HALLIBURTON AND THE DOG THAT DIDN'T BARK

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ABSTRACT

In Halliburton Co. v. Erica P. John Fund, Inc., *the Supreme Court held that defendants in a Section 10(b) class action may use the class-certification process to rebut the "fraud on the market" presumption that their misstatements impacted the price of the relevant security. In so doing, the Court struggled to explain why the class-certification process—rather than trial on the merits—was the proper venue for such disputes, and avoided the most obvious justification, namely, that in the absence of price impact, plaintiffs would still be able to bring individual claims. The Court's unwillingness to hold that plaintiffs may bring "eyeball" reliance claims even without demonstrating price impact suggests that the Court has doubts that such claims are viable.*

If so, the Court misinterpreted the fraud on the market theory and the distinction between claims based on individual evaluation of corporate-specific information and claims based on reliance on the market price. The Court's holding could therefore unfairly impact future claims based on individual reliance. Moreover, the Court's willingness to front-load disputes into the class-certification stage—without offering a clear justification for doing so—demonstrates that Halliburton *was ultimately an exercise in line drawing, representing a compromise position likely motivated by a desire to protect defendants from litigation risks.*

INTRODUCTION

The fraud on the market doctrine is a legal presumption that public misrepresentations regarding a security that trades in an "open and developed" market distort the security's price.[1] Investors who

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1. Basic Inc. v. Levinson, 485 U.S. 224, 241 (1988).

purchase the security may then be said to have "relied" on the misstatement (by paying the manipulated price), allowing them to satisfy the reliance element of a fraud claim brought under Section 10(b) of the Securities Exchange Act of 1934, and facilitating the aggregation of their claims in a class action.[2] In *Halliburton Co. v. Erica P. John Fund, Inc.* ("*Halliburton II*"),[3] the Supreme Court clarified that when plaintiffs seek to certify a class utilizing the fraud on the market doctrine, defendants may offer rebuttal evidence to challenge the presumption of price distortion as part of the certification inquiry. In so doing, the Court struggled to explain why these disputes should be resolved in the context of Rule 23.[4] The Court's difficulty with this point suggests it intended something else entirely: that when defendants make fraudulent representations concerning a security that trades in an open and developed market, investors who purchase the security at the market price *may only* use the fraud on the market doctrine to satisfy the element of reliance when bringing a claim under Section 10(b); they *may not* argue in the alternative that they personally heard, and actually relied upon, the misstatement. If this is what the Court meant, it represents a new—and incorrect—interpretation of the fraud on the market theory, which could unduly restrict a broad swath of individual actions.

II. THE ROAD SO FAR

Private plaintiffs may use Section 10(b) to bring claims for fraud in connection with securities transactions. As is the case with most fraud claims, to prevail, plaintiffs must show that they "relied" upon a false statement. In one-to-one transactions, such as private sales, investors receive information supplied directly from the fraudster, allowing them to identify easily what information they received and the role it played in their investment decision. But when an investor purchases a security in an open-market transaction, "reliance" may be a complicated proposition. Information about publicly traded securities is usually distributed via press releases, SEC filings, conference calls with analysts, and so forth. The same or similar information is often re-publicized multiple times—such as false earnings reports that appear in different company press releases and are repeated in successive quarterly reports—before the truth is

2. 15 U.S.C.A. § 78j(b) (West 2015).
3. 134 S. Ct. 2398 (2014).
4. *See* FED. R. CIV. P. 23 (setting forth the standards for class certification).

revealed and investors suffer losses. Investors may rely directly upon any of the documents in which the information appears, but they also make decisions based on information obtained through a variety of intermediaries—stock brokers, analysts, news articles, recommendations by friends or relatives—all of which may, in turn, incorporate information gleaned from a variety of other sources. Additionally, investor reliance on these sources of information may increase demand for a security, causing its price to rise, thus affecting more investors who purchase at the manipulated price. This entire ecosystem of investors and information intermediaries constitutes "the market," such that a misstatement actually relied upon by a small segment of the market may ultimately have an impact far beyond its initial audience.[5]

