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

BRIEF FOR FORMER SEC COMMISSIONERS AND OFFICIALS AND LAW PROFESSORS AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

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October 11, 2013

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20002

QUESTIONS PRESENTED

1. Whether, in light of the fact that Section 18 of the Securities Exchange Act, the closest express analogue to the judicially created right of action under Section 10(b) of that Act, requires a showing of actual reliance for the recovery of damages, the same showing should be required for the recovery of damages under Section 10(b).

2. Whether this Court's holding in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), establishing a presumption of reliance in Section 10(b) actions, should be overruled because that presumption, intended to be rebuttable, has proven in practice over time to be effectively irrebuttable.

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BRIEF FOR FORMER SEC COMMISSIONERS AND OFFICIALS AND LAW PROFESSORS AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

INTEREST OF *AMICI CURIAE* [1]

Amici curiae are former Commissioners and officials of the United States Securities and Exchange

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[1] No counsel for a party authored this brief in whole or in part, and no person or entity, other than *amici curiae* or their counsel, contributed any money to fund the preparation or submission of this brief. Counsel of record for the parties received at least 10 days' notice of *amici*'s intent to file this brief, and all parties have consented to its filing.

Commission, as well as prominent law professors whose scholarship and teaching focuses on the federal securities laws. *Amici* have devoted substantial parts of their professional careers to drafting, implementing, or studying the federal securities laws, including how those laws should be interpreted to ensure the protection of investors and the promotion of efficiency, competition, and capital formation.

This brief reflects the consensus of the *amici* that this Court should grant certiorari in this case, reverse the Fifth Circuit's decision, and curtail or abandon the fraud-on-the-market presumption of reliance established in *Basic Inc. v. Levinson*, 485 U.S. 224, 241–49 (1988). Each individual *amicus*, however, may not endorse every argument made in this brief. *Amici* are listed below in alphabetical order:

The Honorable Paul S. Atkins served as a Commissioner of the SEC from 2002 to 2008.

Professor Stephen M. Bainbridge is the William D. Warren Distinguished Professor of Law at the University of California, Los Angeles School of Law.

Brian G. Cartwright served as General Counsel of the SEC from 2006 to 2009.

Richard A. Epstein is the Peter and Kirsten Bedford Senior Fellow at the Hoover Institution.

Professor Allen Ferrell is the Greenfield Professor of Securities Law at Harvard Law School.

The Honorable Edward H. Fleischman served as a Commissioner of the SEC from 1986 through 1992.

The Honorable Joseph A. Grundfest is the W.A. Franke Professor of Law and Business at Stanford Law School and served as a Commissioner of the SEC from 1985 to 1990.

Professor M. Todd Henderson is a Professor of Law at the University of Chicago Law School.

Simon M. Lorne served as General Counsel of the SEC from 1993 through 1996.

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The Honorable Laura S. Unger served as a Commissioner of the SEC from 1997 through 2002 and as acting Chairman from February to August 2001.

Andrew N. Vollmer served as Deputy General Counsel of the SEC from 2006 through early 2009.

INTRODUCTION AND SUMMARY OF ARGUMENT

At issue in this case is the viability and scope of the most powerful engine of civil liability ever established in American law: the fraud-on-the-market presumption of reliance under Section 10(b) of the Securities Exchange Act of 1934. That presumption revolutionized private securities litigation, and made it the massive multibillion-dollar industry that it is today. More than 3,050 private class-action securities-fraud lawsuits were filed between 1997 and 2012, generating settlements amounting to more than $73.1 billion, including six of the ten largest settlements in class-action history, and tens of billions in fees for plaintiffs' and defense counsel.[2]

Most of this activity, of course, has taken place under Section 10(b) and its fraud-on-the-market presumption.[3] Because the private Section 10(b) right contains no requirement of contractual privity between plaintiff and defendant, and no requirement that the defendant be a seller of securities, most Section 10(b) class litigation has involved class claims involving "secondary," or "aftermarket" trading.[4] The application of the presumption of reliance in secondary trading cases potentially subjects a corporate issuer and its executives to massive damages in favor of everyone who purchased a company's securities during extended periods of time. As the Court is well aware, this sort of litigation, and the presumption that enables it, remain controversial to this day.

