No. 13-317

In the
Supreme Court of the United States

HALLIBURTON CO. AND DAVID LESAR,
Petitioners,
v.
ERICA P. JOHN FUND, INC., FKA ARCHDIOCESE OF MILWAUKEE SUPPORTING FUND, INC.,
Respondent.

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

BRIEF OF THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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CORPORATE DISCLOSURE STATEMENT

Amicus curiae states that it does not have any parent corporation and that no publicly held company owns more than 10% of its stock.

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STATEMENT OF INTEREST[1]

The American Institute of Certified Public Accountants ("AICPA") is the world's largest member association representing the accounting profession, with more than 394,000 members in 128 countries and a 126-year heritage of serving the public interest. AICPA members represent many areas of practice, including public accounting, business and industry, government, education, and consulting.

Although no member of the AICPA is a party to this case, issues surrounding this Court's decision in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), and its fraud-on-the-market presumption of reliance have a distinct impact on and are of paramount importance to the AICPA and its membership. Accounting firms are frequently named as defendants in securities fraud cases. While securities suits against non-issuers decreased in the years immediately following this Court's decision in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994), and the Private Securities Litigation Reform Act of 1995 ("PSLRA"), securities class actions against accounting firms remain commonplace.

This Court's decisions in cases such as *Central Bank* have thus not eliminated the common practice of naming accounting firms as co-defendants in

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[1] Pursuant to Supreme Court Rule 37.6, *amicus curiae* states that no counsel for any party authored this brief in whole or in part and that no entity or person, aside from *amicus curiae* and its counsel, made any monetary contribution toward the preparation or submission of this brief. Pursuant to Supreme Court Rule 37.3, counsel of record for all parties have consented to this filing in letters on file with the Clerk's office.

private securities suits. That is largely because of the combined effect of regulatory requirements that compel accounting firms to make certain public statements and *Basic*'s presumption of reliance. Unlike other non-issuers that can now generally avoid being named as defendants in private securities suits under § 10(b) because of decisions such as *Central Bank* and *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148 (2008)—*viz.*, underwriters, attorneys, and ratings agencies—federal law compels accounting firms to make public statements. Every public company must file with the SEC an annual financial statement that has been audited by a certified public accountant. *See* 15 U.S.C. § 78j-1 (mandating and setting standards for annual audit). These audits are governed by an extensive body of detailed requirements and typically result in very specific public statements by the audit firm.

When *Basic*'s presumption of reliance is combined with the statements required under the current federal regulatory scheme, it is difficult for accounting firms to avoid being named as a co-defendant when an audit client suffers the kind of price decline that makes a securities class action all but inevitable. Plaintiffs often reflexively allege that the audit report issued on a public company's financial statements was false and misleading and thereby violated § 10(b) of the Securities Exchange Act and Rule 10b-5. The possibility that investors actually relied on distinct representations of the issuer—for example, concerning an upcoming product launch—is irrelevant at the certification stage because of the *Basic* presumption.

A fair number of these allegations survive a motion to dismiss despite the heightened pleading requirements of the PSLRA, and although auditors might well defeat these allegations at a later stage of the proceedings (*e.g.*, summary judgment after discovery, or trial), the cost and risk of attempting to do so can be extraordinarily high. And unlike an issuer that generally faces potential liability only for its own shares, accounting firms face liability for statements about the whole range of their audit clients.[2] Moreover, new proposed regulatory requirements suggest that this dynamic may be exacerbated. The trend is for regulators to impose more requirements on accountants to make additional public statements, which can only increase the number and cost of claims against accounting firms, and ultimately the cost of audit services.[3]

These factors, as well as the changed nature of securities doctrine discussed below, strongly counsel in favor of abandoning *Basic* and its presumption of

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[2] Unlike underwriters, federal accounting independence rules prevent accountants from limiting their liability through indemnification agreements, *see* 17 C.F.R. §§ 210-240 (2001), and unlike rating agencies, accounting firms have not secured First Amendment protection for their public statements, *see, e.g.*, *In re Enron Corp. Sec., Derivative & "ERISA" Litig.*, 511 F. Supp. 2d 742, 819 (S.D. Tex. 2005).

