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What's Left of 'Amgen' After 'Halliburton II'?

From the Experts

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When the U.S. Supreme Court issued its anxiously awaited decision in *Halliburton. v. Erica P. John Fund* (a.k.a., *Halliburton II*), it answered the most critical issue concerning the future of securities fraud class actions: namely, whether they have a future. They do because the court reaffirmed the fraud on the market presumption of reliance that enables securities fraud actions to proceed as class actions. But the decision also left securities litigators on both sides of the bar wondering where the decision left the Court's major ruling on class certification in securities actions that came down just last year: *Amgen v. Connecticut Ret. Plans & Trust Funds*, 133 S. Ct. 1184 (2013).

To understand the seeming disconnect between *Halliburton II* and *Amgen*, it helps to go back to the Supreme Court's 1988 decision in *Basic v. Levinson*, 485 U.S. 224 (1988). In *Basic*, the Court adopted the fraud on the market presumption of reliance, which in a proper case would eliminate issues of individual reliance that would prevent class certification. The Court held that to invoke the presumption the plaintiff must "allege and prove: (1) that the defendant made public misrepresentations; (2) that the misrepresentations were material; (3) that the shares were traded on an efficient market; and [(4)] that the plaintiff traded the shares between the time the misrepresentations were made and the time the truth was revealed."

The requirement that the defendant's securities trade in an efficient market is necessary to tie *any* stock price movement to *any* statement; *i.e.*, only in an efficient market will the stock price react to any material information published to the market. To determine whether the defendant's securities trade in an efficient market, courts typically consider the so-called "*Cammer* factors": (1) the stock's average weekly trading volume; (2) the number of securities analysts that followed and reported on the stock; (3) the presence of market makers and arbitrageurs; (4) the company's eligibility to file a Form S-3 Registration Statement; and (5) a cause-and-effect relationship, over time, between unexpected corporate events or financial releases and an immediate response in stock price. *Cammer v. Bloom*, 711 F. Supp. 2d 1264, 1286-87 (D. N.J. 1989).

As is evident from the factors, the focus of the inquiry is on the efficiency of the market for the securities generally, not on the impact the alleged misstatement had on the market.

Both the publicity and materiality requirements of the fraud on the market presumption, unlike market efficiency generally, relate specifically to the alleged misstatement at issue; *i.e.*, whether the alleged misstatement was published to the market and was material. Assuming the alleged misstatement was published to an efficient market for a defendant's securities, what evidence would be the clearest indication of whether the misstatement was material or not? Surely, the impact on the stock price (or lack thereof) when the alleged misstatement was made or corrected.

Now fast-forward to 2011. In *Erica P. John Fund v. Halliburton* (a.k.a., *Halliburton I*), the Supreme Court considered

whether a securities class action plaintiff would have to prove loss causation in order to take advantage of the fraud on the market presumption at the class certification stage. Loss causation, which is an element of a 10b-5 claim, ensures that the alleged misstatement is a direct cause of the plaintiff's loss. Loss causation typically is established by showing a drop in defendant's stock price when the alleged misstatement was corrected. The Court held that a plaintiff need not prove loss causation to obtain class certification. It noted that reliance is a common element if the plaintiff can invoke the fraud on the market presumption and the presumption does not require a showing of loss causation: "Loss causation addresses a matter different from whether an investor relied on a misrepresentation presumptively or otherwise, when buying or selling a stock."

Interestingly, Halliburton urged the Supreme Court to determine whether proof of materiality, not loss causation, would be required at the class certification stage. It argued that while the Court of Appeals held that plaintiff was required to prove loss causation to obtain class certification, what the Court of Appeals really meant was that the plaintiff was required to prove that the alleged misrepresentation affected the market price—*i.e.*, that the misrepresentation was material. The Supreme Court elected not to address the issue: "While the opinion below may include some language consistent with a 'price impact' approach . . . we simply cannot ignore the Court of Appeals' repeated and explicit references to 'loss causation.'"

In last year's *Amgen* decision, the Supreme Court dealt with the issue of materiality head on and held that a securities fraud class action plaintiff need not prove materiality at the class certification stage. The Court noted that because the issue of materiality is an objective one and is an essential element of the 10b-5 claim, it is a common question that can be determined on a class-wide basis as part of the merits. The court distinguished materiality from market efficiency and publicity: Unlike materiality, market efficiency and publicity are not essential elements of a 10b-5 claim, so a finding that the market is inefficient or the alleged misrepresentation was not published to the market would not require dismissal of the 10b-5 claim on the merits. The Court concluded that materiality and market efficiency (and publicity), though all common questions, should be treated differently at the class certification stage because a finding that the market is inefficient or the misrepresentation was not published to the market would necessarily cause individual issues of reliance to predominate, while a finding of immateriality could never cause individual issues to predominate because it would end the case for the class and all individuals in the class.

Now, in *Halliburton II*, the Court held that a plaintiff seeking to avail itself of the fraud on the market presumption is not required to demonstrate that the alleged misrepresentation actually affected the stock price, but held that defendants must have an opportunity at the class certification stage to rebut the presumption with evidence "showing that the alleged misrepresentation did not actually affect the stock's market price." Having already held in *Amgen* that market efficiency and publicity are the only issues to be considered at the class certification stage concerning the fraud on the market presumption and that materiality is not to be considered until the merits stage, the Court had to somehow tie the price impact inquiry to market efficiency even though most would agree that price impact is much more indicative of materiality than market efficiency.

And so it tried. The Court asserted that "price impact differs from materiality in a crucial respect," but only discussed the difference in terms of the timing as to when during the course of the litigation materiality and price impact should be considered. The Court reiterated its *Amgen* holding that materiality is a discrete issue that can be confined to the merits stage. Price impact, it noted, is "*Basic's* fundamental premise" and "thus has everything to do with the issue of predominance at the class certification stage." The Court explained that price impact is highly relevant to the fraud on the market presumption because "publicity and market efficiency are nothing more than prerequisites for an indirect showing of price impact." The Court continued that it "saw no need to artificially limit the inquiry at the certification stage to indirect evidence of price impact" and therefore concluded that direct evidence of price impact (or lack of price impact) should be considered at the class certification stage.

The Court's conclusion makes perfect sense, but its logic not so much. Take the *Halliburton* (both *I* and *II*) fact scenarios as an example. There can be no doubt that the market for Halliburton securities is efficient. In fact, defendants stipulated to market efficiency. So evidence of lack of price impact cannot go to the efficiency of the market. Nor is there any issue in *Halliburton* as to whether the alleged misstatement was published to the market. Nevertheless, the case was remanded to the district court to permit Halliburton to rebut the fraud on the market presumption with evidence that the alleged misstatement or its correction did not impact its stock price. How could the evidence rebut the presumption? Not by showing market inefficiency (which Halliburton has admitted) or lack of publicity (which is not at issue). So it can only rebut the presumption by demonstrating the efficient market did not react to the alleged misstatement—*i.e.*, the statement was not material.

Therefore, for all practical purposes, hasn't the Supreme Court in *Halliburton II* reversed its holding in *Amgen* that materiality is not to be considered at the class certification stage?

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