No. 13-317

IN THE
Supreme Court of the United States

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

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

BRIEF FOR PETITIONERS

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QUESTIONS PRESENTED

1. Whether the Court should overrule or substantially modify the holding of *Basic Inc.* v. *Levinson*, 485 U.S. 224 (1988), to the extent that it recognizes a presumption of classwide reliance derived from the fraud-on-the-market theory.

2. Whether, in a case where the plaintiff invokes the presumption of reliance to seek class certification, the defendant may rebut the presumption and prevent class certification by introducing evidence that the alleged misrepresentations did not distort the market price of its stock.

PARTIES TO THE PROCEEDINGS BELOW

Halliburton Company and David Lesar were the defendants in the district court, and the appellants in the court of appeals.

Erica P. John Fund, Inc., fka Archdiocese of Milwaukee Supporting Fund, Inc. was the plaintiff in the district court, and the appellee in the court of appeals.

CORPORATE DISCLOSURE STATEMENT

Pursuant to this Court's Rule 29.6, Petitioner Halliburton Company states that it is a publicly held company, which has no parent company.

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

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BRIEF FOR PETITIONERS

Petitioners Halliburton Co. and David Lesar (collectively Halliburton) respectfully request that this Court reverse the judgment of the United States Court of Appeals for the Fifth Circuit.

OPINIONS BELOW

The court of appeals' opinion (Pet. App. 1a-22a), on remand from this Court, see *Erica P. John Fund, Inc.* v. *Halliburton Co.*, 131 S. Ct. 2179 (2011), is reported at 718 F.3d 423. The court of appeals' denial of rehearing (Pet. App. 23a-25a), and the opinion of the district court (*id*. at 26a-31a), are unreported. The court of appeals' previous opinion (*id*. at 32a-53a) is reported at 597 F.3d

330. The district court's previous opinion (Pet. App. 54a-99a) is unreported.

STATEMENT OF JURISDICTION

The judgment of the court of appeals was filed on April 30, 2013. The court of appeals denied rehearing on June 11, 2013. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTES AND RULES INVOLVED

Section 10(b) of the Securities Exchange Act is codified at 15 U.S.C. § 78j(b) and reproduced at App., *infra*, 1a.

Section 18(a) of the Securities Exchange Act is codified at 15 U.S.C. § 78r(a) and reproduced at App., *infra*, 2a.

SEC Rule 10b-5 is codified at 17 C.F.R. § 240.10b-5 and reproduced at App., *infra*, 3a.

Federal Rule of Civil Procedure 23 is reproduced at App., *infra*, 4a-12a.

Federal Rule of Evidence 301 is reproduced at App., *infra*, 13a.

PRELIMINARY STATEMENT

The presumption of reliance created by a four-Justice majority in *Basic Inc.* v. *Levinson*, 485 U.S. 224 (1988), rests on a two-part economic theory: that well-developed capital markets efficiently incorporate material information into a stock's market price and that investors purchase in reliance on the integrity of the market price. Under *Basic*, a putative class of investors is allowed to eschew actual proof of common reliance on a misrepresentation in order to obtain class certification and prevail on the merits. Instead, it can invoke a classwide presumption that all class members relied on the misrepresentation when they purchased stock at a price distorted by the misrepresentation.

Basic's substitution of nascent economic theory for bedrock securities and class-action law was questionable from the start, as Justices White and O'Connor argued in dissent. In the ensuing twenty-five years, *Basic*'s theoretical framework has been the subject of withering scholarly and empirical attack. Four Justices recognized as much in *Amgen, Inc.* v. *Connecticut Retirement Plans and Trust Funds*, 133 S. Ct. 1184 (2013). See *id*. at 1204 (Alito, J., concurring); *id*. at 1208 n.4 (Thomas, J., joined by Scalia and Kennedy, JJ., dissenting).

Basic's simplistic understanding of market efficiency is at war with economic reality. It massively expands 10b-5 liability in stark contrast to the Court's consistent holdings that the judicially created action must be narrowly construed. And it undercuts this Court's insistence that plaintiffs invoking Rule 23 must *affirmatively show* that common issues predominate, not presume that they do. Unsurprisingly, lower courts struggle to rationalize *Basic*'s fictions with the facts of cases before them.

Accordingly, the Court should overrule *Basic*. Even if an outright reversal is not deemed appropriate, the Court should at least substantially modify the threshold for invoking its presumption of reliance. Even in well-developed markets, stock prices do not efficiently incorporate all types of information at all times. Thus, if *Basic* survives, plaintiffs seeking class certification should be required to prove that the alleged misrepresentations *actually* distorted the market price. This approach would more closely align the reliance presumption with economic reality and with Rule 23's requirement that common issues predominate.

The decision below illustrates the anomalies that *Basic* generates. The court of appeals previously found that no alleged misrepresentation affected Halliburton's stock price. Pet. App. 37a, 42a-53a. It nonetheless affirmed class certification under *Basic*'s presumption.

And while *Basic* permits defendants to rebut the presumption by showing the absence of price distortion, 485 U.S. at 248, the court below ruled that such rebuttal was prohibited at the class-certification stage—the very stage where the presumption matters most. This Court reserved that question in *Erica P. John Fund, Inc.* v. *Halliburton Co.*, 131 S. Ct. 2179, 2187 (2011) ("*EPJ Fund*"), and did not address it in *Amgen.* Even if the Court declines to overrule or modify *Basic*, it should at least clarify that price distortion—*Basic*'s "fundamental premise," *EPJ Fund*, 131 S. Ct. at 2186—may be rebutted at the class-certification stage.

STATEMENT

I. BACKGROUND

Respondent Erica P. John Fund, Inc. (the Fund) is the lead plaintiff in this securities-fraud class action against Petitioners Halliburton Company and its CEO David Lesar. Pet. App. 2a. The Fund alleges three divergent categories of misrepresentations. These concern Halliburton's (1) potential liability in asbestos litigation; (2) accounting for revenue on fixed-price construction contracts; and (3) potential benefits from a merger with Dresser Industries. *Id.* at 3a. The Fund contends investors lost money when Halliburton's stock price dropped following the release of negative news that touched on one or more of the categories of alleged misrepresentations. *Ibid.*

The Fund relies on the judicially created action fashioned from Section 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b), and from SEC Rule 10b-5, 17 C.F.R. § 240.10b-5. To prevail on the merits, the Fund must prove: (1) a material misrepresentation; (2) scienter; (3) a connection with the purchase or sale of a security; (4) reliance; (5) economic loss; and (6) loss causation. See *Dura Pharms., Inc.* v. *Broudo*, 544 U.S. 336, 341-342 (2005).

The Fund sought class certification under Rule 23(b)(3), which requires it to show that "the questions of law or fact common to class members predominate over any questions affecting only individual members." The Fund was required to "affirmatively demonstrate * * * compliance" with this requirement by "prov[ing] * * * *in fact*" that common issues predominate. *Wal-Mart Stores, Inc.* v. *Dukes*, 131 S. Ct. 2541, 2551 (2011).

To satisfy Rule 23(b)(3), the Fund relied exclusively on *Basic*. *Basic* recognized that, under traditional fraud and class-certification principles, securities-fraud plaintiffs could rarely satisfy Rule 23(b)(3)'s predominance requirement because, if proof of actual reliance were required, "individual issues" would "overwhel[m] the common ones." 485 U.S. at 230, 242; *EPJ Fund*, 131 S. Ct. at 2185.

To remedy this perceived problem, *Basic*'s four-Justice majority[1] created a "rebuttable presumption" of classwide reliance, available to plaintiffs who invoke the "fraud-on-the-market" theory. 485 U.S. at 242, 247. That theory assumes that in an efficient, well-developed market, all public information about a company is reflected in the company's stock price, *id.* at 246, and that "[a]n investor who buys or sells stock at the price set by the market does so in reliance on the integrity of [the market] price," *id.* at 247.

To trigger the presumption at the certification stage, the plaintiff must show that (1) the misrepresentations were public; (2) the stock traded in an efficient market; and (3) the plaintiff traded between when the misrepre-

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[1] Only Justices Brennan, Marshall, and Stevens joined Justice Blackmun's opinion creating the presumption of reliance. Justices White and O'Connor dissented from that portion of the opinion. Chief Justice Rehnquist and Justices Scalia and Kennedy did not participate. *Basic*, 485 U.S. at 225.

sentations were made and when the truth was revealed. *Amgen*, 133 S. Ct. at 1198; *EPJ Fund*, 131 S. Ct. at 2185. These "threshold facts," *Basic*, 485 U.S. at 248, establish that the "investor presumptively relie[d] on [the] defendant's misrepresentation if that information [was] reflected in the market price of the stock at the time of the relevant transaction." *EPJ Fund*, 131 S. Ct. at 2186 (quotation omitted).

Basic permits defendants to "rebut the 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." 485 U.S. at 248. The defendant may do so by "show[ing] that the misrepresentation in fact did not lead to a distortion of price." *Ibid.* Such rebuttal breaks the "causal connection" because "the basis for finding that the fraud had been transmitted through [the] market price would be gone." *Ibid.* In other words, a misrepresentation that "does not affect market price * * * cannot be relied upon indirectly by investors who, as the fraud-on-the-market theory presumes, rely on the market price's integrity." *Amgen*, 133 S. Ct. at 1195.

II. Proceedings Below

A. Initial proceedings below

1. On June 3, 2002, the Fund filed suit in the U.S. District Court for the Northern District of Texas. Pet. App. 26a. Five years later, the Fund moved to certify a class of all purchasers of Halliburton stock between June 1999 and December 2001. *Id.* at 3a. During those five years, the Fund amended its complaint four times and obtained more than 600,000 pages of discovery from Halliburton.

The district court denied certification because the Fund failed to establish loss causation, a requirement under then-governing Fifth Circuit case law. *Ibid.* "Loss

causation * * * requires a plaintiff to show that a misrepresentation that affected the integrity of the market price *also* caused a subsequent economic loss." *EPJ Fund*, 131 S. Ct. at 2186. The district court observed that the Fund did "not point to *any* stock price increases resulting from positive misrepresentations." Pet. App. 58a n.11.

2. The Fifth Circuit affirmed. It noted that the Fund made no attempt to prove that the stock price moved in response to Halliburton's alleged misrepresentations but instead "relie[d] only on stock price decreases following allegedly corrective disclosures by Halliburton." Pet. App. 36a. For a plaintiff who relies solely on such price declines, the evidence "must raise an inference that the price was actually affected by earlier alleged misrepresentations." *Id.* at 37a. Without proof that the price decline was caused by a "correction to a prior misleading statement," *id.* at 36a, "there would be no inference raised that the original, allegedly false statement caused an inflation in the price to begin with," *id.* at 37a.

The Fifth Circuit concluded that none of the disclosures raised the necessary inferences; consequently, the Fund failed to prove market movement and therefore loss causation. *Id.* at 42a-53a.

B. This Court's opinion

This Court granted the Fund's petition for certiorari. Halliburton conceded that a plaintiff need not prove loss causation—price impact *plus* a subsequent loss caused by the fraud—to invoke *Basic*'s presumption of classwide reliance. *EPJ Fund,* 131 S. Ct. at 2186. Halliburton argued instead that the lower courts properly denied certification because Halliburton had rebutted the presumption by showing the absence of "price impact"—*i.e.*, that the alleged misrepresentation did not affect the stock's market price in the first place. *Id.* at 2186-2187.

This Court vacated and remanded because, contrary to the Fifth Circuit's rule, plaintiffs need not show "loss causation" to invoke *Basic*'s presumption. "Loss causation addresses a matter different from whether an investor relied on a misrepresentation, presumptively or otherwise, when buying or selling a stock." *Id.* at 2186.

The Court began with *Basic*'s premise that "an investor presumptively relies on a defendant's misrepresentation if that 'information is reflected in [the] market price' of the stock at the time of the relevant transaction." *Ibid.* (quoting *Basic*, 485 U.S. at 247). While *Basic*'s presumption focuses on price impact at the time of the transaction, "[l]oss causation, by contrast, requires a plaintiff to show that a misrepresentation that affected the integrity of the market price *also* caused a subsequent economic loss." *Ibid.* Consequently, an investor may have "purchased the stock at a distorted price, and thereby presumptively relied on the misrepresentation reflected in that price," yet "not be able to prove loss causation." *Ibid.* The court of appeals' loss-causation rule, therefore, "contravene[d] *Basic*'s fundamental premise—that an investor presumptively relies on a misrepresentation *so long as it was reflected in the market price at the time of his transaction*." *Ibid.* (emphasis added).