At least as remarkable as the change and controversy that the presumption has wrought, is how it came about. Not by an act of Congress. The fraud-on-the-market presumption was, instead, the work of a bare majority of a bare quorum of this Court. A judicially created rule, tacked on to a judicially created right of action, the fraud-on-the-market presumption did not derive from the text, structure, or history of the

[2] Joseph A. Grundfest, *Damages and Reliance Under Section 10(b) of the Exchange Act* 1 & nn.1–5 (Rock Ctr. for Corp. Governance Working Paper No. 150, 2013), 69 BUS. LAW. (forthcoming Feb. 2014), *available at* http://ssrn.com/abstract=2317537.

[3] *Id.* at 2 & n.10.

[4] The "aftermarket" or "secondary market" refers to "[t]he market in which existing securities are traded among investors," DAVID L. SCOTT, WALL STREET WORDS 8, 330 (3rd ed. 2003), as opposed to a public offering of securities by an issuer.

federal securities laws. Instead, it embodied two raw judicial policy judgments—*first*, a belief that "[r]equiring proof of individualized reliance" should be dispensed with, so that Section 10(b) plaintiffs could be free to "proceed[] with a class action"; and, *second*, an acceptance of what were then "[r]ecent empirical studies" supporting the efficient capital markets hypothesis, the theory "that the market price of shares traded on well-developed markets reflects all publicly available information, and, hence, any material misrepresentations." *Basic Inc. v. Levinson*, 485 U.S. 224, 242, 246 (1988).

The petition trains its fire on *Basic's* dependence on the latter premise, pointing out that the efficient capital markets hypothesis was in 1988 "'a mere babe'" of an economic theory. *Id.* at 250 (White, J., dissenting), *quoted in* Pet. 18. Whatever its merits as an economic theory, the hypothesis was not designed or intended to be used to prove reliance in securities fraud cases. And twenty-five years on, it has become clear that this expansive theory cannot, as a practical matter, be applied by judges to actual cases. The petition thus correctly contends that the judiciary should not be an arbiter of economic theory, that it is ill-equipped to assess market efficiency, and that these are good and sufficient reasons why *Basic* should be overruled. On a narrower level, the petition is also right that, if *Basic* is to be retained, there is a sharp and consequential circuit split over how it applies, a split that by itself requires the attention of this Court.

But there are other reasons why *Basic* should be constrained, if not overruled. The first that we present below, in contrast to rendering judgments on economic theory and market efficiency, *does* involve a task that a court of law is particularly well-suited to perform—the application of settled principles of construction to interpret a federal statute. Applying those principles to the Securities Exchange Act makes clear that there is no basis for imposing a presumption of reliance to actions seeking damages under Section 10(b).

Because Section 10(b) does not provide for a private right of action, its text tells us only what conduct it prohibits. Accordingly, this Court has repeatedly explained that divining the additional elements of the judicially created private right requires a form of "historical reconstruction," *Musick, Peeler & Garrett v. Emp'rs Ins. of Wausau*, 508 U.S. 286, 294 (1993), by which the Court must try "'to infer how the 1934 Congress would have addressed the issue[s] had the 10b–5 action been included as an express provision in the 1934 Act,'" *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 173 (1994) (quoting *Musick, Peeler*, 508 U.S. at 294)). To do that, the Court consults "the express causes of actions in the securities Acts as the primary model for the § 10(b) action," *id.* at 178, and borrows from the provision that existed in 1934 that is "most analogous to the private 10b–5 right of action that is of judicial creation," *Musick, Peeler*, 508 U.S. at 294.

As we show below, that "most analogous" provision is unquestionably Section 18(a) of the Securities Exchange Act of 1934. Section 18(a) contains the only express right of action in existence in 1934 that authorizes damages actions for misrepresentations or omissions that affect secondary, aftermarket trading. It is the only express right that provides a cause of action for damages in favor of open-market purchasers and sellers against those (such as issuers or their executives) who allegedly made false or misleading statements, but did not transact with the plaintiffs—the quintessential Section 10(b) class claim today, and the precise fact pattern presented in this case.

