d 24 (2011) (''*Halliburton I*'')). The Court noted that a third requirement discussed in *Halliburton I*, ''that a putative class representative establish that it executed trades between the time the misrepresentations were made and the time the truth was revealed relates primarily to the Rule 23(a)(3) and (a)(4) inquiries into typicality and adequacy of representation, not to the Rule 23(b)(3) predominance inquiry.'' *Amgen*, 133 S. Ct. at 1198.

[15] *Amgen*, 133 S. Ct. at 1192.

[16] *Halliburton II*, Brief for Respondent (the ''Respondent's' Brief''), 2014 WL 356636, at *3 (Jan. 29, 2014).

[17] *Halliburton II*, Petitioners' Brief, 2013 WL 6907610, at *6 (citing *Basic*, 485 U.S. at 248). In *Basic*, the Court asserted that defendants may rebut the fraud on the market presumption with ''[a]ny showing that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff, or his decision to trade at a fair market price,'' noting that the lower court had observed that this might be accomplished by ''show[ing] that the misrepresentation in fact did not lead to a distortion of price.'' *Basic*, 485 U.S. at 248. In Halliburton's case, the court of appeals acknowledged a lack of evidence that the alleged misrepresentations actually affected Halliburton's stock price, yet ruled that rebuttal on this issue was not permitted at the class certification stage of the case. *See Halliburton II*, Petitioners' Brief, 2013 WL 6907610 at *3-*4.

[18] *Halliburton II*, Petitioners' Brief, 2013 WL 6907610 at *6; *see also Amgen*, 133 S. Ct. at 1199 (if misrepresentations are not ''reflected in the security's market price,'' there is ''no grounding for any contention that investors indirectly relied on those misrepresentations through their reliance on the integrity of the market price''); *Basic*, 485 U.S. at 248 (''the basis for finding that the fraud had been transmitted through [the] market price would be gone'').

[19] *Halliburton II*, Cert. Petition, 2013 WL 48559724, at *18-19.

[20] *Halliburton II*, Brief of Law Professors as *Amici Curiae* in Support of Petitioners (the ''Law Professors' Brief''), 2014 WL 60721, at *24 (Jan. 6, 2014).

[21] *Id*. at *2.

[22] *Id*. at *24-*32.

sumptions to implement them,'' but rather ''should overturn *Basic*'s presumption entirely.''[23]

In so doing, SIFMA argued that ''requiring proof of price impact—though a logical prerequisite to the *Basic* presumption—is insufficient to correct *Basic*'s error.''[24] While imposing a price impact requirement ''would be better than leaving *Basic* unchanged, it lacks a sound economic basis.''[25] Among other things, price 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.''[26] In other words, to invoke the fraud on the market presumption, plaintiffs would have to show *both* market efficiency (at least to the extent that ''the misrepresentation was of a type that the market digests quickly and accurately'') *and* price impact to support a conclusion ''that the information at issue was transmitted to investors through the market price.''[27]

D. Questions at Oral Argument Suggest a Possible Search for a "Midway Position." From the questioning at the *Halliburton II* argument, it appears that several of the justices on the Court may be considering the approach advocated by Professors Pritchard and Henderson in their *amicus* brief. To that end, Justice Kennedy specifically referred to ''the law professors' '' proposal of requiring an event study at class certification as a ''midway position'' that might provide ''a substantial answer'' to the challenge made by Halliburton to the economic premises of the *Basic* decision.[28] Over the course of the argument, the ''law professors' brief'' and/or the usefulness of an event study were topics covered by questions posed to counsel by Chief Justice John Roberts and by Justices Samuel Alito, Stephen Breyer, Elena Kagan, Kennedy, and Antonin Scalia.[29] In light of these expressions of interest from the Court, it is worth exploring the proposal in ''the law professors' brief'' in a bit more depth.

III. Does the Fraud on the Market Doctrine Make Legal or Economic Sense if It Is Untethered From the Efficient Market Hypothesis?