The Court acknowledged Halliburton's argument that it was entitled to rebut the presumption—and thereby defeat class certification—by showing an absence of "price impact." *Id.* at 2187. The Court declined to reach that issue, however, concluding only that "the Court of Appeals erred by requiring EPJ Fund to prove loss causation at the certification stage." *Ibid.* The Court "d[id] not * * * address any other question about *Basic*, its presumption, or how and when it may be rebutted." *Ibid.* It remanded so that Halliburton's price-impact argument could "be addressed in the first instance by the Court of Appeals." *Ibid.*

C. Proceedings on remand

1. The court of appeals remanded to the district court, see Pet. App. 4a, which certified the class. The five-page certification order contained only one sentence implicitly rejecting Halliburton's argument that it could rebut the classwide reliance presumption by showing the absence of price impact: "The fraud-on-the-market theory applies to this case, so proof of each individual class member's reliance is not required." *Id.* at 30a.

2. The Fifth Circuit granted leave to appeal. Before oral argument, this Court issued its decision in *Amgen*, 133 S. Ct. 1184, holding that plaintiffs need not establish that misrepresentations were material to gain class certification via the presumption of reliance. Four Justices signaled their willingness to reconsider the validity of *Basic*'s presumption of reliance. *Id.* at 1204 (Alito, J., concurring); *id.* at 1208 n.4 (Thomas, J., joined by Scalia and Kennedy, JJ., dissenting).

The court of appeals affirmed. It identified "[t]he pivotal question in this case [as] whether a defendant should be permitted to show the absence of price impact at the class certification stage * * * to establish that common issues among class members do not predominate and that class certification is inappropriate." Pet. App. 5a. The court acknowledged that *Amgen* prohibited consideration of materiality at the class-certification stage "[b]ecause materiality is an element of every fraud claim" and thus "[t]he absence of materiality 'ends the case for one and for all.'" *Id.* at 17a (quoting 133 S. Ct. at 1196). A decision on materiality could never cause individual questions to predominate.

The court acknowledged that *Amgen* requires certain fraud-on-the-market predicates to be considered at class certification, including market efficiency and whether the misrepresentation was made publicly. *Id.* at 11a-12a (cit-

ing *Amgen*, 133 S. Ct. at 1198-1199). These issues properly pertain to class-certification because they are not 10b-5 elements; "[a] plaintiff can fail to establish publicity [or] market efficiency * * * and therefore lose the class-wide presumption of reliance, but still establish individual reliance and prove fraud." *Id.* at 12a-13a (citing *Amgen*, 133 S. Ct. at 1198-1199).

Despite conceding that price impact is similarly not a 10b-5 element, Pet. App. 17a, the court of appeals characterized price impact as more analogous for Rule 23 purposes to materiality than to publicity and market efficiency. It reasoned that, even though price impact is not an element, "a plaintiff must nevertheless prevail on this fact in order to establish [the element of] loss causation." *Ibid.* According to the court, "if Halliburton were to successfully rebut the fraud-on-the-market presumption by proving no price impact, the claims of all individual plaintiffs would fail because they could not establish an essential element of the fraud action." *Id.* at 18a. Under that premise, price impact is not relevant to common-issue predominance and therefore is off-limits at class certification. *Ibid.* Consequently, the court of appeals refused to consider "the extensive evidence of no price impact offered by Halliburton." *Id.* at 19a n.11.

3. Halliburton sought rehearing *en banc*, which was denied. *Id.* at 23a-25a.

SUMMARY OF ARGUMENT

Basic's presumption of reliance rests on two premises: that (1) an efficient market accurately reflects all "public material misrepresentations" and that (2) "[a]n investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price." 485 U.S. at 247. Both premises have proven unsound and are widely rejected by economists, the very scholarly community that *Basic* thought had irrevocably endorsed

them. Today, even scholars who support a wide-ranging presumption for policy reasons almost uniformly attack *Basic*'s efficient-markets underpinnings. *Basic* was wrong when decided, and time has only made things worse. *Basic* carved a gaping hole in this Court's class-certification case law—an escape hatch available only to securities plaintiffs. It contravenes this Court's otherwise cautious approach to Section 10(b), has been impossible for federal courts to apply consistently, and has been roundly rejected by state courts.

Given these manifold flaws, the simplest and best solution is to overrule *Basic* altogether. As a procedural and evidentiary rule that creates no reliance interests (because it does not regulate primary conduct), *Basic* merits minimal *stare decisis* protection. The private right of action would remain available. Institutional-investor actions and increasingly frequent opt-outs from securities classes demonstrate that classes are not essential. Moreover, SEC enforcement does not require reliance at all. Overruling *Basic* would not disturb those core conduits of deterrence and compensation; it would preclude the least meritorious cases and create enormous savings for the very investors Section 10(b) is supposed to help.

Even if the Court decides to retain the presumption, plaintiffs should be required to demonstrate that the alleged misrepresentations actually affected the stock price, because the *Basic* presumption cannot spring to life until such a showing is made. And at the very least, the Court certainly should permit defendants to *rebut* the presumption by showing that the misrepresentation did not distort the market price, thereby defeating class certification.

ARGUMENT

I. *BASIC* WAS WRONGLY DECIDED AND DOES NOT MERIT *STARE DECISIS* PROTECTION

A. *Basic* was wrong when it was decided

1. The Section 10(b) action is a "judicial construct that Congress did not enact * * * ." *Stoneridge Inv. Partners LLC* v. *Scientific-Atlanta, Inc.*, 552 U.S. 148, 164 (2008). In limning its contours, the Court has long looked to "the express causes of action in the securities Acts as the primary model for the § 10(b) action" "to infer how the 1934 Congress would have addressed the issue had the 10b-5 action been included as an express provision." *Cent. Bank of Denver, N.A.* v. *First Interstate Bank of Denver, N.A.*, 511 U.S. 165, 173, 178 (1994). See, *e.g.*, *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 206-211 (1976). Specifically, the Court must identify—and borrow from—the express provision that is "most analogous to the private 10b-5 right of action." *Musick, Peeler & Garrett* v. *Employers Ins. of Wausau*, 508 U.S. 286, 294 (1993). See *id.* at 295-296 (identifying Sections 9 and 18(a) as analogous to Section 10(b)). In this way, the Court "ensure[s] the [10b-5] action does not conflict with Congress' own express rights of action." *Id.* at 295.

Basic fails that elementary test. Section 18(a) of the '34 Act is the closest textual analogue to the Section 10(b) action. See Br. for Former SEC Commissioners et al. as *Amici Curiae* 11-18; Grundfest, Damages and Reliance Under Section 10(b) of the Exchange Act, Rock Center for Corporate Governance at Stanford University Working Paper No. 150 (Aug. 28, 2013).[2] Only Section 18(a), codified at 15 U.S.C. § 78r(a), broadly authorizes damages for misrepresentations by a defendant who did not buy from or sell to the plaintiff when those statements affect

[2] http://ssrn.com/abstract=2317537. All Internet sources cited in this brief are on file with counsel.

aftermarket trading—the basis for most Section 10(b) suits. Section 18(a) expressly requires actual reliance, allowing recovery only by those "who, in reliance upon such [false or misleading] statement, shall have purchased or sold a security at a price which was affected by such statement," 15 U.S.C. § 78r(a).

The Act's legislative history confirms the importance of the actual-reliance requirement. Congress discarded a preliminary version of Section 18(a) because it lacked such a requirement, and instead substituted the version that exists today specifically to require reliance. See Br. for Former SEC Commissioners at 16-17; see also *Basic*, 485 U.S. at 257 (White, J., dissenting) (observing that the rejected version of Section 18(a) was "closely akin" to the fraud-on-the-market presumption). *Basic*, in other words, adopted a rule for Section 10(b)'s *implied* action that Congress specifically considered and rejected in Section 18(a)'s analogous *express* action.

That was error. Once Congress required an affirmative showing of actual reliance for causes of action that Congress felt were important enough to create, what could justify permitting a far *lesser* showing for causes of action that the *judiciary* crafted? By disregarding the Act's textual command in favor of a fictional presumption of reliance, *Basic* exceeded the Court's proper judicial role. The fraud-on-the-market presumption of reliance for Section 10(b) actions was wrong in 1988, and remains wrong today.

2. Justices White and O'Connor made the statutory-construction argument just described. See 485 U.S. at 257-258 (White, J., dissenting). They also offered other compelling reasons to reject the presumption.

The dissent found it extraordinary that the Court "embrace[d]" the fraud-on-the-market theory "with the sweeping confidence usually reserved for more mature

legal doctrines." *Id.* at 251. "[D]angers" lurk "when economic theories replace legal rules as the basis for recovery. Yet the Court today ventures into this area beyond its expertise," and does so "with no staff economists, no experts schooled in the 'efficient-capital-market hypothesis,' [and] no ability to test the validity of empirical market studies * * * ." *Id.* at 253. The dissent's skepticism of engrafting this nascent economic theory into law presaged scholars' later condemnation of *Basic*'s economic foundations.

The dissent further argued that even if market realities justified major adjustments to the judicially created cause of action, "such changes [should] come from Congress in amending § 10(b). The Congress, with its superior resources and expertise, is far better equipped than the federal courts for the task of determining how modern economic theory" should affect the law. *Basic*, 485 U.S. at 254. "In choosing to make these decisions itself, the Court, I fear, embarks on a course that it does not genuinely understand, giving rise to consequences it cannot foresee." *Ibid.*

The dissent presciently "fear[ed] that the Court's decision may have many adverse, unintended effects as it is applied and interpreted in the years to come." *Id.* at 251. *Basic*'s freewheeling approach to securities class actions has in fact imposed huge costs on the very investors Section 10(b) aims to protect. See *infra* Part II.C.

B. Time has only magnified *Basic*'s flaws

Basic was legally wrong from day one. And it did not take long for the academy to decisively reject its underlying economic theory as well.

1. *Scholarship has fatally discredited* Basic*'s key premises*

Basic relied upon "[r]ecent empirical studies" to incorporate into federal law a robust view of market effi-

ciency, where "the market price of shares traded on well-developed markets reflects all publicly available information, and, hence, any material misrepresentations." 485 U.S. at 246. The dissent was underwhelmed: while the "theories which underpin the fraud-on-the-market presumption may have the appeal of mathematical exactitude and scientific certainty, they are—in the end—nothing more than theories which may or may not prove accurate upon further consideration." *Id.* at 254. "[F]urther consideration" has devastated *Basic*'s core premises. Economists now largely agree that *Basic*'s efficient-markets hypothesis does not reflect reality.

a. **Academic consensus now rejects *Basic*'s view of market efficiency**

Basic's economic theory enjoyed support at the time. Prompted by the "applau[se]" of several "commentators," *Basic*, 485 U.S. at 247, the majority proclaimed fraud-on-the-market's apotheosis from theory into law. But "*Basic* came at the *end* of a long line of legal scholarship that, nearly universally, supported the efficient capital markets hypothesis," a "scholarly consensus" that "has now evaporated." Rapp, Proving Markets Inefficient: The Variability of Federal Court Decisions on Market Efficiency in *Cammer* v. *Bloom* and Its Progeny, 10 U. Miami Bus. L. Rev. 303, 323 (2002) (emphasis added).

A new "consensus," that *Basic*'s efficient-markets theory "simply did not work in practice," emerged quickly. Bratton & Wachter, The Political Economy of Fraud on the Market, 160 U. Pa. L. Rev. 69, 74 (2011). Shortly after *Basic*, a leading professor explained that "the *opposite*" of *Basic*'s presumption "appears to be true." Macey, The Fraud on the Market Theory: Some Preliminary Issues, 74 Cornell L. Rev. 923, 925 (1989) (emphasis added). That is partly because many investors' "strategies" involve "attempt[ing] to locate undervalued stocks

in an effort to 'beat the market,'" meaning that they "are in essence betting that the market for the securities they are buying *is in fact inefficient*." *Ibid.* (emphasis added). At most, therefore, "[s]ome investors rely on market integrity and others do not." *Id.* at 926.[3]

Thus, while "under the efficient market hypothesis, investors are likely to display similar, or common, behavior, at least in terms of relying on the market price," that "likelihood no longer holds if different investors are behaving according to different behavioral rules." Dunbar & Heller, Fraud on the Market Meets Behavioral Finance, 31 Del. J. Corp. L. 455, 520-521 (2006). For instance, some investors may rationally purchase a stock "on the probability that a bubble will continue," while others "rationally her[d] because they weigh more the decisions of others" than information about the stock. *Id.* at 521 (listing seven different types of purchasers). *Basic* simplistically presumed that investors generally purchase in reliance on the integrity of the market price. See 485 U.S. at 244, 247. But reality demonstrates otherwise: the commonality of reliance generated by the *Basic* presumption is fictional.

b. New evidence demonstrates fundamental inefficiency that *Basic* did not anticipate

As importantly, "overwhelming empirical evidence" now "suggests that capital markets are not fundamentally efficient." Lev & de Villiers, Stock Price Crashes and 10b-5 Damages: A Legal, Economic and Policy Analysis, 47 Stan. L. Rev. 7, 20 (1994). As "empirical research became more specialized and sophisticated," the evidence

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[3] Justice White recognized that "'many investors purchase or sell stock because they believe the price *inaccurately* reflects the corporation's worth.'" 485 U.S. at 256 (quoting Black, Fraud on the Market: A Criticism of Dispensing with Reliance Requirements in Certain Open Market Transactions, 62 N.C. L. Rev. 435, 455 (1984)).

mounted, producing "hundreds of papers documenting pricing anomalies, even for *the most actively traded* common stocks." Cornell, Market Efficiency and Securities Litigation: Implications of the Appellate Decision in *Thane*, 6 Va. L. & Bus. Rev. 237, 243-244 (2011) (emphasis added). *Basic*'s presumption of reliance cannot coexist with the reality that where one would expect maximum market efficiency and rationality, markets can prove extraordinarily *in*efficient and *ir*rational.