Section 18(a) explicitly tells us what Congress intended such plaintiffs to prove in order to obtain damages: that they transacted "in reliance upon such [false or misleading] statement[s]," 15 U.S.C. § 78r(a)—actual, "eyeball" reliance. And if this clear text could leave any doubt about "how Congress would have balanced the policy considerations" involved here, *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 359 (1991), Section 18(a)'s history dispels that doubt. As originally drafted, Section 18(a) contained *no* reliance requirement, but Congress rejected that no-reliance version in the face of a torrent of criticism—criticism that Congress took to heart. Thus, as enacted, Section 18(a) prohibits recovery "unless the buyer bought the security with knowledge of the [false or misleading] statement and relied upon the statement." 78 CONG. REC. 7701 (1934) (statement of Rep. Sam Rayburn), *cited in Basic*, 485 U.S. at 258 (White, J., dissenting).

Accordingly, to "ensure the [Section 10(b)] action does not conflict with Congress' own express right[] of action" in Section 18, *Musick, Peeler*, 508 U.S. at 295, and because this Court must "give 'narrow dimensions … to a right of action Congress did not authorize,'" *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2302 (2011) (quoting *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 167 (2008)), this Court should similarly require plaintiffs in Section 10(b) actions to prove actual reliance to obtain damages. Such a ruling would not necessarily require that this Court overrule *Basic* outright, because, as the Court in *Basic* made clear, its "decision

… is not to be interpreted as addressing the proper measure of damages in litigation of this kind." 485 U.S. at 248 n.28. In conforming the Section 10(b) damages right to the reliance limitation contained in Section 18(a), the Court could treat actual reliance as part of the showing needed to establish the element of damages under Section 10(b); the *Basic* presumption could stand as a valid interpretation of the Section 10(b) reliance element, and remain a sufficient form of reliance in private actions not seeking money damages as relief.

Alternatively, the Court should grant certiorari to overrule *Basic*'s fraud-on-the-market holding, because that holding, even apart from its defiance of statutory text and congressional intent, has become "entirely untethered from [its] original rationale." *Montejo v. Louisiana*, 556 U.S. 778, 786 (2009). The Court originally intended the presumption to be "just that"—a presumption, and hence rebuttable "by appropriate evidence." *Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179, 2185 (2011); *see Basic*, 485 U.S. at 248–49. The Court tried to make the presumption rebuttable because it sought to preserve the requirement of reliance, "an essential element of the § 10(b) private cause of action." *Stoneridge*, 552 U.S. at 159. But as we show below, rebuttals of the presumption in the past quarter-century are few and far between. The rule of *Basic* has become exactly what the dissent in that case feared—"[a] nonrebuttable presumption of reliance" that "effectively convert[s] Rule 10b–5 into a scheme of investor's insurance." *Basic*, 485 U.S. at 252 (White, J., dissenting; citation and internal quotation marks omitted). The decision to create such "an investor insurance scheme[] should" have—and should still—"come from Congress, and not from the courts." *Id.* at 256–57 (White, J. dissenting).

ARGUMENT

I. PRIVATE PLAINTIFFS SEEKING DAMAGES UNDER SECTION 10(b) SHOULD BE REQUIRED TO PROVE ACTUAL RELIANCE.

When this Court created the fraud-on-the-market presumption of reliance in *Basic*, it expressly made clear that its "decision … is not to be interpreted as addressing the proper measure of damages in litigation of this kind." *Basic Inc. v. Levinson*, 485 U.S. 224, 248 n.28 (1988). And in none of its decisions since then has the Court addressed that issue. Exactly what a private Section 10(b) plaintiff must show to prove damages thus still remains an open question.

A. The text of Section 10(b), of course, cannot answer that question. "The § 10(b) private cause of action is a judicial construct that Congress did not enact in the text of the relevant statutes," *Stoneridge Inv. Partners LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 164 (2008); this Court has "made no pretense that it was Congress' design to provide the remedy afforded," *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 359 (1991). Congress envisioned Section 10(b) "as a 'catchall' clause to enable the [Securities and Exchange] Commission"—not private plaintiffs—'to deal with new manipulative … devices.'" *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 203 (1976) (citation omitted). The statute's text therefore addresses only "'the scope of [the] conduct prohibited"—and not "the additional 'elements of the 10b–5 private liability scheme'" later fashioned by the courts. *Morrison v. Nat'l Austl. Bank Ltd.*, 130 S. Ct. 2869, 2881 n.5 (2010) (quoting *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 173 (1994)).