[3] *See, e.g.*, Public Company Accounting Oversight Board, *Proposed Auditing Standard Regarding the Auditor's Report and the Auditor's Responsibilities Regarding Other Information* (Aug. 13, 2013), http://pcaobus.org/Rules/Rulemaking/Docket034/Release_2013-005_ARM.pdf (proposing, among other things, an expansion of the auditor's report to include critical audit matters).

reliance or, at a minimum, allowing that presumption to be rebutted at the class certification stage.

SUMMARY OF ARGUMENT

The presumption of reliance this Court adopted in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), has no place in the § 10(b) private cause of action as this Court has refined it over the last quarter century. In the years since *Basic*, in decisions such as *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994), *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148 (2008), and *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011), this Court has made clear that defendants in private securities fraud suits are responsible only for those fraudulent statements and actions which they themselves direct to the public. At the same time, in decisions such as *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336, 341-43 (2005), this Court has emphasized that market declines themselves do not warrant legal damages. Like other legal claims, plaintiffs bringing a claim under federal securities laws can recover only for the damage that a defendant actually caused them. Thus, while plaintiffs could once lump all defendants and all statements together under an aiding and abetting liability theory, and all market declines together as claimed damages, current doctrine requires proof of every element of a § 10(b) action for each distinct statement of each defendant.

In the wake of these developments, *Basic* is outdated and out of place. A presumption that treats all speakers and statements alike is incompatible with a doctrine that mandates that an individual defendant can be liable only for what he or she actually says, and only to the extent that the defendant's statement caused the plaintiff's injury. And such a presumption cannot be squared with this Court's acknowledgement in *Stoneridge* and *Janus* that the judicially created § 10(b) cause of action should be given "'narrow dimensions,'" *Janus*, 131 S. Ct. at 2301-02, or the common-law origins of the § 10(b) action, *Dura*, 544 U.S. at 343-44.

The combined effect of *Basic* and the federal law requirements that accounting firms provide audit reports makes accountants easy targets for securities plaintiffs even when plaintiffs ultimately could not satisfy the elements of a § 10(b) action for the accountants' distinct statements. In the absence of *Basic*, private securities plaintiffs seeking to name an accounting firm as a defendant would need to show that they relied on the accountants' statements, not just those of the issuer. That requirement could make class certification more difficult and thus discourage plaintiffs from naming accountants as co-defendants when doing so is unwarranted. But *Basic* eliminates that check and increases the likelihood that an accountant will be added as a co-defendant when the stock price of a company it has audited precipitously declines. As a result, accountants may be hesitant to provide audit services to risky companies—the precise companies where audits could be most critical. *See Central Bank*, 511 U.S. at 189. This in turn undermines the achievement of the transparency and "'full disclosure'" that the securities laws seek to achieve. *Basic*, 485 U.S. at 234.

This Court's more recent precedent and the threat that *Basic* presents to fostering disclosure, coupled with the recognition that reliance is an "essential element of the § 10(b) private cause of action," *Stoneridge*, 552 U.S. at 159, make the need for reconsideration of *Basic* and its presumption plain. But, at a minimum, this Court should hold that defendants can rebut the presumption of reliance at the class certification stage. As this Court has recognized in prior cases, class actions create the very real risk of *in terrorem* settlements that bear no real relationship to the merits of the underlying claims. Allowing rebuttal of the *Basic* presumption at the class certification stage will help mitigate the risk of such settlements.

ARGUMENT

I. This Court's More Recent Decisions Regarding Securities Liability Have Made *Basic* And Its Presumption Of Reliance Outliers.

The securities law landscape has changed substantially since the Supreme Court decided *Basic Inc. v. Levinson*, 485 U.S. 224 (1988). When *Basic* was decided, businesses of all stripes were lumped together as defendants in private securities fraud cases even though many of them had never themselves made any relevant public statement. Moreover, in the pre-*Basic* era (and for several years after *Basic*), plaintiffs often made loose allegations of misconduct and claims for damages under a relatively amorphous cause of action.