Even in these well-developed markets, public information is often not incorporated immediately (much less rationally) into market prices. For example:

> On May 3, 1998, the Sunday *New York Times* carried a front-page story on recent innovations in cancer research, and featured EntreMed prominently. The next day, Monday, May 4, EntreMed stock, which had closed the previous Friday at $12/share, shot up on heavy volume, ending the day at $52/share.
>
> What is remarkable about this episode is that the front-page *Times* story contained essentially no real news: the substance of the story had been reported five months earlier * * * in the scientific journal *Nature*, as well as in the popular media (including the *Times* itself, in a less high-profile article on page A28).

Hong & Stein, Disagreement and the Stock Market, 21 J. Econ. Persp., Spring 2007, at 109, 116-117. Similarly, Wall Street Journal reports on insider trades appear to quickly affect a stock's trading price, despite the SEC's earlier disclosure of the same information. See Chang & Suk, Stock Prices and the Secondary Dissemination of Information, 33 Fin. Rev. 115, 115-117 (1998). See also *In re Merck & Co. Sec. Litig.*, 432 F.3d 261, 263-271 (3d Cir. 2005) (similar example of Wall Street Journal report af-

fecting price weeks after the information was publicly released in an SEC filing).

This fundamental criticism of *Basic*'s premise extends to entire exchanges. For instance, just two weeks before oral argument in *Basic* was "Black Monday," October 19, 1987, which

> provides strong and direct evidence that the New York Stock Exchange (NYSE) is not fundamentally efficient because it is impossible to locate any information that could be responsible for a twenty-two percent devaluation of corporate assets on that single day, or a thirty-six percent devaluation from the market's peak in late August.

Ayres, Back to *Basic*s: Regulating How Corporations Speak to the Market, 77 Va. L. Rev. 945, 974 (1991). The NYSE may be America's most efficient exchange—but not efficient enough to justify *Basic*'s breezy confidence.

Many other examples disprove "the assumption that the market acts rationally," an assumption "[i]mplicit in the notion of an efficient market * * * as courts understand the securities markets to be * * * ." Fisher, Does the Efficient Market Theory Help Us Do Justice in a Time of Madness?, 54 Emory L.J. 843, 898 (2005). The 1998-2001 technology bubble is one, "with stock prices far away from fundamental values," thus "dissolv[ing] the link between the efficient market theory and the normative notions underlying 10b-5 elements." *Id.* at 847. The "economic crisis" of 2008 is another, further "undermin[ing] 'efficient markets' theory." Posner, On the Receipt of the Ronald H. Coase Medal, 12 Am. L. & Econ. Rev. 265, 278 (2010).

The bottom line is that "[t]he fraud-on-the-market (FOTM) cause of action just doesn't work. At least that is the consensus view among academics respecting the primary class action vehicle under federal securities

laws." Bratton & Wachter, *supra*, at 72 & n.1 (2011) (describing how even the views of academic proponents have evolved in recent years).

c. **Irrationality is understandable and on the rise**

Basic assumed that the market "act[s] 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." 485 U.S. at 244. But what is rational behavior for the "market professionals" on which *Basic* relied, *id.* at 247 n.24, often is not rational for the market as a whole and does not translate into rational prices or market efficiency. "[S]ophisticated investors may be able to make money in the short term by exploiting their understanding of the herd mentality of other, less able investors," meaning that "even these sophisticated investors will appear, at times, to behave irrationally, leading to a feedback effect which enhances the inefficiency of the market." Rapp, Proving Markets Inefficient, *supra*, at 324; see also Dunbar & Heller, *supra*, at 520-521 (observing distinct "behavioral rules" that affect price formation). What is lost, of course, is the link between a market price and the stock's value as disclosed by *actual market information*.

Trades based on things *other than* material information about the company inevitably limit the efficiency of the market—and generate what has been called a "noisy market." See generally Ribstein, Fraud on a Noisy Market, 10 Lewis & Clark L. Rev. 137 (2006); see also Burch, Reassessing Damages in Securities Fraud Class Actions, 66 Md. L. Rev. 348, 379 n.155 (2007) (describing "the large body of literature on behavioral finance and noise traders"). Relatedly, the Fifth Circuit has observed that market makers and analysts often do not advance—and even frustrate—market efficiency. *Bell* v. *Ascendant Solutions, Inc.*, 422 F.3d 307, 315 &

nn.16-17 (5th Cir. 2005).

Worse, human market professionals are increasingly supplanted by computerized trading programs using complex algorithms that aim to beat the market, executing trades based on predetermined metrics, not rationally assimilating public disclosures. These trading programs sometimes compound market irrationality by generating price fluctuations unrelated to material information about particular securities. Mehta et al., Futures Sale Caused May 6 Panic as Traders Lost Faith in Data, Bloomberg, Oct. 1, 2010 (describing SEC and CFTC report on 998-point drop in 20 minutes caused by trading algorithms).[4] See generally Findings Regarding the Market Events of May 6, 2010, Report of the Staffs of the CFTC and SEC (Sept. 30, 2010).[5]

d. ***Basic*'s binary view of efficiency is invalid**

The academic and empirical assault on *Basic* does not mean that there is *never* efficiency in any market. The point is that "efficiency is not a binary, yes or no question." Langevoort, *Basic* at Twenty: Rethinking Fraud on the Market, 2009 Wis. L. Rev. 151, 167. Yet *Basic* subjects courts and litigants to "the misleading notion of binary market efficiency," Cornell, *supra*, at 250. It is thumbs-up or thumbs-down under *Basic*: "[I]f *a market* is shown to be efficient, courts may presume" investors' reliance on *all* "public, material misrepresentations regarding those securities." *Amgen*, 133 S. Ct. at 1192 (emphasis added).

As a binary concept, efficiency has almost no real meaning. "A stock might trade efficiently some of the time, for some information types, but then trade ineffi-

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[4] http://www.bloomberg.com/news/2010-10-01/automatic-trade-of-futures-drove-may-6-stock-crash-report-says.html

[5] http://www.cftc.gov/ucm/groups/public/@otherif/documents/ifdocs/staff-findings050610.pdf

ciently at other times, for other information types." Rapp, Rewiring the DNA of Securities Fraud Litigation: *Amgen*'s Missed Opportunity, 44 Loy. U. Chi. L.J. 1475, 1484 (2013). "Information that is easy to understand and that is trumpeted in the business media * * * may be incorporated into market prices almost instantaneously," Stout, The Mechanisms of Market Inefficiency, 28 J. Corp. L. 635, 656 (2003), although counterexamples abound. The more difficult information is to understand, the more likely it will take longer "to be fully incorporated into prices," if it is indeed ever "incorporated at all." *Ibid.* "[T]reat[ing] market efficiency in a binary manner," therefore, "often makes case law irreconcilable with the actual behavior of markets." Cornell, *supra*, at 255.

Basic consequently mandates both under- and overinclusive results. If a market for a given stock is generally inefficient or undeveloped, defendants who made affirmative misrepresentations may escape certification and liability, even if the misrepresentation unquestionably distorted the stock's price. See, *e.g.*, *Bell*, 422 F.3d at 316 & n.18 (rejecting class certification because price decline following alleged corrective disclosure was insufficient to prove market efficiency); *Gariety* v. *Grant Thornton, LLP*, 368 F.3d 356, 364 n.*, 368 (4th Cir. 2004) (similar). Yet, as this case demonstrates, if a stock trades on a market that is generally efficient or well-developed, that says little about whether it was efficient with respect to a particular misrepresentation and whether the market in fact reacted to the information. The examples above confirm as much.

Indeed, many scholars who favor the result in *Basic* now repudiate *Basic*'s economic premise precisely because efficiency is far from a binary question. See, *e.g.*, Black, Behavioral Economics and Investor Protection: Reasonable Investors, Efficient Markets, 44 Loy. U. Chi.

L.J. 1493, 1500 (2013). "Because the notion of information efficiency *upon which the fraud-on-the-market presumption rests* is crumbling under sustained academic scrutiny, the future of securities fraud class action litigation—dependent on this presumption—may be in jeopardy." *Id.* at 1502 (emphasis added).

2. *Federal courts cannot consistently and reasonably apply* Basic

Justice White correctly prophesied that "[c]onfusion and contradiction in court rulings are inevitable when traditional legal analysis is replaced with economic theorization by the federal courts." *Basic*, 485 U.S. at 252. By requiring courts to assess whether "shares were traded on an efficient market," *id.* at 248 n.27 (maj. op.), *Basic* insists that judges perform a task that flummoxes economic scholars. Experts "have yet to observe a workable test for determining whether the market for a particular security is efficient." Macey, *supra*, at 926. Eugene Fama, the father of the efficient-capital-markets hypothesis and recent Nobel laureate in economics, pronounced shortly after *Basic* that "market efficiency per se is not testable." Fama, Efficient Capital Markets: II, 46 J. Fin. 1575, 1575 (1991). Financial economists still "do not know how to calculate the price that fully reflects the available information," meaning that there is no baseline to gauge efficiency. Brav & Heaton, Market Indeterminacy, 28 J. Corp. L. 517, 525 (2003).

"*Basic*'s obfuscation about the role of efficiency sent the [lower] courts off on a long journey without a particularly good compass." Langevoort, *Basic* at Twenty, *supra*, at 167. Unable to measure efficiency itself, judges have gamely searched for market features that tend to accompany efficiency as an imperfect proxy. Factors listed in two district court cases are most commonly cited when courts grapple with this problem. See *Cammer* v. *Bloom*, 711 F. Supp. 1264, 1286-1287 (D.N.J. 1989);

Krogman v. *Sterritt*, 202 F.R.D. 467, 477-478 (N.D. Tex. 2001).

But applying those factors to a given fact pattern generates a mirage of accuracy at best. The *Cammer* factors "do not directly speak to efficiency * * * [and] are best understood as constituting an indirect test by which courts infer efficiency for reliance purposes." Cornell & Rutten, Market Efficiency, Crashes, and Securities Litigation, 81 Tul. L. Rev. 443, 455 (2006).

Nor are they especially helpful. One frequently cited study of eight leading factors (including the *Cammer* factors and supplements) found that *only two*—the average volume and the number of analysts who track a given stock—"systematically differentiate[d] between efficiently and inefficiently priced stocks." Barber et al., The Fraud-on-the-Market Theory and the Indicators of Common Stocks' Efficiency, 19 J. Corp. L. 285, 285-286 (1994). And at least some heralded factors, like the number of market makers, proved incapable of "discriminat[ing] between efficient and inefficient stocks." *Id.* at 290. The factors are indeterminate and frequently self-correlating, and have deservedly been criticized. See, *e.g.*, *Unger* v. *Amedisys Inc.*, 401 F.3d 316, 324-325 (5th Cir. 2005); Erenburg et al., The Paradox of "Fraud-on-the-Market" Theory: Who Relies On the Efficiency of Market Prices?, 8 J. Empirical Legal Stud. 260, 289-291 (2011) (explaining how the *Cammer* factors are often useless or deceptive); Bernard et al., Challenges to the Efficient Market Hypothesis: Limits to the Fraud-on-the-Market Theory, 73 Neb. L. Rev. 781, 796-797 (1994).

Not surprisingly, the effort to accommodate *Basic*'s theoretical construct has produced wildly disparate outcomes. See *In re DVI, Inc. Sec. Litig.*, 639 F.3d 623, 632-633 (3d Cir. 2011). "[S]imilar factual circumstances have led to different conclusions by courts about market efficiency." Rapp, Proving Markets Inefficient, *supra*, at

305, 306. Each passing year has more clearly demonstrated the "high level of inconsistency in the courts regarding what makes a market sufficiently efficient to trigger the fraud-on-the-market presumption." Rapp, Rewiring the DNA, *supra*, at 1484. As long as *Basic* remains binding, courts will generate this "massive hodgepodge of * * * outcomes." Ferrillo et al., The "Less Than" Efficient Capital Markets Hypothesis: Requiring More Proof from Plaintiffs in Fraud-on-the-Market Cases, 78 St. John's L. Rev. 81, 102 (2004).