Recognizing these dynamics, courts developed the "fraud on the market" doctrine for use in Section 10(b) actions, which the Supreme Court endorsed in *Basic Inc. v. Levinson*.[6] As articulated by the *Basic* majority, the doctrine consists of two rebuttable presumptions that favor Section 10(b) plaintiffs: first, that in an open and developed market, public, material information about a security will influence its price, and second, that investors who purchase at the market price are, in some sense, subjectively "relying" on that price to communicate information about the security's value.[7] "Material" information, according to the *Basic* Court, means information that "would have been viewed by the reasonable investor as having significantly altered the total mix of information made available."[8]

Put together, then, the fraud on the market presumptions allow an open-market purchaser to establish that he or she "relied," indirectly, on a defendant's fraud, if the purchaser can demonstrate that the fraudulent information was material. Even if the plaintiff cannot prove that she personally heard the defendant's statements or took them into account when making an investment decision, the plaintiff may nonetheless establish "indirect" reliance by taking advantage of the presumptions to show that she purchased the security at a market price that was distorted by fraud. Defendants are entitled to try to

5. Jill E. Fisch, *The Trouble with* Basic*: Price Distortion after* Halliburton, 90 WASH. U. L. REV. 895, 901–02 (2013).

6. 485 U.S. 224 (1988).

7. *See id.* at 247.

8. *Id.* at 231–32.

rebut these presumptions, but if they fail to do so, the plaintiff will prevail on the reliance element of her claims.

The fraud on the market doctrine has been employed to establish reliance in lawsuits brought by individual investors,[9] but it has attracted extensive judicial and scholarly attention because of its role in facilitating class-action claims. Not only does the doctrine make it *easier* for a plaintiff to establish reliance, but it also allows *all* plaintiffs who purchase a given security to establish reliance by common evidence. Courts entertaining Section 10(b) claims need not conduct individualized inquiries into the types of information upon which particular investors relied; the fraud on the market doctrine allows that question to be resolved for all investors in one fell swoop. As a result, the doctrine removes the main stumbling block to class certification for Section 10(b) claims concerning publicly traded securities. Most classes may only be certified if the plaintiffs demonstrate that questions "common" to the class predominate over questions that raise individualized issues;[10] the fraud on the market doctrine replaces individualized questions of reliance with a common question regarding the characteristics of the market in which the security traded.

However, the fraud on the market doctrine is not without its difficulties, starting with the slipperiness of the concept of an "open and well developed" market. The *Basic* Court never defined the phrase, and though it is generally understood that such a market involves a high volume of secondary trading and relative price transparency,[11] that only begs the question of *how* active, *how* liquid, the market must be to justify a presumption that false information has impacted a security's price. The essential difficulty is that no market perfectly absorbs information the moment at which it is disseminated. Complex information may be difficult for analysts to digest; information disclosed in an obscure location may not be immediately noticed. The more high-profile and widely traded a security, the more likely it is that new information will be rapidly assimilated, but there are no bright line rules for determining how quickly a particular type of information will impact prices in various types of markets.[12]

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9. Black v. Finantra Capital, Inc., 418 F.3d 203, 209 (2d Cir. 2005).
10. *See* FED. R. CIV. P. 23(b)(3).
11. *See, e.g.*, Cammer v. Bloom, 711 F. Supp. 1264, 1276 n.17 (D.N.J. 1989).
12. Donald C. Langevoort, Basic *at Twenty: Rethinking Fraud on the Market*, 151 WIS. L. REV. 151, 170 (2009); James D. Cox, *Understanding Causation in Private Securities Lawsuits:*

Thus, after *Basic*, courts faced two conundrums: how open and developed must a market be before the fraud on the market doctrine is deemed to apply? And if such an open and developed market exists, how "public" and easily digestible must the information be before it is presumed to have an impact? These are related questions—the more developed the market, the more likely it is that obscure information will influence stock prices—but the fraud on the market doctrine does not allow courts to (explicitly) adopt a sliding scale based on the interaction of market characteristics and statement prominence. As a result, courts answered the questions with, respectively, "very," and (at least in some cases) "minimally."