As it never enacted a "private cause of action under § 10(b), Congress had no occasion to address how to … compute … liability arising from it." *Musick, Peeler & Garrett v. Emp'rs Ins. of Wausau*, 508 U.S. 286, 295 (1993). Determining the elements that a private plaintiff must establish to recover damages under Section 10(b) thus requires a kind of "historical reconstruction." *Id.* at 294. The Court must "face[] the awkward task," *Lampf, Pleva*, 501 U.S. at 359, of answering a hypothetical question—of "attempt[ing] to infer 'how the 1934 Congress would have addressed the issue had the 10b–5 action been included as an express provision in the 1934 Act.'" *Cent. Bank*, 511 U.S. at 178 (quoting *Musick, Peeler*, 508 U.S. at 294).

And "[f]or that inquiry," the Court must "use the express causes of action in the securities Acts as the primary model for the § 10(b) action," *id.*—"in particular, … those portions of the 1934 Act most analogous to the private 10b–5 right of action that is of judicial creation," *Musick, Peeler*, 508 U.S. at 294. "The reason is evident: Had the 73d Congress enacted a private § 10(b) right of action, it likely would have designed it in a manner similar to the other private rights of actions in the securities Acts." *Cent. Bank*, 511 U.S. at 178. Indeed, there can be "no clearer indication of how Congress would have balanced the policy considerations" involved "than the balance struck by Congress in … similar and related protections" contained in "the statute of origin." *Lampf, Pleva*, 501 U.S. at 359.

Drawing from an analogous express provision serves to promote "a fundamental canon of statutory construction": that courts should construe a statute "as a symmetrical and coherent regulatory scheme, and fit, if possible, all parts into an harmonious whole." *FDA* *v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 133 (2000) (citations and internal quotation marks omitted). As for the securities laws in particular, looking to comparable provisions "ensure[s] that the rules established to govern the 10b–5 action are symmetrical and consistent with the overall structure of the 1934 Act." *Musick, Peeler*, 508 U.S. at 294. The Court has found it "'anomalous to impute to Congress an intention to expand … a judicially implied cause of action beyond the bounds it delineated for comparable express causes of action.'" *Cent. Bank*, 511 U.S. at 180 (quoting *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 736 (1975)). Indeed, "in establishing limits for the 10b–5 action," one of the Court's "goals" has been "to ensure the action does not conflict with Congress' own express rights of action." *Musick, Peeler*, 508 U.S. at 295.

B. Here, the provision "most analogous to the private 10b–5 right of action that is of judicial creation," *id.* at 294, is the express right of action contained in Section 18(a) of the Securities Exchange Act. As this Court has previously observed, Section 18(a) "impose[s] liability upon defendants who stand in a position most similar to 10b–5 defendants." *Id.* at 296. In fact, Section 18(a) is the *only* express private right of action in the 1933 and 1934 Acts that provides an aftermarket damages remedy analogous to that recognized under Section 10(b).

As this Court has observed, there are "eight express liability provisions contained in the 1933 and 1934 Acts," seven of which existed when those acts were originally enacted. *Id.* at 296. Three of those seven—Sections 11, 12, and 15—reside in the 1933 Act, 15 U.S.C. §§ 77k, 77*l*, 77o, and plainly do not compare well to the inferred Section 10(b) right. Section 11 is, as this Court has observed, "limited in scope"; "[i]n contrast" to the "'catchall'" Section 10(b) right, which authorizes actions "by a purchaser or seller of '*any* security' against '*any* person' who has used '*any* manipulative or deceptive device or contrivance' in connection with the purchase or sale of a security," Section 11 only addresses securities offerings: it permits actions only "by a purchaser of a registered security, … based on misstatements or omissions in a registration statement, and can only be brought against certain parties" involved in making a securities offering. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 382 (1983) (emphasis in original; quoting 15 U.S.C. § 78j(b)); *see* 15 U.S.C. § 77k(a). Section 11 does not establish liability for secondary, aftermarket trading against issuers.