3. *State courts refuse to follow* Basic*'s lead*

State courts, of course, are not bound by *Basic*, and thus it is a marked critique that they have overwhelmingly refused to adopt its fraud-on-the-market approach.

States that have considered *Basic*'s argument have rejected it because "the persuasiveness of [*Basic*'s] intellectual underpinning, the Efficient Capital Markets Hypothesis," was found wanting. *Kaufman* v. *i-Stat Corp.*, 754 A.2d 1188, 1198 (N.J. 2000). *Kaufman* concluded that "[a]s more time has passed, and there has been greater opportunity to examine and test market efficiency, the hypothesis has shown greater weakness." *Ibid.* The California Supreme Court observed that "to permit common law claims based on the fraud-on-the-market doctrine would open the door to class action lawsuits based on exceedingly speculative theories." *Mirkin* v. *Wasserman*, 858 P.2d 568, 584 (Cal. 1993). "[S]uch decisions are more appropriately the subject of legislative deliberation and resolution" than adoption by courts. *Id.* at 582.

Twelve years in, "*no* state court with the authority to consider whether *Basic* is persuasive ha[d] chosen to apply it" under state law. *Kaufman*, 754 A.2d at 1198 (em-

phasis added).[6] *Basic*'s record has continued to deteriorate. Beyond New Jersey and California, many other state courts have rejected the principles of *Basic* in securities-fraud contexts, with none going the other way. And only one legislature has adopted the fraud-on-the-market doctrine. See *State* v. *Marsh & McLennan Cos.*, 292 P.3d 525, 527-528, 535-536 (Or. 2012).

C. This Court's case law on class actions and Section 10(b) makes *Basic* increasingly anomalous

Basic is not merely unsound on its own terms. It also undermines this Court's class-certification jurisprudence and its approach to Section 10(b).

1. Basic *is fundamentally at odds with this Court's class-certification cases*

This Court has long insisted that "actual, *not presumed*, conformance with [Rule 23] remains * * * indispensable." *Gen. Tel. Co. of Sw.* v. *Falcon*, 457 U.S. 147, 160 (1982) (emphasis added). Rule 23 permits certification only after "the court *finds* that the questions of law or fact common to class members predominate over" individual ones. Fed. R. Civ. P. 23(b)(3) (emphasis added).

Basic flouts that principle by presuming common reliance in the face of near-certain falsity. Recent cases have insisted with increasing rigor that plaintiffs *show* compliance with Rule 23, deepening the divide between *Basic* and the Court's class-certification jurisprudence. See, *e.g.*, *Comcast Corp.* v. *Behrend*, 133 S. Ct. 1426 (2013); *Wal-Mart Stores, Inc.* v. *Dukes*, 131 S. Ct. 2541 (2011). *Basic* opens an escape hatch for 10b-5 plaintiffs alone.

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[6] *Kaufman* noted that the Mississippi Supreme Court had "accepted the theory in dictum, but no claim based directly on the theory appears to have been adjudicated in the jurisdiction." 754 A.2d at 1194 (citing *Allyn* v. *Wortman*, 725 So. 2d 94 (Miss. 1998)). Nothing appears to have changed since then.

In any non-securities context, the class in this case could not be certified. In *Wal-Mart*, the Court required a putative class to "affirmatively demonstrate * * * compliance" with Rule 23, and thereby "prove * * * *in fact*" that the issues were common. 131 S. Ct. at 2551. *Basic*'s presumption treats reliance issues as common in ways that *Wal-Mart* rejected. The alleged gender discrimination in *Wal-Mart* purportedly was "common to *all* Wal-Mart's female employees," because all women would be affected by the "strong and uniform 'corporate culture'" that plaintiffs had described. *Id.* at 2548. To establish this commonality, plaintiffs offered "statistical evidence about pay and promotional disparities" and sociological testimony that Wal-Mart's culture "was 'vulnerable' to gender discrimination." *Id.* at 2549. The Court rejected all of that as failing to *prove* the bare existence of common issues, given the diversity of outcomes among class members. *Id.* at 2554-2557. *Basic*'s presumption erases equally plain distinctions by treating all investors as relying in common on market prices presumptively affected by misrepresentations—despite economic evidence showing that no such common reliance, and no such consistent price distortion, exists.

Comcast reinforced that certification is improper when proponents do not actually "establis[h]" predominance under Rule 23(b)(3). 133 S. Ct. at 1433. Thus, it was error to certify a class without determining "whether the methodology" that purported to show predominance of common damages issues "[was] a just and reasonable inference or [was] speculative." *Ibid.* (quotation omitted). Different class members in *Comcast* would likely have had damages of vastly differing amounts, if any, because the basis for the damages would vary widely. *Id.* at 1434-1435. Equally, different class members in securities suits may have vastly different forms of reliance, if any at all. Merely identifying a method that "can be applied class-

wide," while ignoring "how arbitrary the measurements may be," cannot satisfy Rule 23 without "reduc[ing] Rule 23(b)(3)'s predominance requirement to a nullity." *Id.* at 1433.

Basic's entire *raison d'être* is reducing predominance "to a nullity." It acknowledges that the presumption is necessary precisely because, if left to actual facts, *individual* issues of reliance would predominate. 485 U.S. at 242. And *Basic*'s binary market-efficiency test does not remotely establish that alleged misrepresentations actually distorted market price—thus failing to produce even *theoretical* common reliance. *Basic* impermissibly embraced the "speculative" and "arbitrary" proxies for actual predominance that *Comcast* emphatically rejected. 133 S. Ct. at 1433.

Nothing justifies insisting that all plaintiffs *except securities plaintiffs* must actually demonstrate predominance, rather than assume it. Because *Basic*'s discredited vision of market efficiency does not supply the requisite "glue holding the alleged *reasons* for [investors'] decisions together," *Wal-Mart*, 131 S. Ct at 2552, securities classes should not be exempt from Rule 23's requirements.

2. Basic *is increasingly anomalous in light of this Court's Section 10(b) cases*

Basic also runs counter to the Court's repeated admonitions that extension of the judicially created Section 10(b) action "is for Congress, not for us." *Stoneridge*, 552 U.S. at 165. *Basic* stands virtually alone in disregarding "caution against [the] expansion" of the private right of action, *ibid.*, and ignoring the longstanding rejection of "expansive imposition of civil liability" under Section 10(b), see *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 739 (1975) (limiting 10b-5 liability to "purchasers and sellers"). Even as this Court has reaffirmed 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 Group, Inc.* v. *First Derivative Traders*, 131 S. Ct. 2296, 2302 (2011) (quoting *Stoneridge*, 552 U.S. at 167), *Basic*'s contrary approach continues to generate liability that would not otherwise be countenanced under this Court's 10b-5 jurisprudence.

Central Bank illustrates this point. There, the Court refused to imply a "private right of action for aiding and abetting a § 10(b) violation." *Stoneridge*, 552 U.S. at 155 (citing *Cent. Bank*, 511 U.S. at 191). Following established methodology, see *supra* Part I.A, *Central Bank* concluded that private aiding-and-abetting claims should not be judicially recognized under the Section 10(b) action, in part because no express action in the securities laws authorized such a claim. 511 U.S. at 180. Congress responded by authorizing aiding-and-abetting claims *only for the SEC*. See 15 U.S.C. § 78t(e) (Section 20(e) of the '34 Act, adopted as Section 104 of the PSLRA, Pub. L. 104-67, 109 Stat. 737, 757 (1995)). Congress thereby reaffirmed its preference that any expansion of Section 10(b) should not extend to private actions.

The Court has especially avoided diminishing the required showing of reliance in private Section 10(b) actions. "Were we to allow the aiding and abetting action proposed in this case," the Court explained in *Central Bank*, "the defendant could be liable *without any showing that the plaintiff relied* upon the aider and abettor's statements or actions." 511 U.S. at 180 (emphasis added). *Stoneridge* reaffirmed *Central Bank*'s strong view of "[r]eliance by the plaintiff upon the defendant's deceptive acts" as "an essential element of the § 10(b) private cause of action." 552 U.S. at 157, 159. Plaintiffs therefore could not recover from secondary actors who had made no statements upon which plaintiffs could rely.

Id. at 160 (expressly refusing to extend *Basic*'s presumption). These cases cement *Basic*'s outlier status.

In short, *Basic* is an accidental anachronism of the "*ancien regime*," in which the Court created and expanded causes of actions "to provide such remedies as are necessary to make effective the congressional purpose." *Alexander* v. *Sandoval*, 532 U.S. 275, 287 (2001) (quoting *J.I. Case Co.* v. *Borak*, 377 U.S. 426, 433 (1964)). For the last 35 years, the Court has almost unerringly "sworn off" that approach in interpreting the '34 Act. See *ibid.* (collecting cases narrowly construing 10b-5 action). *Basic* is the notable exception, and no good reason exists to perpetuate its transgression of the judicial function.

D. *Stare decisis* is no bar to overruling or modifying *Basic*

Given the foregoing, *stare decisis* is the last hope for salvaging *Basic*. But it offers no reprieve.

1. Basic *fails this Court's* stare decisis *tests*

Whether viewed as a procedural rule or a substantive securities-law principle, *Basic* is not due *stare decisis* protection.

a. *Basic*'s presumption is largely a procedural and evidentiary construct implicating Rule of Civil Procedure 23 and Rule of Evidence 301. See 485 U.S. at 242, 245. These aspects of *Basic*'s holding are uniquely within the judicial ken and subject to lessened precedential weight. *Stare decisis* concerns are at their nadir "in cases * * * involving procedural and evidentiary rules." *Payne* v. *Tennessee*, 501 U.S. 808, 828 (1991). That is because a "procedural rule" like the *Basic* presumption "does not serve as a guide to lawful behavior." *United States* v. *Gaudin*, 515 U.S. 506, 521 (1995).

In *Pearson* v. *Callahan*, 555 U.S. 223 (2009), the Court revisited the procedure in Section 1983 cases for addressing questions of qualified immunity set forth in *Saucier* v.

Katz, 533 U.S. 194, 200 (2001). The Court unanimously found no *stare decisis* bar to "modif[ying] or abandon[ing]" the *Saucier* procedure. *Pearson*, 555 U.S. at 233. "[T]he *Saucier* rule is judge made and implicates an important matter involving internal Judicial Branch operations." *Id.* at 233-234. Moreover, although *Saucier*'s rule affected Section 1983, an *express* statutory cause of action, "[a]ny change should come *from this Court*, not Congress." *Id.* at 234 (emphasis added). "Where a decision has been questioned by Members of the Court in later decisions and [has] defied consistent application by the lower courts, these factors weigh in favor of reconsideration. Collectively, the factors we have noted make our present reevaluation * * * appropriate." *Id.* at 235 (quotation and citations omitted).

Like *Saucier*, *Basic* "has been questioned by Members of the Court in later decisions." *Ibid.* Indeed, only last Term, four Justices—the same number that constituted the *Basic* majority—expressly indicated that *Basic* may be ripe for reconsideration. See *Amgen*, 133 S. Ct. at 1204 (Alito, J., concurring); *id.* at 1208 n.4 (Thomas, J., dissenting, joined by Scalia and Kennedy, JJ.). All nine Justices at least recognized serious problems with *Basic*'s economic foundations. See *id.* at 1197-1198 n.6 (maj. op.) (acknowledging "modern economic research" that rejects a binary notion of efficiency). And, as described above, lower courts attempting to comply with *Basic* have been unable to achieve "consistent application" or results. *Pearson*, 555 U.S. at 235.

Pearson also examined the costs and benefits of the *Saucier* rule. "[E]xperience has pointed up the precedent's shortcomings," and "the rigid *Saucier* procedure c[ame] with a price." 555 U.S. at 233, 236. The "price" of *Basic* appears quite costly when viewed through *Pearson*'s lens:

- *"[S]ubstantial expenditure of scarce judicial re-*

sources on difficult questions * * * *."* 555 U.S. at 236-237. As this case and broader data show, Section 10(b) class actions ravenously consume judicial resources. See *infra* Part II.C.1.d. And *Basic*'s efficiency requirement is difficult, if not impossible, for judges to administer. See *supra* Part I.B.2.