All of this has now changed. In the twenty-five years since *Basic*, this Court has clarified that only those entities that direct fraudulent statements and actions at the public can be held liable for securities fraud, and only for the damages those statements caused. And it has repeatedly emphasized that the judge-made § 10(b) cause of action should be narrowly construed and should reflect the cause of action's common-law origins. *Basic* and its presumption of reliance are of a piece with the earlier regime in which all the defendants' statements were lumped together and claims and damages were assessed under an amorphous standard. Doctrinal developments since *Basic* have rendered the presumption an anachronism.

A. *Basic*'s Presumption of Reliance Is Out of Step With This Court's Decisions in *Central Bank*, *Stoneridge*, and *Janus* Defining What Conduct Is Actionable Under the Securities Law.

The nature and scope of civil claims under the federal securities law has changed fundamentally since this Court's decision in *Basic*. When *Basic* was decided, individuals and entities that aided and abetted a violation of the securities law could be held liable in private suits for the issuer's misstatements. *See, e.g.*, *Cleary v. Perfectune, Inc.*, 700 F.2d 774, 777 (1st Cir. 1983); *Edwards & Hanly v. Wells Fargo Sec. Clearance Corp.*, 602 F.2d 478, 485 (2d Cir. 1979); *Kerbs v. Fall River Indus., Inc.*, 502 F.2d 731, 740 (10th Cir. 1974); *Cumis Ins. Society, Inc. v. E.F. Hutton & Co.*, 457 F. Supp. 1380, 1386 (S.D.N.Y. 1978); *see also* Alan R. Bromberg & Lewis D. Lowenfels, *Aiding and Abetting Securities Fraud: A Critical Examination*, 52 Alb. L. Rev. 637, 662 (1988);

David S. Ruder, *Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy* In Pari Delicto*, Indemnification, and Contribution*, 120 U. Pa. L. Rev. 597 (1972). This Court's decision in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994), sought to end that practice. The *Central Bank* Court held that "only the making of a material misstatement (or omission) or the commission of a manipulative act" was proscribed by § 10(b), and that "proscription does not include giving aid to a person who commits a manipulative or deceptive act." *Id.* at 177-78. It is now black letter law that private plaintiffs may not recover from defendants that aided and abetted a securities law violation, but did not themselves commit a violation. That does not mean that third-parties are free to aid and abet securities fraud. But when Congress expressly considered the matter, it granted the SEC the authority to police secondary actors, rather than create a private cause of action that reached aiding and abetting. *See* 15 U.S.C. § 78t(e) (directing prosecution of aiders and abettors by the SEC).

The plaintiffs' bar strongly resisted *Central Bank* and went to great lengths—which were successful in some circuits—to re-establish a form of aiding and abetting liability under the rubric of "scheme liability." *See, e.g.*, *Simpson v. AOL Time Warner, Inc.*, 452 F.3d 1040 (9th Cir. 2006). In *Stoneridge Investment Partners, LLC v. Scientific-Atlanta*, 552 U.S. 148 (2008), this Court reaffirmed that liability in a private § 10(b) action depends on the defendant's own misrepresentations. *Stoneridge* rejected the theory that defendants that allegedly enabled an issuer's misleading statements, but who did not themselves actually make any public statement, are primary violators. Reaffirming *Central Bank*, the Court stated that were it to adopt such a "construction of § 10(b), it would revive in substance the implied cause of action against all aiders and abettors" it had previously extinguished. *Id.* at 162-63. The Court emphasized that Congress had expressly addressed secondary liability, and addressed it through expanded SEC authority, and not via an expanded private action. *Id.* at 158.

The Court took all this one step further in *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011). There, this Court reiterated "that the maker of a statement is the entity with authority over the content of the statement and whether and how to communicate it." *Id.* at 2302-03. In recognition of that fact, the Court held that merely providing information that another entity uses in a public statement cannot, without more, give rise to a private cause of action for securities fraud. *Id.*

Against this backdrop, *Basic*'s presumption of reliance is an anachronism. When every plaintiff could recover against every defendant for any defendant's statement, sorting out which plaintiffs relied on which statements was unnecessary. But when liability turns on the distinct statements of specific defendants, as is now the case, that presumption makes little sense.