Section 12 is likewise limited in scope. Section 12(a)(1) imposes liability only upon those who sell unregistered securities in violation of Section 5 of the Securities Act, and requires no misrepresentation or omission. *See* 15 U.S.C. § 77*l*(a)(1) ("Any person who … offers or sells a security in violation of section 77e of this title … shall be liable …."). And Section 12(a)(2), which authorizes rescission or damages for sales made "by means of a prospectus or oral communication" that is materially false or misleading, contains "an express privity requirement,"[5] as it only imposes liability on those who "offer[] or sell[] a security." 15 U.S.C. § 77*l*(a)(2). It thus does not cover aftermarket trading. That sharply contrasts with Section 10(b), which commonly applies to aftermarket trading, has no privity requirement, and does not limit liability to offerors or sellers of securities. Finally, the last of the

[5] *Joseph v. Wiles*, 223 F.3d 1155, 1161 (10th Cir. 2000).

three express 1933 Act liability provisions, Section 15(a), is the most limited of all: it "impose[s] derivative liability only," *Musick, Peeler*, 508 U.S. at 296, on "person[s] who … control[] any person liable" under Sections 11 or 12, 15 U.S.C. § 77o(a).

The remaining express rights are found in the Securities Exchange Act of 1934—Sections 9, 16, 18, and 20. 15 U.S.C. §§ 78i, 78p, 78r, 78t. Section 16 merely "regulates short-swing trading by owners, directors, and officers," *Cent. Bank*, 511 U.S. at 179 (citing 15 U.S.C. § 78p), does not address misstatements and omissions, and thus greatly "differs in focus from § 10(b)," *Lampf, Pleva*, 501 U.S. at 360 n.5. And Section 20 of the 1934 Act, like Section 15 of the 1933 Act, only provides for "controlling person" derivative liability, 15 U.S.C. § 78t, and does not establish primary liability, as does the judicially augmented Section 10(b). *See Musick, Peeler*, 508 U.S. at 296.

In contrast, as this Court explained when it "historical[ly] reconstruct[ed]" a contribution rule for Section 10(b), Sections 9 and 18 of the 1934 Act are the provisions that "impose liability upon defendants who stand in a position most similar to 10b–5 defendants." *Musick, Peeler*, 508 U.S at 294, 296. Sections 9 and 18 "both 'target the precise dangers that are the focus of § 10(b),'" *id.* at 296 (quoting *Lampf, Pleva*, 501 U.S. at 360), as "the intent motivating all three sections is the same—'to deter fraud and manipulative practices in the securities markets, and to ensure full disclosure of information material to investment decisions,'" *id.* (quoting *Randall v. Loftsgaarden*, 478 U.S. 647, 664 (1986)). But as between Section 9 and Section 18, the latter is clearly the closer analogue to Section 10(b). For Section 9 is narrowly and specifically targeted at "manipulative practices such as wash sales, matched orders, and the like," *Cent. Bank*, 511 U.S. at 179 (citing 15 U.S.C. § 78i), whereas Section 10(b) far more broadly reaches misrepresentations and omissions of material facts.

Section 18(a), in contrast, closely approximates the reach of Section 10(b). It provides that "[a]ny person" who "shall make or cause to be made" "any" materially "false or misleading" "statement in any application, report, or document filed" with the SEC "shall be liable to any person … 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," if the person making the statement cannot show that she acted in "good faith and had no knowledge that [her] statement was false or misleading." 15 U.S.C. § 78r(a); *see Ernst & Ernst*, 425 U.S. at 211 n.31. Section 18(a) thus expressly provides for liability of issuers to aftermarket traders who rely on false statements made by the issuer that affect the price of the issuer's securities.

The parallel to the implied right under Section 10(b) and Rule 10b–5 is plain. Section 18(a) is the "[o]nly … express private right of action in existence as of the time of Section 10(b)'s enactment [that] addresses misrepresentations or omissions that affect aftermarket prices."[6]

C. Because Section 18(a) is the express right of action "most analogous to the private 10b–5 right of action that is of judicial creation," *Musick, Peeler*, 508 U.S. at 294, the Court must use that express right "as the primary model for the § 10(b) action," *Cent. Bank*, 511 U.S. at 178. So "in establishing limits for the 10b–5 action," *Musick, Peeler*, 508 U.S. at 295, the Court

[6] Grundfest, *Damages and Reliance*, at 29.

must look to the limits established by Congress in Section 18.