- *"Unnecessary litigation" that "also wastes the parties' resources."* 555 U.S. at 237. *Basic*'s smooth path to class certification incentivizes weak claims, and litigation costs are borne almost entirely by the very shareholders who are supposedly being protected. See *infra* Part II.C.1.b.
- *"Adherence to" precedent "departs from the general rule" and contravenes principles in "other analogous contexts,"* 555 U.S. at 241. *Basic*'s presumption "departs from the general rule" that predominance must be affirmatively established rather than presumed under Rule 23, and that the Section 10(b) cause of action should be narrowly constrained. See *supra* Part I.C.

b. *Basic* may be even more vulnerable if it is assessed as "a substantive doctrine of federal securities-fraud law * * * ." *Amgen*, 133 S. Ct. at 1193. The Court's *stare decisis* factors test a precedent's durability, correctness, and utility. "[T]he fact that a decision has proved 'unworkable' is a traditional ground for overruling it." *Montejo* v. *Louisiana*, 556 U.S. 778, 792 (2009). "Beyond workability, the relevant factors in deciding whether to adhere to the principle of *stare decisis* include the antiquity of the precedent, the reliance interests at stake, and of course whether the decision was well reasoned." *Id.* at 792-793. *Basic* cannot satisfy any of those four criteria.

First, *Basic* is especially "unworkable." It offers no reliable methodology and cannot generate consistent,

predictable, justifiable results. See *supra* Part I.B.2.

Second, *Basic* is not a case from "antiquity."

Third, there are no "reliance interests at stake." *Basic*'s presumption does not "serve as a guide to lawful behavior," *Gaudin*, 515 U.S. at 521, but merely facilitates establishing the reliance element in litigation.

Fourth, *Basic* was not "well reasoned." Its presumption flows from serious misjudgments about the nature of securities markets, and it impinges on other important jurisprudence. This Court has historically reconsidered precedents when necessary to "bring its opinions into agreement with experience and with facts newly ascertained." *Vasquez* v. *Hillery*, 474 U.S. 254, 266 (1986) (quotation marks omitted). This factor strongly supports a course correction.

2. *Congress has left the fate of* Basic *in this Court's hands*

If *Basic* is in error, this Court has the authority—and responsibility—to correct it. There is no occasion for applying the heightened form of *stare decisis* that attends statutory construction, for *Basic*'s presumption stems from a judicially implied cause of action. Congress, moreover, while constraining private Section 10(b) litigation in multiple ways, has remained silent about the validity of the presumption of reliance itself, leaving any revisions to this Court. The Court should not "place on the shoulders of Congress the burden of the Court's own error." *Girouard* v. *United States*, 328 U.S. 61, 70 (1946) (overruling Naturalization Act precedent).

a. **Correcting judicially created errors generally lies with the judiciary**

Section 10(b) case law is particularly suited for judicial self-scrutiny and revision. "The federal courts have accepted and exercised the principal responsibility for the continuing elaboration of the scope of the 10b-5 right and

the definition of the duties it imposes." *Musick, Peeler*, 508 U.S. at 292. There is, therefore, "a judicial authority to shape, within limits, the 10b-5 cause of action." *Id.* at 293. Those "limits" are important; they require fidelity to statutory guidance, which *Basic* contravened. See *supra* Part I.A. But beyond that elementary principle, ensuring the integrity of the Section 10(b) action remains this Court's responsibility.

Antitrust provides a close analogue. Like Section 10(b), "Congress 'expect[s] the courts to give shape to the [Sherman Act's] broad mandate by drawing on common-law tradition.'" *State Oil Co.* v. *Khan*, 522 U.S. 3, 20 (1997) (quoting *Nat'l Soc. of Prof'l Eng'rs* v. *United States*, 435 U.S. 679, 688 (1978)). In *State Oil*, the Court overruled a 29-year old precedent and cited multiple similar overrulings. *Id.* at 20-22. Where "changed circumstances and the lessons of accumulated experience" undermine precedent, *stare decisis* poses no bar. *Id.* at 20. And where "respected authorities in the economics literature suggest[ed]" that a *century-old* precedent was "inappropriate," the Court overruled it. See *Leegin Creative Leather Prods., Inc.* v. *PSKS, Inc.*, 551 U.S. 877, 899-900 (2007). That test is almost custom-built for overruling *Basic*.

Similarly, in *Moragne* v. *States Marine Lines, Inc.*, 398 U.S. 375 (1970), the Court overturned *The Harrisburg*, 119 U.S. 199 (1886), which had adopted a substantive rule against certain wrongful-death recoveries in federal maritime cases. The ordinary *stare decisis* factors supported overruling it: *The Harrisburg*'s "dubious foundation when announced," its status as "an increasingly unjustifiable anomaly" in the law, and its "litigation-spawning confusion." *Id.* at 404. Supposed congressional acquiescence over the preceding *84 years* posed no bar: "To conclude that Congress, by not legislating * * * , has in effect foreclosed * * * reconsideration of prior judicial

doctrine would be to disregard the fact that Congress has largely left to this Court the responsibility for fashioning the controlling rules of admiralty law." *Id.* at 405 n.17.

Absent direction from Congress, this Court retains full discretion to overrule the judicially fashioned presumption of reliance.

b. **Congress has not considered, much less embraced, the presumption of reliance**

Congress has not addressed *Basic*'s presumption. The PSLRA's targeted *restrictions* on plaintiffs, which govern private Section 10(b) cases, do not somehow cement by implication every other pre-existing feature of Section 10(b) litigation. To the contrary, even before the PSLRA, the Court explained that "Congress has acknowledged the 10b-5 action without any further attempt to define it." *Cent. Bank*, 511 U.S. at 187 (citing *Musick, Peeler*, 508 U.S. at 293-294). Congressional-acquiescence arguments did not stop *Central Bank* from rejecting aiding-and-abetting liability, despite various other amendments to the securities laws. *Id.* at 186. Nor does congressional silence about the fraud-on-the-market theory and the presumption of reliance constitute Congress's "attempt to define" them.

Congressional silence only reflects "Congress's failure to express any opinion." *Rapanos* v. *United States*, 547 U.S. 715, 750 (2006) (plurality op.). Congress never voted—affirmatively or negatively—on the presumption. To be sure, a bill that would have effectively eliminated *Basic*'s presumption was proposed in the House of Representatives during the run-up to the PSLRA. See Common Sense Legal Reform Act of 1995, H.R. 10, 104th Cong. (1995); *Amgen*, 133 S. Ct. at 1201 (noting that bill). But the full House, much less Congress as a whole, never considered that bill. See *Blonder-Tongue Labs., Inc.* v. *Univ. of Ill. Found.*, 402 U.S. 313, 327 n.17, 340 n.34

(1971) (no congressional approval of Court precedent where statute was otherwise revised and provisions of bills to overrule precedent "disappeared" from proposed legislation). The Senate bill, S.240, said nothing about the fraud-on-the-market theory, and neither did the Conference Committee's reconciliation that ultimately became the PSLRA. Only "[t]he intent of the full Congress (or at least a majority of each House) is thought relevant to the interpretation of statutes, since they must be passed by the entire Congress." *FCC* v. *Fox Television Stations, Inc.*, 556 U.S. 502, 525 n.5 (2009). Congressional silence leaves the fate of the reliance presumption where it originated—with this Court.

II. *BASIC*'S PRESUMPTION OF RELIANCE SHOULD BE OVERRULED OR MODIFIED

A. The Court should overrule *Basic* and require actual reliance on misrepresentations

1. The Court should overrule the fraud-on-the-market presumption of reliance for the 10b-5 implied cause of action. This approach would respect the text of the Act and alleviate the conflict between the implied cause of action and the most analogous express cause of action—Section 18(a) of the Securities Exchange Act. While Section 18(a) requires actual reliance in private claims challenging an issuer's misleading disclosures to the SEC, *Basic* allows plaintiffs bringing an *identical* claim—as well as a swath of other aftermarket-liability claims—to proceed without showing actual reliance. There is no reason to allow this anomaly to persist. While Congress has modified or codified various other aspects of the 10b-5 cause of action, it has never suggested that presumed—rather than actual—reliance is sufficient. Section 18's enacted text stands undisturbed as the best indicium of Congressional intent regarding the necessary reliance showing here.

Requiring actual reliance would also bring *Basic* into line with this Court's consistent admonition that the implied action "must" be "give[n] 'narrow dimensions.'" *Janus*, 131 S. Ct. at 2302 (quoting *Stoneridge*, 552 U.S. at 167). By drastically expanding 10b-5 liability, *Basic* departed from this well-trodden path of judicial humility in elucidating a cause of action Congress did not enact. Nothing prevents the Court from revisiting that error and electing Section 18(a)'s and the common law's narrower understanding of reliance. Cf. *Dura*, 544 U.S. at 345 (adopting narrower common-law conception of loss causation rather than Ninth Circuit's looser approach).

2. An actual-reliance requirement would also best respond to the erosion of empirical support for the fraud-on-the-market presumption. Investors do not uniformly rely on the integrity of the market price, which does not rationally reflect all public information, even in developed markets. When these premises seemed more plausible, the policy justification for dispensing with actual reliance appeared stronger. With the dissolution of those premises, *Basic* rests on nothing more than a naked desire to "facilitat[e] class certification," *Amgen*, 133 S.Ct. at 1193, and lighten plaintiffs' burdens. That cannot justify departing from the actual-reliance test dictated by cognate portions of the Act and this Court's narrow-construction approach to the 10b-5 action.

3. Because *Basic* created the presumption of reliance to ease class certifications that would otherwise be impossible, developments in Rule 23 case law provide an additional reason for requiring actual reliance. As discussed, *Wal-Mart* and *Comcast* require that common-issue predominance be proven, not presumed. Thus, in a 10b-5 action, plaintiffs must be able to demonstrate that common issues of reliance in fact exist. Because the presumption of classwide reliance unjustifiably eliminates this burden, it should be overruled. Returning to a tradi-

tional understanding of reliance would be most consistent with this Court's holdings under Rule 23.

B. Alternatively, the Court should require class plaintiffs to prove that alleged misrepresentations affected the market price

If the Court retains *Basic*'s presumption, it should nonetheless modify what plaintiffs must show to invoke it. *Basic*'s binary market-efficiency test for invoking the presumption conflicts with modern economics and Rule 23. If courts are to presume classwide reliance on misrepresentations via reliance on a distorted market price, plaintiffs should first be required to demonstrate that the misrepresentations actually distorted the market price.

1. The "fundamental premise" of *Basic*'s presumption remains "that an investor presumptively relies on a misrepresentation *so long as it was reflected in the market price* at the time of his transaction." *EPJ Fund*, 131 S. Ct. at 2186 (emphasis added).[7] If misrepresentations were 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." *Amgen*, 133 S. Ct. at 1199; accord *id.* at 1195 (information that "does not affect market price * * * cannot be relied upon indirectly by investors"). In that instance, the "causal connection" between the misrepresentation and the transaction would be "broken" because "the basis for finding that the fraud had been transmitted through [the] market price would be gone." *Basic*, 485 U.S. at 248.

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[7] See also *ibid.* ("an investor presumptively relies on a defendant's misrepresentation *if* that 'information is reflected in [the] market price' of the stock at the time of the transaction"); *ibid.* (*Basic*'s presumption applies when "the investor purchased the stock *at a distorted price*, and thereby presumptively relied on the misrepresentation *reflected in that price.*") (emphases added).

Incongruously, the current test for invoking the presumption of reliance does not require plaintiffs to show, in the first instance, that the alleged misrepresentations distorted the market price. Instead, plaintiffs must establish certain "predicates" that allow a rebuttable "presum[ption]" that the misrepresentations affected the market price. *Amgen*, 133 S. Ct. at 1199. At the class-certification stage, those predicates include market efficiency, publicity, and trade timing (materiality must be shown later). *Ibid.* Defendants may then rebut the presumption by "show[ing] that the misrepresentation in fact did not lead to a distortion of price." *Basic*, 485 U.S. at 248.

2. If the presumption is to be retained, the Court should place the initial burden on plaintiff to establish the presumption's "fundamental premise" of price impact.

a. As discussed, post-*Basic* economic research shows that the current "predicates" for invoking the presumption—chiefly, market efficiency—do not confidently predict whether a particular misrepresentation will distort the market price. Merely showing that a stock is widely traded and generally responds to unexpected news is no guarantee that the stock quickly assimilates all types of public information, much less the representations at issue in a given case.