This Court's emphasis that a defendant's liability turns on its own statements and not those of its co-defendants presupposes the possibility that a plaintiff could rely on one defendant's misrepresentation, but not the other. For example, in a case involving multiple allegedly fraudulent statements by the issuer, some of which are related to audited financial statements, and some of which involve the launch date of a new product, there is no basis for holding an audit firm liable for a purchaser who relies on the latter statements. Absent the *Basic* presumption, the need to allege and ultimately prove reliance on each defendant's specific statement or statements could preclude class certification and deter class action counsel from adding the audit firm as a co-defendant as a matter of course. Reliance is traditionally viewed as an individualized issue, and the possibility that some class members could rely on one defendant's statement but not another defendant's statement complicates matters further. But the *Basic* presumption allows such issues to be swept aside on the assumption that all purchasers relied on the market and the statements that were priced into the stock. In light of doctrinal developments since *Basic*, there is no justification for holding an auditor liable for the losses of a purchaser who relied on the issuer's distinct statement (or vice-versa).

Basic is also at odds with *Stoneridge* and *Janus* at a more fundamental level. *Stoneridge* expressly acknowledged that the "§ 10(b) private cause of action is a judicial construct" and that, as such, "[c]oncerns with the judicial creation of a private cause of action caution against its expansion." 552 U.S. at 164-65. The Court stressed that "[t]hough it remains the law, the § 10(b) private right should not be extended beyond its present boundaries." *Id.* And, as noted, *Stoneridge* emphasized that Congress remains able to intervene and employ tools—such as expanded SEC jurisdiction—that are unavailable to judges administering a judge-made cause of action. *Id*. at 158. *Janus* repeated *Stoneridge*'s concern regarding the judicial creation of private causes of action and noted that the Court was "mindful 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*, 131 S. Ct. at 2301-02 (quoting *Stoneridge*, 552 U.S. at 165-67); *see id*. at 2303 ("Our holding also accords with the narrow scope that we must give the implied private right of action."). The Court's modern impulse to construe the § 10(b) action narrowly is of a piece with the Court's modern reluctance to create new implied causes of action or to expand existing ones. *See, e.g.*, *Alexander v. Sandoval*, 532 U.S. 275, 287 (2001) ("Having sworn off the habit of venturing beyond Congress's intent, we will not accept respondents' invitation to have one last drink."); *Corr. Servs. Corp. v. Malesko*, 534 U.S. 61 (2001) (refusing to create an implied cause of action for damages against private entities that engaged in alleged constitutional deprivations while acting under color of federal law).[4]

The continued application of *Basic*'s presumption of reliance is inconsistent with the now repeated acknowledgement that implied causes of action

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[4] To be sure, the Court was already cutting back on the practice of recognizing new implied causes of action at the time *Basic* was decided. But this Court's decisions since *Basic* have emphasized that such implied causes of action, including under § 10(b), must be narrowly construed.

generally, and the § 10(b) cause of action specifically, must be narrowly construed. The creation of a presumption of reliance, a presumption with no grounding in common-law fraud actions, *see infra* p. 14, is a particularly muscular exercise of judicial law-making. The presumption does far more than simply round out a previously recognized private cause of action. The inevitable result of a presumption of reliance is the creation of a broader cause of action, and one more amenable to class treatment. In the absence of such a presumption, plaintiffs in individual securities cases would need to prove they actually relied on the statements at issue, and class plaintiffs would need to establish that the reliance issue was an issue common to the class (and then prove actual reliance). The application of the *Basic* presumption makes it easier to file and litigate securities cases and, as described *infra* to obtain judgments (or unjustified settlements), making the presumption irreconcilable with the narrow construction of the cause of action this Court's post-*Basic* precedent requires.[5]

[5] *Basic* is also out of step with the Court's modern insistence that class actions are simply a procedural mechanism to aggregate individual claims that by their nature are amenable to class treatment, as opposed to manipulating the substance of claims to make them fit within the class-action device. *See, e.g.*, *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541 (2011); *see also* Pet. Br. at 25-26.