And the most critical limitation that Congress placed on the Section 18 right is a strict requirement of actual reliance. Section 18(a) expressly allows recovery only by persons who buy or sell "in reliance upon" the allegedly false or misleading statement that affects the market price. 15 U.S.C. § 78r(a). Given this unambiguous text, courts have consistently held that "Section 18 requires that a plaintiff establish knowledge of and reliance upon the alleged misstatements contained in any document filed with the SEC"[7]—in other words, "'eyeball' reliance," that the plaintiff "actually read and relied on the filed document."[8] As a result, "constructive reliance is not sufficient" under Section 18,[9] and the fraud-on-the-market "presumption of reliance … is not available for Section 18 claims."[10]

It follows, then, that Section 18's requirement of actual reliance must also be a prerequisite for the recovery of damages under Section 10(b). That would "ensure the [Section 10(b)] action does not conflict with Congress' own express right[] of action" for damages in Section 18. *Musick, Peeler*, 508 U.S. at 295. Indeed, to hold otherwise would improperly "'expand … a judicially implied cause of action beyond the bounds

[7] *See*, *e.g.*, *Ross v. A.H. Robins Co.*, 607 F.2d 545, 552 (2d Cir. 1979).

[8] *In re Alstom SA Sec. Litig.*, 406 F. Supp. 2d 433, 479 (S.D.N.Y. 2005) (citation omitted).

[9] *Heit v. Weitzen*, 402 F.2d 909, 916 (2d Cir. 1968).

[10] *Cohen v. Stevanovich*, 722 F. Supp. 2d 416, 433 (S.D.N.Y. 2010); *see also*, *e.g.*, 4 THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION § 12.18[2] (6th ed. 2013).

[Congress] delineated for [the] comparable express cause[] of action'" in Section 18. *Cent. Bank*, 511 U.S. at 180 (citation omitted). Plaintiffs seeking damages for misstatements or omissions should not be allowed to evade Section 18's congressionally mandated actual reliance requirement by suing under the judge-made right under Section 10(b).

D. That the text of Section 18 provides the clearest "indication of how Congress would have balanced the policy considerations" involved, *Lampf, Pleva*, 501 U.S. at 359, is strikingly confirmed by the legislative history of the 1934 Act. The legislative history leaves no doubt that, had the Seventy-Third Congress addressed the question, it would not have created a private Section 10(b) right unless that right required proof of actual reliance, and would never have condoned a presumption of reliance, rebuttable or not.

The "initial draft" of the "predecessor" of Section 18 contained *no* reliance requirement, and Congress *rejected* that draft for that very reason. *Basic Inc. v. Levinson*, 485 U.S. 224, 257 (1988) (White, J., dissenting). That proto-Section 18 would have "allowed recovery by any plaintiff 'who shall have purchased or sold a security the price of which may have been affected by such [misleading] statement.'" *Id.* (White, J., dissenting; quoting S. 2693, 73d Cong., 2d Sess., § 17(a) (1934)). It "would have permitted suits by plaintiffs based solely on the fact that the price of the securities they bought or sold was *affected* by a misrepresentation"—"a theory closely akin" to the fraud-on-the-market presumption of reliance. *Id.* (White, J., dissenting; emphasis in original).

But "in congressional hearings on the proposed Securities Exchange Act," witnesses "roundly criticized" the provision's failure to require reliance. *Id.* at

257 (White, J., dissenting). "The really objectionable feature of this provision," testified one stock-exchange president, "is that the civil penalties may be recovered by persons who have not relied upon the inaccurate or misleading statement"; "[t]he penalty provision leaves a wide open door for … blackmail," testified another.[11] Congress agreed, and inserted a strict requirement of reliance. As Sam Rayburn, then Chairman of the House Committee on Interstate and Foreign Commerce, explained:

> The first provision of the bill as originally written was very much challenged on the ground that reliance should be required. This objection has been met. In other words, if a man bought a security following a prospectus that carried a false or misleading statement, he could not recover from the man who sold to him … unless the buyer bought the security with knowledge of the statement and relied upon the statement. It seemed to us that this is as little as we could do.

78 CONG. REC. 7701 (1934), *quoted in part in Basic*, 485 U.S. at 258 (White, J., dissenting).

"Congress thus anticipated meaningful proof of 'reliance' before civil recovery can be had under the Securities Exchange Act." *Basic*, 485 U.S. at 258 (White, J., dissenting). Presuming reliance, even rebuttably, "negates congressional intent expressed during adoption of the 1934 Act," and disregards the

[11] Stock Exchange Regulation, Hearing on H.R. 7852 and 8720, before the House Committee on Interstate and Foreign Commerce, 73d Cong., 2d Sess. 226, 262 (1934) (statements of Richard Whitney and Eugene Thompson); *see also Basic*, 485 U.S. at 258 n.8 (White, J., dissenting; citing this and other testimony).

clear text of Section 18 that Congress approved. *Id.* (White, J., dissenting).