For the types of markets subject to the fraud on the market doctrine, courts have adopted a very demanding standard of "efficiency."[13] Plaintiffs must show the security trades in a market that rapidly and fully adjusts to all public, material information.[14] This is an extraordinarily high bar that often excludes, for example, stocks of smaller companies,[15] newly issued stock,[16] and securities other than common stock.[17]

At the same time, courts often presume that even "fine print" and generic disclosures influence prices, such as a representation that the company is in compliance with the law.[18] This is a mixed blessing for plaintiffs: on the one hand, it means that even obscure statements buried in lengthy SEC filings can form the basis of a fraud claim, but on the other hand, it allows defendants to argue that whatever false information they shouted from the rooftops, a tiny, offsetting disclosure was sufficient to inform the market of the truth, thus negating any price impact caused by the initial false statement.[19]

Building on Amgen, 66 VAND. L. REV. 1719, 1732 (2013).

13. Langevoort, *supra* note 12, at 173; James D. Cox, *Fraud On The Market After* Amgen, 9 DUKE J. CONST. L. & PUB. POL'Y 1, 13 (2013).

14. *In re* PolyMedica Corp. Sec. Litig., 432 F.3d 1 (1st Cir. 2005).

15. Geoffrey Christopher 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, 322 (2002); Krogman v. Sterritt, 202 F.R.D. 467, 474–78 (N.D. Tex. 2001).

16. *In re* Initial Pub. Offering Sec. Litig., 260 F.R.D. 81, 105 (S.D.N.Y. 2009).

17. Teamsters Local 445 Freight Div. Pension Fund v. Bombardier Inc., 546 F.3d 196, 210 (2d Cir. 2008); Aranaz v. Catalyst Pharm. Partners Inc., No. 13-CV-23878-UU, 2014 U.S. Dist. LEXIS 136684 (S.D. Fla. Sept. 29, 2014).

18. Glazer Capital Mgmt., LP v. Magistri, 549 F.3d 736, 745 (9th Cir. 2008).

19. Courts have taken a wide variety of approaches to arguments that truthful information has mitigated false information. Some require that the offsetting information be "transmitted to the public with a degree of intensity and credibility sufficient to effectively counterbalance any misleading impression" left by the original false statement. Nguyen v. Radient Pharm. Corp.,

"Either the market is efficient or it is not. A plaintiff in the Investors' situation must take the bitter with the sweet," as the Eleventh Circuit put it.[20]

This "truth on the market" corollary to the fraud on the market doctrine grows directly out of *Basic*. There, the Court explained that the presumption of price distortion might be effectively rebutted if, for example, "the 'market makers' were privy to the truth . . . and thus [] the market price would not have been affected by [defendants'] misrepresentations."[21] In other words, *Basic* entertained the possibility that an offsetting "truth" about a defendant's fraud might be known only to a segment of the market, but that this knowledge would be sufficient to maintain prices at their proper, un-manipulated levels, even if some individual traders remained fooled.[22] Other courts, by allowing even obscure and scattered bits of nominally public information to defeat the fraud on the market presumption, implicitly seem to agree.[23] Thus, per *Basic*, plaintiffs are entitled to an initial

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No. SA-CV-11-0406-DOC, 2011 U.S. Dist. LEXIS 122533 (C.D. Cal. Oct. 20, 2011). Others are willing to presume that even piecemeal or obscure disclosures offset much more prominent false statements. *See, e.g.*, Meyer v. Greene, 710 F.3d 1189, 1197 (11th Cir. 2013); Asher v. Baxter Int'l Inc., 377 F.3d 727 (7th Cir. 2004).