B. *Basic*'s Presumption of Reliance Is Inconsistent With *Dura*'s Clarification of What Is Required To Establish Loss Causation.

In parallel to the further refinement of what specific actions by defendants can warrant liability in a private securities action, this Court has provided greater clarity on the exact elements that a plaintiff must plead and prove in such an action. As the Court explained in *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336, 341-43 (2005), a plaintiff has to do more than establish that the price of a security was inflated on the day it was purchased to show that it was injured by a defendant's statement. The Court explained that when the "purchaser subsequently resells [its] shares, even at a lower price, that lower price may reflect, not the earlier misrepresentation, but changed economic circumstances, changed investor expectations, new industry-specific or firm-specific facts, conditions, or other events, which taken separately or together account for some or all of that lower price." *Id.* at 342-43. Accordingly, pursuant to *Dura*, a plaintiff must account for "the tangle of factors affecting price" and prove that the misrepresentation *caused* the loss, not merely that it "touches upon" the loss. *Id.* at 343.

As with the increased clarity of what conduct is actionable under the securities law, *Basic*'s sweeping presumption of reliance is in tension—if not direct conflict—with *Dura*'s basic requirement to show loss causation. There is no justification for requiring that a plaintiff bringing a claim under the federal securities laws prove that the defendant's own statement caused its injury (like any other plaintiff), while allowing that same plaintiff to presume its own reliance on the same statement.

Dura's emphasis on the common law origins of private securities fraud actions as part of its reasoning further undermines *Basic*'s presumption of reliance. "Judicially implied private securities fraud actions resemble in many (but not all) respects common-law deceit and misrepresentation actions," *id.* (citing *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 744 (1975)), and common-law fraud and securities fraud share the same basic elements. It is black letter law that "reliance is an element of a common-law fraud" or deceit action. *Bridge v. Phoenix Bond & Indem. Co.*, 553 U.S. 639, 656 (2008).

There is, of course, no presumption in the common-law fraud or deceit context remotely analogous to that announced in *Basic*. To the contrary, reliance must be proved, not presumed, and reliance is widely understood to be an individualized element of a common-law fraud action. *See, e.g.*, *In re St. Jude Med., Inc.*, 522 F.3d 836, 839 (8th Cir. 2008). And while, by its very nature, a judicially-created cause of action will require courts to round out the cause of action to allow it to function, a presumption with no common-law roots goes well beyond filling in the details. There is no valid basis for watering down one of the essential elements of the common-law deceit claim on which the judicially-fashioned civil securities fraud claim is based.

II. *Basic*'s Presumption Of Reliance Has A Detrimental Effect On Accountants—Non-Issuers Required To Make Public Statements—And Deters Conduct That Would Otherwise Promote The Securities Law's Goals.

That *Basic* should be reconsidered is further underscored by the role it plays in undermining the securities law's broader goals. As *Basic* itself pointed out, the Court has "recognized time and again" that one of the "'fundamental purpose[s]' of the various Securities Acts" was to promote "'a philosophy of full disclosure . . . .'" 485 U.S. at 234 (quoting *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186 (1963)); *see also Affiliated Ute Citizens v. United States*, 406 U.S. 128, 151 (1972) (same); *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 477-78 (1977) (same). The accounting profession plays a critical role in facilitating such disclosure by auditing many financial statements issued by public companies. Regulators demand that auditors make their statements public, and those demands are likely to increase. The broad class-action liability that the presumption of reliance perpetuates threatens the willingness and ability of accounting firms to engage in these audits.

Basic eliminates an important counterweight that would otherwise deter plaintiffs from adding accounting firms and other non-issuers as co-defendants when there is no reasonable basis for doing so. But for *Basic* and its presumption, multiplying the number of defendants makes it more likely that individualized issues like reliance will predominate. The need to show that class members relied distinctly on the issuer's statements (which often address matters unrelated to any audited financial statements) and the auditor's opinion (when there is a very real prospect that some class members relied only on the former, some on the latter, some on a mix and some on unrelated factors) would provide a built-in disincentive for adding an accounting firm as a co-defendant unless the facts warranted. But *Basic* and its presumption obscure the need to show actual reliance, and make it unduly easy for plaintiffs to include a host of co-defendants in private securities fraud suits.