Consequently, *Basic*'s focus on a binary notion of market efficiency simply misses the point. The heart of presumed classwide reliance is not the character of the market in which the stock trades, but whether the misrepresentation actually distorted the market price. It makes scant sense to presume that plaintiffs relied on alleged misrepresentations by purchasing at a distorted market price without asking whether the misrepresentation actually distorted that price in the first place. A price-distortion test would eliminate the false positives and false negatives that result at the class-certification

stage when courts focus on market efficiency rather than the effect of the alleged misrepresentations. See *supra* Part I.B.1.d; *Unger*, 401 F.3d at 322 n.4 (noting "persuasive[ness]" of scholarly advocacy for price-distortion test); Bebchuk & Ferrell, Rethinking *Basic*, Discussion Paper No. 756, Harvard Olin Ctr. for Law, Bus. & Econ. 2-3, 11-14 (Dec. 2013)[8] (proposing price-distortion test and providing examples of price distortion in inefficient markets). It would also refocus courts on the misrepresentations that, after all, must be the subject of common reliance, rather than vexing questions of market efficiency that strain judicial competence and produce wildly disparate results. *Id.* at 20.

b. While any fraud-on-the-market presumption of common reliance is problematic under *Wal-Mart* and *Comcast*, see *supra* Part I.C.1, requiring plaintiffs to initially prove price distortion to invoke the presumption would be more consistent with Rule 23 than the current approach. Plaintiffs bear the burden under Rule 23 to prove that common issues predominate. *Comcast*, 133 S. Ct. at 1432. Because price distortion is the key to even *presuming* common issues of reliance, plaintiffs ought to bear the initial burden on that question. *Basic* improperly places the initial burden on defendants to rebut price impact. 485 U.S. at 248.

C. Overruling or modifying *Basic* would advance the '34 Act's policies

Securities class actions premised on *Basic*'s presumption of reliance hinder the goals of the '34 Act generally and Section 10(b) specifically. They harm innocent shareholders and minimally deter wrongdoers. Given that there are better alternatives, there is no reason to retain a presumption that lacks a legal or economic foundation and that wreaks havoc on this Court's general case

[8] http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2371304

law.

1. *The status quo undermines the Act's purposes*

"[T]he fundamental problem" for *Basic* is that 10b-5 class actions "produce wealth transfers among shareholders that neither compensate nor deter." Coffee, Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation, 106 Colum. L. Rev. 1534, 1535-1536 (2006). Yet they impose great costs—on the parties, shareholders, and the judicial system.

a. **Modern securities class actions force settlement without regard to merit**

Basic's presumption ineffectively compensates and deters because it has generated a system of settlements that correspond to the threat of certification, not merit. "With vanishingly rare exception, class certification sets the litigation on a path toward resolution by way of settlement, not full-fledged testing of the plaintiffs' case by trial." Nagareda, Class Certification in the Age of Aggregate Proof, 84 N.Y.U. L. Rev. 97, 99 (2009).

Securities settlements are routine tolls that large companies must pay. In any given five-year period, the odds of a public corporation being sued by a putative class for a Section 10(b) claim are about 10%. Coffee, *supra*, at 1548 (citation omitted). Some early proponents of the efficient-market hypothesis believed that its adoption would curtail the number of securities-fraud class actions, see, *e.g.*, Fischel, Use of Modern Finance Theory in Securities Fraud Cases Involving Actively Traded Securities, 38 Bus. L. 1, 16 (1982), but they were proven wrong. Between 1988 and 1991, the number of such suits nearly tripled, see O'Brien, The Class-Action Shakedown Racket, Wall St. J., Sept. 10, 1991, at A20, and notwithstanding the enactment of the PSLRA, the number increased still further over the ensuing decades. Comolli et al., Recent Trends in Securities Class Action Litigation:

2012 Full-Year-Review 3 (2013).[9] From the enactment of the PSLRA through 2012, plaintiffs have filed 3,988 securities class actions, but a mere 14—about one-third of 1%—went to verdict. *Id.* at 38. Indeed, there were *no* verdicts in 2012. *Id.* at 23. From 1996 to 2012, securities class settlements amounted to $73 billion, with over $53 billion paid since 2005. *Id.* at 31 (sums in Figure 28).

This Court has long recognized that defendants in a certified securities class face such "increase[d] * * * potential damages liability and litigation costs that [they] may find it economically prudent to settle and to *abandon a meritorious defense*." *Coopers & Lybrand* v. *Livesay*, 437 U.S. 463, 476 (1978) (emphasis added). Accord *AT&T Mobility LLC* v. *Concepcion*, 131 S. Ct. 1740, 1752 (2011) ("even a small chance of a devastating loss" pressures defendants "into settling questionable claims," amounting to "'in terrorem' settlements"). Judge Friendly aptly called them "blackmail settlements."[10] All class actions raise this problem, but "litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general." *Blue Chip Stamps*, 421 U.S. at 739. Beyond a potentially staggering judgment, "[t]he very pendency of the lawsuit may frustrate or delay normal business activity of the defendant which is totally unrelated to the lawsuit." *Id.* at 740. In short, securities litigation is costly, and, like the rain, it falls both "on the just and on the unjust." Matthew 5:45 (King James Version).

b. **Securities class actions poorly compensate investors**

Despite these enormous costs, the *Basic*-generated system poorly compensates investors, who *themselves* pay the judgments. As Judge Friendly and Justice

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[9] http://www.nera.com/nera-files/PUB_Year_End_Trends_2012_1113.pdf.

[10] Friendly, Federal Jurisdiction: A General View 120 (1973).

White long foresaw, expansion of private class actions "'lead[s] to large judgments, payable in the last analysis by innocent investors, for the benefit of speculators and their lawyers.'" *Basic*, 485 U.S. at 262 (White, J., dissenting) (quoting *SEC* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833, 867 (2d Cir. 1968) (*en banc*) (Friendly, J., concurring)). Indeed, settlements merely "shif[t] money from one shareholder pocket to another at enormous expense." Pritchard, *Stoneridge Investment Partners* v. *Scientific-Atlanta*: The Political Economy of Securities Class Action Reform, 2008 Cato S. Ct. Rev. 217, 255 (2008).

"[T]he costs of securities class actions—both the settlement payments and the litigation expenses of both sides—fall largely on the defendant corporation," which means that "its shareholders ultimately bear these costs indirectly and often inequitably." Coffee, *supra*, at 1536. Diversified investors, the bulk of any class, cannot win; they are both "plaintiffs and defendants," members of "both classes, having bought stock at different times." *Id.* at 1556. Given transaction costs and the likelihood of retaining more shares than were sold during a class window, "most of the plaintiff class will lose more as holders than they gain as buyers." Booth, Class Conflict in Securities Fraud Litigation, 14 U. Pa. J. Bus. L. 701, 701 (2012); see *id.* at 716.

Settlements are even worse for smaller *undiversified* shareholders. They are more likely to "be * * * 'buy and hold' investor[s]," meaning that they more frequently "purchased their stock before the class period commenced," Coffee, *supra*, at 1559-1560, and therefore share the costs of the litigation, but no benefits. The only "clear winner[s]" from *Basic*'s settlement system fit "the profile of the contemporary hedge fund"—not quite the earnest investors *Basic* had in mind. *Id.* at 1560.

Except for those few, "the cost of class actions—in at-

torney fees and other expenses—constitutes a deadweight loss," simply "rearrang[ing]" shareholders' own money, "minus a cut for the lawyers." Booth, *supra*, at 706. And that is a prime, juicy "cut." Plaintiffs' attorney fees amount to somewhere between 23% and 32% of aggregated settlement amounts; defense fees, generally paid regardless of outcome, rival that amount overall. *Id.* at 703 n.1; Coffee, *supra*, at 1546-1547.

Securities class actions would still poorly compensate investors even without these structural impediments. "From 1996 to 2010, median settlements returned only 2.8%" of alleged plaintiff losses. Bratton & Wachter, *supra*, at 77. In 2012, that number was even lower—1.8%. Ryan & Simmons, Securities Class Action Settlements: 2012 Review & Analysis 8 (2012).[11] And that is *before* the huge transaction costs—attorneys' fees, litigation expenses, D&O insurance, "and the possible costs of disruption, stigma, and adverse publicity." Coffee, *supra*, at 1545-1546.

Thus, it is a decided understatement to observe that "[t]here are serious questions about whether fraud-on-the-market lawsuits generate more costs than benefits for investors and/or our capital markets, much more so than in 1988 when *Basic* was decided." Langevoort, Judgment Day for Fraud-on-the-Market? Reflections on *Amgen* and the Second Coming of *Halliburton*, Georgetown Public Law and Legal Theory Research Paper No. 13-058, at 21 (Nov. 16, 2013).[12]

c. **Securities class actions do not deter culpable parties**

Any "deterrent effect" from securities class litigation

[11] http://securities.stanford.edu/Settlements/REVIEW_1995-2012/Settlements_Through_12_2012.pdf.

[12] http://ssrn.com/abstract=2281910.

"is significantly muted" because, "rather than the corporation's culpable agents," it is "the corporation and its insurance company [that] make the [settlement] payments * * * ." Bratton & Wachter, *supra*, at 77. "To punish the corporation and its shareholders * * * is much like seeking to deter burglary by imposing penalties on the victim for having suffered a burglary." Coffee, *supra*, at 1537.

Culpable individuals pay less than one-half of 1% of class-action settlements, while insurers pay about 68%, and companies pay 31%. *Id.* at 1550. Since even that minuscule amount of individual payment is typically indemnified by the company, it is extremely rare for executives or directors to personally pay *anything* from their own assets. *Id.* at 1567-1568; Grundfest, Damages and Reliance, *supra*, at 59.

This state of affairs—where the innocent pay and the guilty do not—*undermines* deterrence, because "securities fraud appears to be primarily motivated by the manager's own personal interests * * * ." Coffee, *supra*, at 1562. When "insiders who are most culpable can apparently escape personal liability in securities class actions, then the deterrent rationale * * * seems largely undercut." *Id.* at 1553. Injecting the fraud-on-the-market theory into securities litigation does "[s]o little" to achieve deterrence that, "it seems, * * * the system has begun to evolve around [fraud-on-the-market]," rather than the other way around. Bratton & Wachter, *supra*, at 115.

d. **Securities class actions consume excessive judicial resources**

Making matters worse, fraud-on-the-market class actions are gluttonous consumers of judicial resources. It is a "myth" that "securities class actions are simply one of many varieties of class action * * * ." Coffee, *supra*, at 1539. "[S]ecurities class actions disproportionately claim

judicial time and attention" because "they take longer to resolve" and "require the court to play a more active monitoring role" than other class actions. *Id.* at 1540; see Fitzpatrick, An Empirical Study of Class Action Settlements and Their Fee Awards, 7 J. Empirical Legal Stud. 811, 820 (2010) (comparing settlement times). Indeed, 60-70% of securities-fraud cases *that settle* take more than three years to resolve (and 20% take more than five years). Ryan & Simmons, *supra*, at 6. The present case pended for more than five years before the Fund even filed its motion for class certification and generated more than 400 docket entries before the first class-certification appeal. Fraud-on-the-market class actions are truly "the 800-pound gorilla that dominates and overshadows other forms of class actions." Coffee, *supra*, at 1539.

2. *Overruling or modifying* Basic *would facilitate the securities laws' objectives*

Basic's presumption of reliance is not essential for Section 10(b) private actions, much less for vindicating the securities laws more generally. Justice White's dissent fiercely opposed the presumption, but "[did] not propose that the law retreat from * * * § 10(b) and Rule 10b-5, as interpreted in our prior cases * * * ." 485 U.S. at 256. Beyond private litigation, many other mechanisms achieve the goals of Section 10(b). Overruling or modifying *Basic* would advance those goals without any meaningful downside—and considerable upside, because it would mitigate the deficiencies described above.

a. **Public enforcement provides superior deterrence and compensation**

Public enforcement is now the most potent mechanism for achieving the goals of the securities laws, marking a considerable change from *Basic*'s day. In 1988, the SEC's budget was $135.2 million; by 2013, it had reached $1.26 billion—a five-fold increase in inflation-adjusted

dollars. See 1988 SEC Annual Report 186;[13] U.S. SEC, Fiscal Year 2013 Agency Financial Report 38.[14] "[P]ublic antifraud enforcement has become a growth industry," Bratton & Wachter, *supra*, at 115-116, and "disgorgement and penalties" now "dwarf those imposed by financial regulators in other jurisdictions," such as the United Kingdom. Rose, Reforming Securities Litigation Reform, 108 Colum. L. Rev. 1301, 1346 (2008). With "over $10 billion in disgorgement and penalties" collected from 2002-2007 alone, SEC "enforcement power" is decidedly "not toothless." *Stoneridge*, 552 U.S. at 166.