At the heart of ''the law professors' brief'' is the assertion that ''[t]he efficient capital markets hypothesis is not necessary to the use of the fraud on the market theory.''[30] Pritchard and Henderson argue that this is because the fraud on the market doctrine and the efficient market hypothesis embody ''two distinct concepts,'' and neither is dependent on the other.[31] In their view, ''the fraud on the market theory . . . provides that reliance may be presumed where a fraud affects the price of a publicly traded security because investors will be affected even if they trade without knowledge of the misrepresentations that influenced the price at which they traded.''[32] The efficient market hypothesis simply ''postulates that security prices fully reflect all available information.''[33] According to Pritchard and Henderson, the Supreme Court thus went further than it had to in *Basic* when it combined these concepts ''to allow plaintiffs to employ the fraud on the market theory only if they can demonstrate that the relevant market reflects all publicly available information.''[34]

In Pritchard and Henderson's assessment, requiring plaintiffs to establish general market efficiency is overkill because a claim under Section 10(b) and Rule 10b-5 is focused on particular misstatements. In this sense, although finding that a security traded in an efficient market ''provides a basis for the assumption that the market would be fooled by any and all instances of fraud . . . such a showing is unnecessary to demonstrate that the market was fooled by a particular statement.''[35] But even more critically, quoting fellow law professor Donald Langevoort, Pritchard and Henderson contend that '' 'fraud can and does distort prevailing prices' even in inefficient markets.''[36] Thus, they argue, whenever the market incorporates fraudulent information into the price, a 'fraud on the market' has occurred, whether the market is efficient or not.''[37]

Although Pritchard and Henderson make good points (such as the need to focus on the particular misstatements alleged in a case), to the extent that their proposal is interpreted as divorcing the fraud on the market doctrine from the efficient market hypothesis, it would be inconsistent with the nature of the private right of action under Section 10(b) and Rule 10b-5. Such a suggestion may also reflect flawed economic reasoning.

First, in *Basic*, the Supreme Court focused on the nature of the reliance element and why it would be appropriate to allow reliance on the integrity of the market price to substitute for direct reliance on an alleged misstatement. As the Court explained, the reliance element

[23] *Halliburton II*, Brief Of The Securities Industry And Financial Markets Association As Amicus Curiae In Support Of Petitioners (the ''SIFMA Brief''), 2014 WL 60720, at *22 (Jan. 6, 2014).
[24] *Id.*
[25] *Id.* at *3.
[26] *Id.* at *4.
[27] *Id.* at *28.
[28] *See Halliburton II*, Transcript of Oral Argument, at 17 (Mar. 5, 2014) (No. 13-317). In addition, the very first question during the argument came from Justice Ginsburg, who indicated that allowing plaintiffs to use the fraud on the market presumption of reliance might be acceptable as a matter of policy, without depending on any economic theory. *See id.* at 3-4.
[29] *See id.* at 20, 21, 22, 24, 29, 34, 40-41, 44, 47-48, 49, & 52.
[30] Law Professors' Brief, at *2.
[31] *Id.*
[32] *Id.* at *5 (quotation and citations omitted).
[33] *Id.* (quotation and citations omitted).
[34] *Id.* at *6 (quotation omitted).
[35] *Id.* at *8.
[36] *Id.* at *7 (quoting Donald C. Langevoort, *Basic at Twenty: Rethinking Fraud on the Market*, 2009 Wis. L. Rev. 151, 161).
[37] *Id.* at *2. Langevoort – whose papers are cited repeatedly throughout the law professors' brief – recently acknowledged his view that ''[w]hat *Basic* does, as much as anything, is create an entitlement to an undistorted stock price via, as I have described it, an act of juristic grace,'' and that this can lead to the conclusion that ''the most straight-forward way of articulating this . . . is to jettison reliance entirely and give investors a right to recover whenever they show price distortion that harmed them.'' *See* Donald C. Langevoort, *Judgment Day for Fraud-on-the-Market?: Reflections on Amgen and the Second Coming of Halliburton*, Geo. Pub. L. & Legal Theory Research Paper No. 13-058 (draft dated Nov. 16, 2013).

is a causation requirement, focused on the effect of the alleged fraud on the investor's decision to enter into the challenged transaction.[38] In this context, the role of the market in assessing the value of a proposed investment was critical in the Court's consideration of the propriety of the fraud on the market doctrine. The Court explained:

> In face-to-face transactions, the inquiry into an investor's reliance upon information is into the subjective pricing of that information by that investor. With the presence of a market, the market is interposed between seller and buyer and, ideally, transmits information to the investor in the processed form of a market price. Thus the market is performing a substantial part of the valuation process performed by the investor in a face-to-face transaction. The market is acting as the unpaid agent of the investor, informing him that given all the information available to it, the value of the stock is worth the market price.[39]