There are already numerous incentives to include accounting firms as defendants without regard to their ultimate responsibility for the plaintiffs' injuries. As numerous commentators have recognized, accountants and accounting firms are inviting "deep pockets" in private securities fraud suits. *See, e.g.*, S. Rep. No. 104-98, at 9 (1995) (noting that "professionals are prime targets of abusive securities lawsuits" and that "[t]he deeper the pocket, the greater the likelihood that a marginal party will be named as a defendant"). In many cases, the issuer responsible for the allegedly misleading financial statements has gone bankrupt or become otherwise judgment-proof, leaving the accountant as the only entity from which plaintiffs can hope to recover their investment losses. *See* Daniel L. Brockett, *Line Between Primary and Secondary Liability Still Blurred in Securities Cases*, 50 Fed. Law. 29, 30 (2003).

Moreover, an accountant's prospects of being named as a defendant in a private securities fraud case are orders of magnitude greater than the prospects of other non-issuers or any given issuer. As noted, accounting firms have no option but to make public statements. While other non-issuers can respond to the incentives of *Central Bank* and *Stoneridge* by refraining from making public statements, for accounting firms such statements are mandated by federal law. And an issuer typically makes representations (and potential misrepresentations) about only its own affairs. Not so with accounting firms. Audit firms audit and report on the financial condition of a diverse array of audit clients, such that it is all but inevitable that some portion of those clients will experience the kind of precipitous decline in share price that virtually guarantees securities litigation.

In light of these dynamics, allowing accountants and accounting firms to be caught up in securities class actions—essentially because they issued an audit statement—threatens the widespread availability of the audit services on which the securities laws' goals of transparency and "'full disclosure'" depend. *Basic*, 485 U.S. at 234. This Court has repeatedly recognized as much. *See Credit Suisse Sec. (USA) LLC v. Billing*, 551 U.S. 264, 282 (2007) (unduly expansive securities laws may cause auditors to "act in ways that will avoid not simply conduct that the securities law forbids . . . but also a wide range of . . . conduct that the securities law permits or encourages"). What is more, the impact will likely be greatest on the companies that could benefit the most from a robust audit. As this Court recognized in *Central Bank*, unduly broad liability theories may make it "difficult" for "newer and smaller companies . . . to obtain advice from professionals. A professional may fear that a newer or smaller company may not survive and that business failure would generate securities litigation against the professional, among others." 511 U.S. at 189.

Even where litigation risk does not cause accountants and accounting firms to forego providing their much-needed services, those risks will be reflected in the price of audit services. *See* Jamie Pratt & James D. Stice, *The Effects of Client Characteristics on Auditor Litigation Risk Judgments, Required Audit Evidence, and Recommended Fees*, 69 Acct. Rev. 639, 655 (1994). This outcome runs directly counter to the consumer-protection focused aims of the federal securities laws. *See Central Bank*, 511 U.S. at 189 ("[I]ncreased costs incurred by professionals . . . may be passed on to the[professional's] client companies, and in turn incurred by the company's investors, the intended beneficiaries of the statute." (citing Ralph K. Winter, *Paying Lawyers, Empowering Prosecutors, and Protecting Managers: Raising the Cost of Capital in America*, 42 Duke L.J. 945, 948-66 (1993))).

III. While *Basic*'s Presumption Of Reliance Should Be Discarded, At A Minimum, Defendants Should Be Permitted To Rebut It During Class Certification.