E. Finally, other principles of statutory interpretation support requiring a showing of reliance for damages claims under Section 10(b). The Court has always emphasized that "the breadth of the right once recognized should not, as a general matter, grow beyond the scope congressionally intended." *Va. Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1102 (1991). Indeed, now that the Court has definitively "sworn off the habit of the venturing beyond Congress's intent" to invent unexpressed rights of action, *Alexander v. Sandoval*, 532 U.S. 275, 287 (2001), it has become ever "mindful that we must give 'narrow dimensions … to a right of action Congress did not authorize when it first enacted the statute and did not expand when it revisited the law,'" *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2302 (2011) (quoting *Stoneridge*, 552 U.S. at 167). Given the "'concern, grounded in separation of powers, that Congress rather than the courts controls the availability of remedies for violations of statutes,'" any doubt about the scope of the Section 10(b) right must be resolved "against its expansion," and any "decision to extend the cause of action" must be left "for Congress." *Stoneridge*, 552 U.S. at 165 (citation omitted).

Nor does *stare decisis* stand in the way of requiring a plaintiff to show reliance to obtain damages under Section 10(b). The Court in *Basic* expressly left open the question of what must be shown to obtain aftermarket damages under Section 10(b): it stated that its "decision … is not to be interpreted as addressing the proper measure of damages in litigation of this kind." 485 U.S. at 248 n.28. The Court has never addressed that question. The Court could answer it in this case by holding that actual reliance is part of the element of, and is a precondition for recovering, damages under Section 10(b). At the same time, the *Basic* presumption could stand as a valid interpretation of the Section 10(b) reliance element, and remain a sufficient form of reliance in private actions not seeking damages as relief.

II. *BASIC* SHOULD BE OVERRULED BECAUSE ITS PRESUMPTION OF RELIANCE IS EFFECTIVELY IRREBUTTABLE.

An alternative basis for overruling *Basic*'s fraud-on-the-market holding is that the holding is at war with itself, and, far from acting as a proxy for reliance, it effectively eliminates reliance as an element of a Section 10(b) action.

An essential premise behind *Basic*'s fraud-on-the-market presumption was that "[t]he presumption … is 'just that'"—a presumption—"'and [can] be rebutted by appropriate evidence.'" *Amgen Inc. v. Conn. Ret. Plans and Trust Funds*, 133 S. Ct. 1184, 1193 (2013) (quoting *Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179, 2185 (2011)); *see Basic*, 485 U.S. at 248–49. The Court intended the presumption to be rebuttable because reliance has always been a critical element of a private Section 10(b) action. "Reliance by the plaintiff upon the defendant's deceptive acts is an essential element of the § 10(b) private cause of action," the Court has explained, because "[i]t ensures that, for liability to arise, the 'requisite causal connection between a defendant's misrepresentation and a plaintiff's injury' exists as a predicate for liability." *Stoneridge*, 552 U.S. at 159 (quoting *Basic*, 485 U.S. at 243).

But a quarter-century of experience with *Basic* has demonstrated that the fraud-on-the-market presumption is effectively *not* rebuttable, and that it essentially eradicates the element of reliance. Time has borne out Justice White's concern that, "while, in theory, the Court allows for rebuttal of its 'presumption of reliance' … in practice … such rebuttal is virtually impossible in all but the most extraordinary case." *Basic,* 485 U.S. at 256 n.7 (White, J., dissenting). For as numerous commentators have observed, the reality today is that the presumption is in fact rarely rebutted.[12]

To be sure, defendants have sometimes successfully prevented the presumption from attaching in the first place by showing that a market for a security is inefficient,[13] or by establishing a "truth on the market"

