Academic highlight: Rethinking securities class actions

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Legal academics are playing an unusually prominent role in *Halliburton Co. v. Erica P. John Fund, Inc.*, argued on Wednesday. At issue is whether the Court should rethink its approach to securities class actions established in *Basic Inc. v. Levinson*, and, if so, what the new standard should be. In *Basic*, a four-Justice majority embraced the "efficient capital markets hypothesis," which assumes that capital markets integrate all public information into a stock price, and thus that purchase and sale price is always affected by material misrepresentations. As a result, plaintiffs do not have to prove that they relied on the misrepresentation when they purchased or held the stock, which makes bringing a class action on behalf of securities holders a much easier proposition. Halliburton, the petitioner in the case, is hoping to put an end to that presumption, replacing it with the requirement that securities plaintiffs first prove that the misrepresentations *actually* distorted the market price for the stock. At the very least, Halliburton wants the opportunity to rebut the presumption prior to class certification. Academic commentators have had a lot to say on this topic, and the Supreme Court appears to be listening.

Economics have long debated the efficient capital markets thesis, which may be why the Court is now taking a second look at *Basic*. Academic experts in securities law are weighing in as well in the hopes of shaping the Supreme Court's view of these issues. In their article *Rethinking* Basic — cited in both both sides' briefs — Lucian Bebchuk and Allen Ferrell argue that Justices should avoid addressing the thorny question whether markets are perfectly efficient, and instead focus on whether there has been actual fraudulent distortion of market price — a determination they argue can be made through the use of "event studies." (Event studies examine whether there was a statistically significant reaction to a fraudulent misrepresentation, and are a commonly used analytical tool for establishing fraudulent distortion in markets.) This is also the position taken by Adam Pritchard and Todd Henderson, whose *amicus* brief was the subject of favorable discussion by the Justices at oral argument.

A dissenting view comes from Jill Fisch. In her article, *The Trouble with* Basic: *Price Distortion after* Halliburton, Fisch argues that event studies are of limited use, in part because they are not capable of measuring the effect that inaccurate statements confirming market expectations have on stock prices. For example, although event studies work well when measuring the effect of a fraudulent statement at odds with market expectations (for example, "the third quarter was surprisingly profitable"), they are less effective at measuring statements that are in line with market expectations (for example, "our third quarter profits were just as expected"). Securities fraud more often arises from an effort to cover up an unexpected problem than from making false statements about positive developments, and so Fisch asserts that they are not good tools with which to measure the effect on stock price in most of these cases. Indeed, as Fisch points out, *Basic* itself was an example of the latter type of fraudulent misrepresentation. Thus, the Court will have to decide not only whether to scrap or modify *Basic*, but also whether there is any realistic alternative to its presumption that misinformation is incorporated into market price.