In this sense, then, the *Basic* Court found that the reliance element can be satisfied by the ''decision to trade at a fair market price,'' and it may be presumed—subject to rebuttal—that a market participant making an investment decision on that basis does so in reliance on information transmitted through the market's pricing mechanism.[40] Just last term, in *Amgen*, the Court reiterated the importance of the market valuation process in justifying the fraud on the market presumption of reliance, explaining that ''it is reasonable to presume that most investors—knowing that they have little hope of outperforming the market in the long run based solely on their analysis of publicly available information—will rely on the security's market price as an unbiased assessment of the security's value in light of all public information.''[41]

The approach espoused by Pritchard and Henderson marginalizes the conceptual role that market efficiency plays in allowing investors to reasonably rely on the market price as a fair reflection of the value of the stock. As noted above, at least for purposes of the plaintiffs' burden on class certification, it does not matter to Pritchard and Henderson if a market is not acting efficiently so long the alleged fraud distorts the market price. This is because, ''[i]f the rationale for the fraud on the market presumption is that investors should be able to rely on securities markets from being free from fraud, it makes little sense to focus on market efficiency.''[42]

Yet when a security trades in a market that is not efficient, *i.e.*, one where the market is not rationally transmitting information to investors about the value of the security, there is little justification for finding that investors may reasonably rely on the market as an ''unpaid agent'' vouching for the fairness of the price. To illustrate the point using a rather colorful commentary on securities claims arising from the era of the dot-com bubble:

> When market values are off in space and lifted by a herd mentality that objective professionals cannot check . . . simply showing that an announcement moved prices from one goofball number to another goofball number seems like a funny way to prove that reliance on the market price was reasonable, that the information moving the price was reasonably important, or that it is just for a plaintiff to recover money from a defendant in a lawsuit, with the amount of the recovery determined by the differences between two prices, both of which were simply wacky.[43]

Using a more measured tone, Justice Alito appeared to express concern about this very issue during the *Halliburton II* argument, questioning whether event studies can accurately ''distinguish between the effect on price of the facts contained in a disclosure and an irrational reaction by the market.''[44] If Pritchard and Henderson are right that a claim may be premised on reliance on an irrational and/or garbled information transmission mechanism, then the private right of action under Section 10(b) and Rule 10b-5 starts to look less like a personal right to recover for injury proximately caused by fraud and more like a universal insurance scheme intended to protect against general market losses.

Furthermore, Justice Alito's question about the efficacy of event studies hints at a fundamental inconsistency in the economic approach advocated in the law professors' brief. Pritchard and Henderson posit that event studies may be used to test price impact at class certification.[45] In support of their position, they quote a paper by Daniel Fischel for the proposition that '' 'an event study [can] determine whether the alleged misrepresentations caused any statistically significant stock price movements when made or when a supposedly corrective disclosure was made, controlling for other possible causes of stock price movements.''[46] But Pritchard and Henderson fail to acknowledge that an event study itself is dependent on market efficiency. In-

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[38] *See Basic*, 485 U.S. at 243 (''Reliance provides the requisite causal connection between a defendant's misrepresentation and a plaintiff's injury.''); *see also Stoneridge*, 552 U.S. at 160 (2008) (''reliance is tied to causation, leading to the inquiry whether respondents' acts were immediate or remote to the injury''); *Dura Pharms., Inc. v. Broudo,* 544 U.S. 336, 341-42 (2005) (reliance is also known as ''transaction causation'').

[39] *Basic*, 485 U.S. at 244 (quoting *In re LTV Sec. Litig.*, 88 F.R.D. 134, 143 (ND Tex.1980)).

[40] *Basic*, 485 U.S. at 248.

[41] *Amgen*, 133 S. Ct. at 1192.