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[12] *See, e.g.*, Grundfest, *Damages and Reliance*, at 46–49; Roger A. Cooper, Matthew M. Bunda & Anthony M. Shults, *Rebutting the Presumption of Reliance in Securities Class Actions*, N.Y.L.J., June 10, 2013, *available at* http://bit.ly/19Cfonj ("defendants have had little luck in rebutting the presumption"); Patrick Hall, *The Plight of the Private Securities Litigation Reform Act in the Post-Enron Era: The Ninth Circuit's Interpretation of Materiality In* Employer-Teamster v. America West, 2004 B.Y.U. L. REV. 863, 870–71 & n.46 (2004) ("defendants have faced a nearly impossible task"); Jeffrey L. Oldham, *Taking "Efficient Markets" out of the Fraud-on-the-Market Doctrine After the Private Securities Litigation Reform Act*, 97 NW. U.L. REV. 995, 1013 (2003); Andrew R. Simmonds, Kenneth A. Sagat & Joshua Ronen, *Dealing with Anomalies, Confusion and Contradiction in Fraud on the Market Securities Class Actions*, 81 KY. L.J. 123, 136 (1993) (rebuttal "virtually impossible"); Elliot J. Weiss & John S. Beckerman, *Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions*, 104 YALE L.J. 2053, 2077 (1995) (rebuttal is a "null, or close to null, set[]").

[13] *See*, *e.g.*, *Gamco Investors, Inc.* v. *Vivendi, S.A.*, 927 F. Supp. 2d 88, 99 (S.D.N.Y. 2013) ("a showing that the market in question

defense, which "is a method of refuting an alleged misrepresentation's materiality" by showing that accurate information in the market negated its effect.[14] But these aren't rebuttals; they are cases in which the presumption never applied. For the most part, "true rebuttals [have] require[d] an individualized inquiry into the buying and selling decisions of particular class members." *Vivendi*, 927 F. Supp. 2d at 100 (internal quotation omitted). And the cases in which such an individualized inquiry has rebutted the presumption after it has attached "are … as rare as hen's teeth."[15]

That the theoretically rebuttable presumption of reliance is practically irrebuttable flows from a fundamental inconsistency in *Basic*'s reasoning. The four-justice majority in *Basic* admittedly created the (purportedly rebuttable) presumption in order to promote class-action treatment of securities claims.[16] But the nature of class action litigation has in practice guaranteed that the presumption cannot be meaningfully rebutted, because if the presumption is overcome, that conclusion only bars a particular representative

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was not efficient does not really 'rebut' the presumption, but rather shows that it does not apply in the first place").

[14] *Conn. Ret. Plans and Trust Funds v. Amgen Inc.*, 660 F.3d 1170, 1177 (9th Cir. 2011) (emphasis omitted), *aff'd*, 133 S. Ct. 1184 (2013).

[15] Grundfest, *Damages and Reliance*, at 47 (identifying only five such cases).

[16] *See Basic*, 485 U.S. at 242 ("Requiring proof of individualized reliance from each member of the proposed class effectively would have prevented respondents from proceeding with a class action, since individual issues then would have overwhelmed the common ones.").

plaintiff from proceeding without proof of reliance.[17] It thus does not foreclose class treatment, and does not prevent plaintiff's counsel from substituting a new representative plaintiff—as there will always be another.

The result is a liability system that effectively dispenses with any substantial requirement of reliance. *Basic*'s presumption has thus become a rule "entirely untethered from [its] original rationale" and is accordingly ripe for overruling. *Montejo v. Louisiana*, 556 U.S. 778, 786 (2009). As Justice White feared, "[a] nonrebuttable presumption of reliance" has "effectively convert[ed] Rule 10b–5 into 'a scheme of investor's insurance'"—a result for which "[t]here is no support in the Securities Exchange Act, the Rule, or our cases …." *Basic*, 485 U.S. at 252 (White, J. dissenting; citations omitted). The decision to make "any extension of these laws, to approach something closer to an investor insurance scheme, should [have] come from Congress, and not from the courts." *Id.* at 256–57 (White, J. dissenting). The Court should take the opportunity of this case to return that decision to the branch of government to which it belongs.

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[17] *See*, *e.g.*, *In re Pfizer Inc. Sec. Litig.*, 282 F.R.D. 38, 45–46 (S.D.N.Y. 2012); *In re WorldCom, Inc. Sec. Litig.*, 219 F.R.D. 267, 281 (S.D.N.Y. 2003); *In re Safeguard Scientifics*, 216 F.R.D. 577, 582 (E.D. Pa. 2003); *Saddle Rock Partners, Ltd. v. Hiatt*, No. 96 Civ. 9474, 2000 WL 1182793, at *5 (S.D.N.Y. Aug. 21, 2000).

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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October 11, 2013