20. *Meyer*, 710 F.3d at 1199.

21. Basic Inc. v. Levinson, 485 U.S. 224, 248 (1988).

22. The traditional view in finance has been that "noise" traders—uninformed investors, those most likely to be fooled by corporate misstatements—contribute little to a stock's price, and that most pricing is due to the trades of sophisticated investors who are harder to mislead. *See* John M. Newman, Jr. et al., *Basic Truths: The Implications of the Fraud-on-the-Market Theory for Evaluating the "Misleading" and "Materiality" Elements of Securities Fraud Claims*, 20 IOWA J. CORP. L. 571, 574 (1995). This traditional view, however, has been challenged by other studies that demonstrate the influence of "noise" traders. *See,* e.g., Claire Hill, *Why Financial Appearances Might Matter: An Explanation for "Dirty Pooling" and Some Other Types of Financial Cosmetics*, 22 DEL. J. CORP. L. 141 (1997).

23. *Meyer*, 710 F.3d at 1197; *In re* Merck & Co. Sec. Litig., 432 F.3d 261 (3d Cir. 2005). To be sure, the line between the materiality concept as a general category, and the truth on the market concept as subset of that category, is a fuzzy one. Materiality is gauged in light of the "total mix of information made available." *Basic*, 485 U.S. at 232. Truth on the market is also a claim that the total mix of information prevented the false information from having an impact on price. Thus, on first blush, the two may appear to be coextensive. Nonetheless, at least in theory, truth on the market remains a distinct subset of the materiality analysis, because it depends on the aggregated trading behavior of the market as a whole, rather than the effect of the misrepresentation on a hypothetical investor. The difference becomes plain when one considers that materiality is gauged from the point of view of the "reasonable investor," who typically is interpreted to mean a typical *retail* investor. Stefan J. Padfield, *Immaterial Lies: Condoning Deceit in the Name of Securities Regulation*, 61 CASE W. RES. L. REV. 143, 155 (2010). Retail investors are not necessarily charged with understanding, or even being aware of, *all* information made public; an offsetting "truth" might be "available" in nominally public fashion to sophisticated investors without being available to, or comprehensible by, retail investors. Markets may even theoretically incorporate privately held "truths," as *Basic* seems to

presumption that public, material false information distorts stock prices but—also per *Basic*—defendants are entitled to *rebut* that presumption by, among other things, demonstrating that the truth was "known" to some, though not necessarily all, persons.

Plaintiffs and defendants invariably lock horns over the types of statements, and markets, that justify the presumption of price impact, but they also dispute *when* courts should make determinations about these issues. In general, they agree that plaintiffs should have the burden of establishing that a market is open and developed at the class-certification stage (though disputes continue over the definition of "open and developed" and what evidence is required to establish its presence). But here the agreement ends: plaintiffs and defendants have continually relitigated the extent to which the specific issue of price distortion—whether it occurred at all and at what point the price was restored to its "correct" level—may be decided at the class-certification stage. Defendants have generally argued that, as with market efficiency, absent price impact there can be no class-wide determination of reliance; therefore, the question is ripe for resolution as part of the class-certification process. Plaintiffs, by contrast, insist that once market efficiency is established, any remaining questions should be decided by the factfinder at summary judgment or trial.

III. THIRD TIME'S THE CHARM?

The Supreme Court has granted certiorari to decide the proper scope of the fraud on the market class-certification inquiry on three separate occasions, the latter two of which are relevant here.[24] In *Amgen Inc. v. Conn. Ret. Plans & Trust Funds*,[25] the Court considered

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contemplate. Thus, when courts entertain securities claims that are *not* predicated on fraud on the market, plaintiffs may satisfy the element of "materiality" even when offsetting information was generally available, because, depending on the context, courts may refuse to charge plaintiffs with knowledge of extraneous source material. *See, e.g.*, N.J. Carpenters Health Fund v. Royal Bank of Scot. Group, PLC, 709 F.3d 109, 127 (2d Cir. 2013); United Paperworkers Int'l Union v. Int'l Paper Co., 985 F.2d 1190, 1199 (2d Cir. 1993); Kapps v. Torch Offshore, Inc., 379 F.3d 207, 214–15 (5th Cir. 2004); *see also* Va. Bankshares v. Sandberg, 501 U.S. 1083, 1097 (1991) (holding, outside the fraud on the market context, that "not every mixture with the true will neutralize the deceptive. If it would take a financial analyst to spot the tension between the one and the other, whatever is misleading will remain materially so").