[42] *Halliburton II*, Law Professors' Brief, 2014 WL 60721, at *11 (citing *Blackie v. Barrack*, 524 F.2d 891, 907 (9th Cir. 1975)). Thus understood, the law professors' proposal would be premised on a doctrinal reformulation of the fraud on the market presumption of reliance. Rather than the investor relying on the market as an ''unpaid agent'' that ''inform[s] him that given all the information available to it, the value of the stock is worth the market price,'' the investor would now simply be relying on the market to be free from fraud – a view that, as noted above, some might see as the equivalent of doing away with the reliance element altogether. Notably, at oral argument in *Halliburton II*, Justice Scalia made the point that reliance is an element that distinguishes a private claim seeking compensation for individual injury from an enforcement action by the SEC, the agency assigned primary responsibility under the statute for policing violations of the antifraud provisions of the securities laws. *See Halliburton II*, Transcript of Oral Argument, at 49. As Halliburton argued in its brief, if the goal is to allow investors to trade in markets free from fraud, then public enforcement of the securities laws by the SEC and by the Department of Justice – without the need to establish reliance – offers ''the most potent mechanism for achieving the goals of the securities laws.'' *See Halliburton II*, Petitioners' Brief, 2013 WL 6907610 at *45-*47.

[43] William O. Fisher, *Does The Efficient Market Theory Help Us Do Justice in a Time of Madness?*, 54 Emory L.J. 843, 976 (2005).

[44] *See Halliburton II*, Transcript of Oral Argument, at 24.

[45] *Halliburton II*, Law Professors' Brief, 2014 WL 60721, at *25-*26.

[46] *Id.* at *25 (quoting Daniel R. Fischel, *Market Evidence in Corporate Law*, 69 U. Chi. L. Rev. 941, 948 (2002)).

deed, as authority for the proposition quoted in the law professors' brief, Fischel cited another paper that provides a practical explanation of how event studies may be used in the courtroom.[47] That paper explained the following:

> Event studies of the type used in litigation rely on two well-accepted principles: first, the semi-strong version of the Efficient Market Hypothesis, which states that stock prices in an actively traded security reflect all publicly available information and respond quickly to new information; and, second, the price of an efficiently traded stock is equal to the present discounted value of the future stream of free cash flow.[48]

Thus, Pritchard and Henderson cannot avoid the efficient market hypothesis by proposing that an event study to test ''price impact'' may be substituted for a test of general market efficiency at class certification. Indeed, even they concede that, while ''proving that a market is generally highly efficient, and thus tends to incorporate all information quickly, is unnecessary [in their view] to demonstrating that there has been a fraud on the market as to a specific statement,'' this is only so ''as long as a market functions well enough to incorporate the specific misrepresentation at issue into a security's price.''[49] In short, if the analysis of ''price impact'' is untethered from the efficient market hypothesis, then there is no principled way to consider a temporal correlation between an alleged misstatement and a change in price to be a reflection of the market's fair assessment of the value of the information imparted by the statement.[50]

IV. Conclusion

There is no doubt that the fraud on the market presumption of reliance recognized in *Basic*, and the economics associated with it, are highly controversial. Assuming that the Supreme Court does not overturn *Basic* altogether—which it may still do as the Court continues to exhibit a less legislative bent in its decision-making—it likely will be very difficult for the Court to forge a workable middle ground that makes sense of the myriad competing positions on the topic. Even the ''midway position'' advocated in the ''law professors' brief'' cannot accomplish what some might hope, that is, provide a clear test for class certification divorced from controversial economic theories. Indeed, if the Court were to adopt this ''price impact'' test, the efficient market hypothesis would still lurk in the background—at the very least offering defendants a basis for contesting the efficacy of plaintiffs' event studies at class certification, to say nothing of its use later in the case to test issues such as materiality, loss causation and damages.

Ultimately, it is clear is that: (1) the adoption of the ''price impact'' test—either standing alone or in concert with the existing *Basic* market efficiency regime—would likely allow many securities class actions to proceed, and (2) a middle ground decision in *Halliburton II*, whatever form it might take, would likely produce a new explosion of litigation in the lower courts over the economic underpinnings and workings of such a new test.

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[47] Fischel, *supra* note 46, at 948 n.12 (citing David I. Tabak & Frederick C. Dunbar, *Materiality and Magnitude: Event Studies in the Courtroom*, NAT'L ECON. RESEARCH ASSOCS. WORKING PAPER No. 34 (April 1999)).

[48] Tabak and Dunbar, National Economics Research Associates Working Paper No 34, at 3.

[49] *Halliburton II*, Law Professors' Brief, 2014 WL 60721, at *7.

[50] *See, e.g.*, Langevoort, *supra* note 36, at 180 & n.127; Frederick C. Dunbar & Dana Heller, *Fraud on the Market Meets Behavioral Finance*, 31 DEL. J. CORP. L. 455, 509 (2006) (''When a market is not efficient . . . the normal conditions for interpreting the valuation component of an event study are not present'').

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