The SEC can target securities fraud unconstrained by the requirements of private litigation. "[R]eliance, damages, and loss causation are not required elements." *SEC* v. *Goble*, 682 F.3d 934, 943 (11th Cir. 2012). "Unlike the private party who has no reason to suspect fraud, the SEC's very purpose is to root it out, and it has many legal tools at hand to aid in that pursuit." *Gabelli* v. *SEC*, 133 S. Ct. 1216, 1222 (2013). Unlike private actions, which generate only compensatory damages (mostly through settlements), SEC enforcement "permit[s] a panoply of remedies, enabling [it] to perform its deterrent function in a finely calibrated manner." Rose, *supra*, at 1310-1311. The SEC can obtain injunctive relief and bar individuals from being officers or directors of publicly traded companies. 15 U.S.C. §§ 78u, 78u-3. While class actions typically do not affect culpable individuals, "93.4% of managers identified as culpable by government enforcers lose their jobs." Bratton & Wachter, *supra*, at 112 (citing Karpoff et al., The Consequences to Managers for Financial Misrepresentation, 88 J. Fin. Econ. 193, 201 (2008) (table 3)).

The Government also prosecutes securities fraud *as a*

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[13] http://www.sec.gov/about/annual_report/1988.pdf.

[14] http://www.sec.gov/about/secpar/secafr2013.pdf.

crime. See, *e.g.*, 15 U.S.C. § 78ff. "Criminal enforcement of the securities laws, once rare, is now institutionalized," with "almost 1300 convictions (including those of 200 CEOs)," just from 2002 to 2008. Bratton & Wachter, *supra*, at 115-116. It is commonly agreed that "criminal penalties are a strong deterrent." *Stoneridge*, 552 U.S. at 166.

Critically, SEC enforcement also can now "act as a substitute" for the compensatory role of private litigation. Grundfest, *supra*, at 40. The SEC can use penalties or disgorged funds to compensate defrauded private investors. See 15 U.S.C. § 7246 ("Fair Funds for Investors"); Rose, *supra*, at 1350. Under this Sarbanes-Oxley provision, "$2.1 billion flowed out in 2009 alone." Bratton & Wachter, *supra*, at 161-162. See also *Stoneridge*, 552 U.S. at 166.

By directing a public-enforcement surge even as it has constrained private securities litigation, Congress has demonstrated a "preference for public enforcement of the securities laws over private enforcement through Section 10(b) litigation or other means." Grundfest, *supra*, at 38; see *id*. at 38-40 (describing statutory changes that uniformly prioritize public enforcement while constraining or ignoring private Section 10(b) litigation).

b. **An artificially low bar for class certification is unwarranted for private Section 10(b) litigation**

Basic adopted the presumption of reliance because it viewed the presumption as necessary for most class actions. See 485 U.S. at 242. But nothing supports the implicit premise that class actions are essential to vindicating federal securities claims. Just last Term, the Court held as much in the antitrust context. Plaintiffs sought to disregard their arbitration agreements' class waiver because the minimum costs of proceeding individually

dwarfed the maximum potential individual recovery. But the Court reasoned that "[t]he Sherman and Clayton Acts"—like the '34 Act—antedate Rule 23 and "make no mention of class actions." *Am. Express Co.* v. *Italian Colors Rest.*, 133 S. Ct. 2304, 2309 (2013). The antitrust laws simply "do not guarantee an affordable procedural path to the vindication of every claim." *Ibid*. Thus, "the individual suit that was considered adequate to assure 'effective vindication' of a federal right before adoption of class-action procedures did not suddenly become 'ineffective vindication' upon their adoption." *Id.* at 2311. For the same reasons, *Basic* erred in diluting Rule 23 and the reliance element to enable Section 10(b) class actions.

Eliminating or modifying the presumption of reliance will, in any event, not preclude private litigation. "[S]ophisticated investors" will be able to "demonstrate * * * that they reviewed documents containing the alleged misrepresentations or omissions," and can "demonstrate actual reliance" in individual actions. Grundfest, *supra*, at 66. Indeed, institutional investors—such as pension funds representing the interests of many small stakeholders—are already opting out of class actions in "increasing numbers" "to pursue individual claims and settlements." *Id.* at 67 (citing Vinik et al., Why Institutional Investors Are Opting Out of Class-Action Litigation, Pensions & Investments (July 25, 2011)[15]).

Aside from Section 10(b), "[c]lass action litigation asserting violations of Sections 11 and 12 of the Securities Act, and Section 14 of the Exchange Act," among others that do not require actual reliance, "would continue unaffected." Grundfest, *supra*, at 66 (noting that "the largest recoveries in class action securities fraud history arise from Section 11 claims").

Thus, even if "*meritorious* private actions to enforce

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[15] http://www.pionline.com/article/20110725/PRINT/307259985.

federal antifraud securities laws" remain an "essential supplement to criminal prosecution and civil enforcement actions," *Tellabs, Inc.* v. *Makor Issues & Rights, Ltd.*, 551 U.S. 308, 313 (2007) (emphasis added), it does not follow that easily certified 10b-5 *class* actions of doubtful merit are "essential" to that goal, or even further it at all.

III. *BASIC* PERMITS DEFENDANTS TO REBUT THE PRESUMPTION AT CLASS CERTIFICATION BY SHOWING THE ABSENCE OF PRICE IMPACT

Even if this Court declines to overrule or modify *Basic*, the court of appeals erred by prohibiting Halliburton from rebutting the presumption of reliance at the certification stage with evidence that the alleged misrepresentations did not affect the market price. *Basic* itself could hardly be clearer: defendants may "rebut the presumption" by "show[ing] that the misrepresentation in fact did not lead to a distortion of price." 485 U.S. at 248. By precluding this rebuttal at the class-certification stage, the court disregarded *Basic* and failed to grasp that the absence of price impact causes individual issues of reliance to predominate. Nothing in *Basic* or *Amgen* allows plaintiffs to invoke a *rebuttable presumption* to obtain certification, while prohibiting rebuttal of the presumption's "fundamental premise," *EPJ Fund*, 131 S. Ct. at 2186, at that stage.

A. *Amgen* supports consideration of price-impact rebuttal at the class-certification stage

The court of appeals misread *Amgen*'s rationale as foreclosing Halliburton from making a price-impact rebuttal at class certification. In fact, *Amgen* dictates the opposite.

1. *Amgen* holds that, to invoke the presumption at certification, plaintiffs need not establish (and thus defendants may not rebut) the "materiality" of alleged mis-

representations.[16] 133 S. Ct. at 1199. Materiality is at that stage altogether irrelevant, because "there is no risk whatever that a failure of proof on the common question of materiality will result in individual questions predominating." *Id.* at 1196; *id.* at 1203-1204. This is so "[b]ecause materiality is an essential element of a Rule 10b-5 claim," and "the failure of proof on the element of materiality would end the case for one and for all; no claim would remain in which individual reliance issues could potentially predominate." *Id.* at 1196. A case involving immaterial misrepresentations fails "as a matter of law" regardless of whether the plaintiff seeks to prove actual or presumed reliance. *Id.* at 1199. The Court emphasized *four more times* that materiality is irrelevant to class certification because materiality is an "element" of a Rule 10b-5 claim. *Id.* at 1191, 1196, 1197, 1199.

The Court contrasted materiality with other fraud-on-the-market predicates that *must* be addressed at class certification: "that the alleged misrepresentations were publicly known" and "that the stock traded in an efficient market." *Id.* at 1198. "[U]nlike materiality, market efficiency and publicity are *not indispensable elements of a Rule 10b-5 claim.*" *Id.* at 1199 (emphasis added). "[W]here the market for a security is inefficient or the defendant's alleged misrepresentations were not aired publicly, a plaintiff cannot invoke the fraud-on-the-market presumption," but individual plaintiffs could attempt to establish actual reliance without resort to the

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[16] Materiality is distinct from price impact. A misrepresentation is material "when there is a substantial likelihood that the disclosure * * * would have been viewed by the reasonable investor as having significantly altered the total mix of information made available." *Matrixx Initiatives, Inc.* v. *Siracusano*, 131 S. Ct. at 1309, 1318 (2011) (quotation omitted). Price impact says nothing about the content of the misstatement; it "simply refers to the effect of a misrepresentation on a stock price." *EPJ Fund*, 131 S. Ct. at 2187.

presumption. *Ibid.* "Individualized reliance issues would predominate in such a lawsuit. The litigation, therefore, could not be certified under Rule 23(b)(3) as a class action." *Ibid.* (citation omitted).

2. The Fifth Circuit erred by treating price impact as more analogous for Rule 23 purposes to materiality than to publicity and market efficiency. Like publicity and market efficiency, price impact is "not [an] indispensable elemen[t] of a Rule 10b-5 claim." *Amgen*, 133 S. Ct. at 1199. And as with publicity and market efficiency, the absence of price impact would mean that "a plaintiff cannot invoke the fraud-on-the-market presumption." *Ibid.*; see *Basic*, 485 U.S. at 248. Precisely because plaintiffs in that instance would have to show reliance on an individual basis, price-impact rebuttal must be entertained at the class-certification stage. See *In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474, 484-485 (2d Cir. 2008) (allowing price-impact rebuttal "prior to class certification" because "successful rebuttal *defeats* certification by defeating the Rule 23(b)(3) predominance requirement"); *In re DVI, Inc. Sec. Litig.*, 639 F.3d 623, 638 (3d Cir. 2011) (same).[17]

The root of the Fifth Circuit's error was its misapprehension that a successful price-impact rebuttal would automatically defeat the loss-causation element. Pet. App. 17a-18a. But price impact is essential to loss causation only in *fraud-on-the-market* cases where the plaintiff necessarily looks to an exchange-traded price to establish reliance and loss causation. Yet even in that context, price impact is indistinguishable from publicity: if alleged

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[17] *Amgen* disapproved of the Second and Third Circuits' holdings that "materiality" may be considered at class certification, 133 S. Ct. at 1194, but did not address their independent holdings that a defendant may defeat class certification by showing the absence of price impact.

misrepresentations are nonpublic, by definition those misrepresentations could not affect market price and loss causation could not be established. See *EPJ Fund*, 131 S. Ct. at 2185 (questioning "how," if misrepresentations are not "publicly known," "would the market take them into account?"). Consequently, the fact that price impact is necessary to proving loss causation in a *fraud-on-the-market case* offers no logical basis for excluding such evidence at class certification.

Equally telling, in explaining why publicity may be considered at certification, the Court declared that in a *non-fraud-on-the-market case*, an individual plaintiff "can * * * attempt to establish reliance through the traditional mode of demonstrating that she was personally aware of [the defendant's] statement and engaged in a relevant transaction . . . based on that specific misrepresentation." *Amgen*, 133 S. Ct. at 1199 (quotation omitted). That is no less true where the defendant directly shows that the misrepresentations did not distort the market price; plaintiffs can still establish personal reliance and loss causation in non-fraud-on-the-market cases where misstatements were nonpublic or otherwise did not affect an exchange-traded price. See, *e.g.*, *EP Medsystems, Inc.* v. *EchoCath, Inc.*, 235 F.3d 865, 871 (3d Cir. 2000) (plaintiff sufficiently alleged a 10b-5 claim against a publicly traded company even though the plaintiff "d[id] not base its claim on public misrepresentations or omissions that affected the price of the stock"); *Livid Holdings Ltd.* v. *Salomon Smith Barney, Inc.*, 416 F.3d 940, 949 & n.2 (9th Cir. 2005) (purchaser in "private sale" adequately pleaded loss causation without reference to exchange-listed price); *McCabe* v. *Ernst & Young, LLP*, 494 F.3d 418, 425-426 (3d Cir. 2007) (distinguishing, in case involving private purchase of public company's stock, methods of proving loss causation in "typical" and "non-typical" cases).

Therefore, the absence of price impact does *not* mean "as a matter of law" that "no claim would remain in which individual reliance issues could potentially predominate." *Amgen*, 133 S. Ct. at 1196, 1199. Indeed, because a price-impact rebuttal would require each plaintiff to individually prove reliance—and because it does not defeat loss causation as a matter of law—individual questions would overwhelm common ones. Thus, price impact, just like publicity, is a proper subject for the certification stage.

B. Price impact itself, not just its "predicates," must be rebuttable at class certification

Amgen requires consideration of publicity and market efficiency at class certification solely because such evidence bears upon whether misrepresentations distorted the market price. Consequently, there is no conceivable reason to prohibit defendants from *directly* establishing the absence of price impact at class certification.

1. The "fundamental premise" of *Basic*'s presumption posits "that an investor presumptively relies on a misrepresentation *so long as it was reflected in the market price* at the time of his transaction." *EPJ Fund*, 131 S. Ct. at 2186 (emphasis added). Information that "does not affect market price * * * cannot be relied upon indirectly by investors." *Amgen*, 133 S. Ct. at 1195. For that reason, *Basic* guaranteed defendants the right to rebut the presumption by controverting "proof of the elements giving rise to the presumption, *or* show[ing] that the misrepresentation in fact did not lead to a distortion of price." 485 U.S. at 248 (emphasis added). *Amgen* clarified that defendants may rebut the presumption at the class-certification stage by controverting market efficiency and publicity because "[u]nless those predicates are established, there is no basis for presuming that the de-

fendant's alleged misrepresentations were reflected in the security's market price."[18] 133 S. Ct. at 1199.