This Court has unequivocally stated that "[r]eliance by the plaintiff upon the defendant's deceptive acts is an essential element of the § 10(b) private cause of action." *Stoneridge*, 552 U.S. at 159. The notion that reliance can be presumed, rather than proved, is an anomaly that involves a muscular exercise of fashioning a judicial cause of action. Whatever its merits at the time it was decided, subsequent developments, both factual and doctrinal, strongly counsel in favor of doing away with *Basic*'s presumption of reliance. Stare decisis is never an inexorable command, and it has less force in the context of a judicially-created cause of action, where there has already been a deviation from the normal separation of powers arrangement under which only Congress may create new causes of action. *See Stoneridge*, 552 U.S. at 164-65. Moreover, subsequent doctrinal developments represent one of the accepted justifications for reconsidering precedent. *See, e.g.*, *Pearson v. Callahan*, 555 U.S. 223, 233-34 (2009).

Petitioners have demonstrated at length that the factual and economic premises underlying *Basic* have been eroded. Pet. Br. 14-25 (discussing critiques of *Basic*). But, as explained above, the legal foundations of *Basic* have been equally undermined in the last twenty-five years. The plaintiffs' need to demonstrate reliance, and the other elements of a modern § 10(b) action, based on each individual statement of each defendant, make the *Basic* presumption highly anomalous. The presumption of reliance obviates the need for a plaintiff to demonstrate that they relied on the auditor's statement as opposed to an issuer's statement about a new product launch, which cannot be reconciled with the requirement that a plaintiff establish the "essential element" of reliance. *Stoneridge*, 552 U.S. at 159.

The general problems with the theory underlying *Basic*'s presumption of reliance are exacerbated further by the way the presumption operates in practice. Whatever this Court's original intention, the *Basic* presumption of reliance has become largely non-rebuttable. *See, e.g.*, Joseph A. Grundfest, *Damages and Reliance Under Section 10(b) of the Exchange Act* 46-47 (Rock. Ctr. for Corp. Governance, Working Paper No. 150, 2013), http://ssrn.com/abstract=2317537; Patrick Hall, *The Plight of the Private Litigation Securities Reform Act in the Post-Enron Era: The Ninth Circuit's Interpretation of Materiality in* Employer-Teamster v. America West, 2004 B.Y.U. L. Rev. 863, 870-71 & n.46 (2004). Accordingly, it has played a critical part in the development of exactly the type of downside insurance scheme this Court has repeatedly warned against. *Dura*, 544 U.S. at 345 ("the statutes make these . . . actions available, not to provide investors with broad insurance against market losses, but to protect them against those economic losses that misrepresentations actually cause") *Cf. Basic*, 485 U.S. at 252 (White, J., joined by O'Connor, J., concurring in part and dissenting in part) ("[A]llowing recovery in the face of affirmative evidence of nonreliance—would effectively convert Rule 10b–5 into a scheme of investor's insurance. There is no support in the Securities Exchange Act, the Rule, or our cases for such a result" (internal quotation marks and citations omitted)).

This Court's more recent precedent, *Basic*'s adverse impact on desirable accounting activity, the current understanding of how information and the market interact, and two and a half decades of experience all counsel in favor of jettisoning *Basic*'s presumption of reliance. But, at a minimum, this Court should hold that the presumption of reliance can be rebutted at the class certification stage. Otherwise, most defendants will never get a chance to rebut it.

The potential for a disastrous damages award, even if very remote, creates overwhelming pressure to settle claims without regard to their merit once a class is certified. *See, e.g., AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1752 (2011) (class actions create risk of *in terrorem* settlements); *Stoneridge*, 552 U.S. at 163 ("[E]xtensive discovery and the potential for uncertainty and disruption in a lawsuit allow plaintiffs with weak claims to extort settlements from innocent companies."). Accountants and accounting firms, as well as other non-issuers, more often than not "find it prudent and necessary, as a business judgment, to abandon substantial defenses and to pay settlements in order to avoid the expense and risk of going to trial." *Central Bank*, 511 U.S. at 189. Permitting rebuttal of reliance early on at the certification stage will help reduce the number of these *in terrorem* settlements and the corresponding harm to wrongly named defendants.

CONCLUSION

This Court should overrule *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), and hold that securities plaintiffs are required to prove, rather than presume, reliance. In the alternative, this Court should hold that *Basic*'s presumption of reliance can be rebutted at the class certification stage.

Respectfully submitted,

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