Thus, all rebuttal allowed by *Basic* is either direct or indirect price-impact rebuttal. It would make no sense to allow defendants at the certification stage to indirectly rebut price impact by rebutting the presumption's publicity and market-efficiency "predicates" while prohibiting defendants from directly contraverting price impact. Both modes of defeating price impact must rise or fall together.

Instead of recognizing that market efficiency, publicity, and materiality are mere "predicates" for price impact, the court of appeals believed it had to determine which particular predicate Halliburton's price-impact evidence was intended to rebut, and from that divine whether the evidence was permissible at class certification. Pet. App. 13a-15a & n.7, 18a-19a n.10. That gets it exactly backwards. A direct price-impact rebuttal is always relevant at class certification because it erases any possibility that there could be classwide reliance via reliance on a distorted market price.

2. Limiting defendants to indirect price-impact rebuttal would render *Basic*'s rebuttal right useless in the very cases where it is most essential—where the presence of the presumption's predicates demonstrates that (under existing precedent) "it is reasonable to presume [price impact]," *Amgen*, 133 S. Ct. at 1192, and yet price impact is in fact lacking. Modern economic analysis teaches that even well-developed markets are frequently irrational or inefficient in incorporating certain types of public statements. See *supra* Part I.B.1. In this very case, the Fund established the predicates of the pre-

[18] Materiality is likewise a predicate of the presumption, but it is irrelevant at class certification because it is also an element of a 10b-5 claim. See *supra* Part III.A.1.

sumption, but the price-impact evidence failed to "raise an inference that the price was actually affected by [the] alleged misrepresentations." Pet. App. 37a, 42a-53a. Yet the court of appeals refused to consider "the extensive evidence of no price impact offered by Halliburton." *Id.* at 19a n.11. Permitting defendants to directly rebut price impact avoids such absurd results, prevents erroneous certifications, and follows ineluctably from allowing consideration of publicity and market efficiency.

Indeed, the need for certification-stage rebuttal is more acute for price impact than for market efficiency or publicity. Although price impact is "*Basic*'s fundamental premise," *EPJ Fund*, 131 S. Ct. at 2186, it is not currently a "predicate" of *Basic*'s presumption. Thus, plaintiffs need not prove it to invoke the presumption in the first instance; rebuttal is therefore the *only* way to challenge it. Without certification-stage price-impact rebuttal, plaintiffs can invoke the presumption even when its fundamental premise is glaringly absent. Demanding that mere predicates of the presumption be present and yet dispensing with its fundamental price-impact premise is worse than illogical; it is incoherent.

3. Allowing price-impact rebuttal is consistent with the relevant federal rules and the policy considerations that govern 10b-5 claims. *Basic* invoked Federal Rule of Evidence 301 when it recognized the utility of its presumption "for allocating the burdens of proof between parties." 485 U.S. at 245. Rule 301 provides that "the party against whom a presumption is directed has the burden of producing evidence to rebut the presumption. But this rule does not shift the burden of persuasion, which remains on the party who had it originally." Fed. R. Evid. 301. Thus, despite the presumption of price impact that arises when plaintiffs establish the fraud-on-the-market predicates, defendants must have the opportunity to "produc[e] evidence to rebut the presumption"

and plaintiffs always retain the ultimate burden of persuasion on the price-impact issue. *Ibid.*

By depriving defendants of the opportunity to directly rebut the presumption's fundamental premise at the certification stage, the court of appeals relieved plaintiffs of their burden to prove the efficacy of the presumption and, ultimately, of their Rule 23 burden to show that common issues predominate. The denial of direct price-impact rebuttal at the certification stage betrays Rule 301's promise to defendants of the *rebuttal* opportunity enshrined in *Basic*, and it defies Rule 23's bedrock mandates.[19]

CONCLUSION

The judgment of the court of appeals should be reversed.

[19] Certifying sprawling classes based on an embattled presumption of price impact, without testing whether that presumption is in fact justified, also contravenes the notions of "fairness, public policy, * * * probability, [and] judicial economy," on which *Basic* itself relied. 485 U.S. at 245. On the other hand, by allowing price-impact rebuttal prior to class certification, "[t]he law guards against a flood of frivolous or vexatious lawsuits." *Salomon*, 544 F.3d at 484.

Respectfully submitted.

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APPENDIX

Section 10(b) of the Securities Exchange Act, codified at 15 U.S.C. § 78j(b)

Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange —

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(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Section 18(a) of the Securities Exchange Act, codified at 15 U.S.C. § 78r(a)

Liability for misleading statements

(a) Persons liable; persons entitled to recover; defense of good faith; suit at law or in equity; costs, etc.

Any person who shall make or cause to be made any statement in any application, report, or document filed pursuant to this chapter or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 78*o* of this title, which statement was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, shall be liable to any person (not knowing that such statement was false or misleading) who, in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement, for damages caused by such reliance, unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading. A person seeking to enforce such liability may sue at law or in equity in any court of competent jurisdiction. In any such suit the court may, in its discretion, require an undertaking for the payment of the costs of such suit, and assess reasonable costs, including reasonable attorneys' fees, against either party litigant.

SEC Rule 10b–5, codified at 17 C.F.R. § 240.10b–5

Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

Federal Rule of Civil Procedure 23

Class Actions

(a) Prerequisites. One or more members of a class may sue or be sued as representative parties on behalf of all members only if:

(1) the class is so numerous that joinder of all members is impracticable;

(2) there are questions of law or fact common to the class;

(3) the claims or defenses of the representative parties are typical of the claims or defenses of the class; and

(4) the representative parties will fairly and adequately protect the interests of the class.

(b) Types of Class Actions. A class action may be maintained if Rule 23(a) is satisfied and if:

(1) prosecuting separate actions by or against individual class members would create a risk of:

(A) inconsistent or varying adjudications with respect to individual class members that would establish incompatible standards of conduct for the party opposing the class; or

(B) adjudications with respect to individual class members that, as a practical matter, would be dispositive of the interests of the other members not parties to the individual adjudications or would substantial-

ly impair or impede their ability to protect their interests;

(2) the party opposing the class has acted or refused to act on grounds that apply generally to the class, so that final injunctive relief or corresponding declaratory relief is appropriate respecting the class as a whole; or

(3) the court finds that the questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy. The matters pertinent to these findings include:

(A) the class members' interests in individually controlling the prosecution or defense of separate actions;

(B) the extent and nature of any litigation concerning the controversy already begun by or against class members;

(C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; and

(D) the likely difficulties in managing a class action.

(c) Certification Order; Notice to Class Members; Judgment; Issues Classes; Subclasses.

(1) Certification Order.

(A) Time to Issue. At an early practicable time after a person sues or is sued as a class representative, the court must deter-

mine by order whether to certify the action as a class action.

(B) Defining the Class; Appointing Class Counsel. An order that certifies a class action must define the class and the class claims, issues, or defenses, and must appoint class counsel under Rule 23(g).

(C) Altering or Amending the Order. An order that grants or denies class certification may be altered or amended before final judgment.

(2) Notice.

(A) For (b)(1) or (b)(2) Classes. For any class certified under Rule 23(b)(1) or (b)(2), the court may direct appropriate notice to the class.

(B) For (b)(3) Classes. For any class certified under Rule 23(b)(3), the court must direct to class members the best notice that is practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort. The notice must clearly and concisely state in plain, easily understood language:

(i) the nature of the action;

(ii) the definition of the class certified;

(iii) the class claims, issues, or defenses;

(iv) that a class member may enter an appearance through an attorney if the member so desires;

(v) that the court will exclude from the class any member who requests exclusion;

(vi) the time and manner for requesting exclusion; and

(vii) the binding effect of a class judgment on members under Rule 23(c)(3).

(3) Judgment. Whether or not favorable to the class, the judgment in a class action must:

(A) for any class certified under Rule 23(b)(1) or (b)(2), include and describe those whom the court finds to be class members; and

(B) for any class certified under Rule 23(b)(3), include and specify or describe those to whom the Rule 23(c)(2) notice was directed, who have not requested exclusion, and whom the court finds to be class members.

(4) Particular Issues. When appropriate, an action may be brought or maintained as a class action with respect to particular issues.

(5) Subclasses. When appropriate, a class may be divided into subclasses that are each treated as a class under this rule.

(d) Conducting the Action.

(1) In General. In conducting an action under this rule, the court may issue orders that:

(A) determine the course of proceedings or prescribe measures to prevent undue repetition or complication in presenting evidence or argument;

(B) require—to protect class members and fairly conduct the action—giving appropriate notice to some or all class members of:

(i) any step in the action;

(ii) the proposed extent of the judgment; or

(iii) the members' opportunity to signify whether they consider the representation fair and adequate, to intervene and present claims or defenses, or to otherwise come into the action;

(C) impose conditions on the representative parties or on intervenors;

(D) require that the pleadings be amended to eliminate allegations about representation of absent persons and that the action proceed accordingly; or

(E) deal with similar procedural matters.

(2) Combining and Amending Orders. An order under Rule 23(d)(1) may be altered or amend-

ed from time to time and may be combined with an order under Rule 16.

(e) Settlement, Voluntary Dismissal, or Compromise. The claims, issues, or defenses of a certified class may be settled, voluntarily dismissed, or compromised only with the court's approval. The following procedures apply to a proposed settlement, voluntary dismissal, or compromise:

(1) The court must direct notice in a reasonable manner to all class members who would be bound by the proposal.

(2) If the proposal would bind class members, the court may approve it only after a hearing and on finding that it is fair, reasonable, and adequate.

(3) The parties seeking approval must file a statement identifying any agreement made in connection with the proposal.

(4) If the class action was previously certified under Rule 23(b)(3), the court may refuse to approve a settlement unless it affords a new opportunity to request exclusion to individual class members who had an earlier opportunity to request exclusion but did not do so.

(5) Any class member may object to the proposal if it requires court approval under this subdivision (e); the objection may be withdrawn only with the court's approval.

(f) Appeals. A court of appeals may permit an appeal from an order granting or denying class-action certification under this rule if a petition for permission to appeal is filed with the circuit clerk within 14 days after the order is entered. An appeal does not stay proceedings in

the district court unless the district judge or the court of appeals so orders.

(g) Class Counsel.

(1) Appointing Class Counsel. Unless a statute provides otherwise, a court that certifies a class must appoint class counsel. In appointing class counsel, the court:

(A) must consider:

(i) the work counsel has done in identifying or investigating potential claims in the action;

(ii) counsel's experience in handling class actions, other complex litigation, and the types of claims asserted in the action;

(iii) counsel's knowledge of the applicable law; and

(iv) the resources that counsel will commit to representing the class;

(B) may consider any other matter pertinent to counsel's ability to fairly and adequately represent the interests of the class;

(C) may order potential class counsel to provide information on any subject pertinent to the appointment and to propose terms for attorney's fees and nontaxable costs;

(D) may include in the appointing order provisions about the award of attorney's

fees or nontaxable costs under Rule 23(h); and

(E) may make further orders in connection with the appointment.

(2) Standard for Appointing Class Counsel. When one applicant seeks appointment as class counsel, the court may appoint that applicant only if the applicant is adequate under Rule 23(g)(1) and (4). If more than one adequate applicant seeks appointment, the court must appoint the applicant best able to represent the interests of the class.

(3) Interim Counsel. The court may designate interim counsel to act on behalf of a putative class before determining whether to certify the action as a class action.

(4) Duty of Class Counsel. Class counsel must fairly and adequately represent the interests of the class.

(h) Attorney's Fees and Nontaxable Costs. In a certified class action, the court may award reasonable attorney's fees and nontaxable costs that are authorized by law or by the parties' agreement. The following procedures apply:

(1) A claim for an award must be made by motion under Rule 54(d)(2), subject to the provisions of this subdivision (h), at a time the court sets. Notice of the motion must be served on all parties and, for motions by class counsel, directed to class members in a reasonable manner.

(2) A class member, or a party from whom payment is sought, may object to the motion.

(3) The court may hold a hearing and must find the facts and state its legal conclusions under Rule 52(a).

(4) The court may refer issues related to the amount of the award to a special master or a magistrate judge, as provided in Rule 54(d)(2)(D).

Federal Rule of Evidence 301

Presumptions in Civil Cases Generally

In a civil case, unless a federal statute or these rules provide otherwise, the party against whom a presumption is directed has the burden of producing evidence to rebut the presumption. But this rule does not shift the burden of persuasion, which remains on the party who had it originally.