24. The first time, in *Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179 (2011) ("*Halliburton I*"), the Court ended up avoiding the most significant disputes. *See id.* at 2187 n.* ("According to Halliburton, a plaintiff must prove price impact only after *Basic*'s presumption has been successfully rebutted by the defendant. We express no views on the merits of such a framework.") (citation omitted).

25. 133 S. Ct. 1184 (2013).

whether materiality is appropriate for resolution at the class-certification stage. Materiality plays a dual role in Section 10(b) litigation: it is a required element of the plaintiff's claim, and it is also a precondition for the presumption of price impact to apply. The *Amgen* defendants contended that because the presumption of price impact necessarily rests on the materiality of the alleged false statements, there could be no such presumption—and thus no commonality on the element of reliance—absent materiality. They therefore argued that plaintiffs should be required to prove materiality or, at the very least, defendants should be granted the opportunity to *rebut* materiality, as part of the Rule 23 inquiry.[26]

The Court rejected the argument, reasoning that because materiality is a required element of *any* Section 10(b) claim, its lack would not create individualized issues. Absent materiality, there may be no price impact, but there is also no claim; the case will stand or fall for all plaintiffs, equally. Thus, materiality is not an element that distinguishes claims that can be resolved on a class-wide basis from claims that cannot, and it is therefore inappropriate for determination at the class-certification stage.[27]

In *Halliburton II*, the Supreme Court again took up the issue of fraud on the market and class certification. This time, the defendants were more direct in their challenge. They sought to have the Court overturn *Basic v. Levinson* entirely, in part on the ground that markets are too erratic to justify presuming that any particular statement affects securities prices.[28] But, similar to the *Amgen* defendants, they argued in the alternative that, because the *Basic* presumption of price impact is rebuttable, defendants should be permitted to offer their rebuttal evidence at the class-certification stage.[29]

The Court rejected the defendants' frontal assault on *Basic*. Echoing a point made by a number of scholars,[30] the Court held that markets need not be perfectly efficient to justify a presumption that

26. *See id.* at 1191.
27. *See id.*
28. *Halliburton II*, 134 S. Ct. at 2409–10.
29. *See id.* at 2413.
30. *See, e.g.*, Langevoort, *supra* note 12, at 171–72; Bradford Cornell & James C. Rutten, *Market Efficiency, Crashes, and Securities Litigation*, 81 TUL. L. REV. 443, 456 (2006); Cox, *supra* note 12, at 1732.

false information generally affects prices.[31] Instead, it described the *Basic* presumption of price impact as "modest," resting only on the premise that "market professionals generally consider most publicly announced material statements about companies."[32] The Court's holding on this point has led Donald Langevoort to speculate that going forward, courts may loosen their overly strict definitions of market efficiency.[33]

After affirming *Basic*'s continued vitality, the Court accepted defendants' fallback position that they should be permitted to rebut the presumption of price impact as a part of their challenge to class certification. In doing so, the Court had to distinguish *Amgen* and explain why rebuttal evidence concerning price impact was appropriate while rebuttal evidence concerning materiality was not.

Happily, there is a natural explanation that flows from *Amgen*'s logic: Price impact, unlike materiality, is not a necessary element of a Section 10(b) claim. Price impact is simply one mechanism for proving the element of reliance. If defendants establish there has been no price impact, they have made it impossible for plaintiffs to establish reliance on a common basis, but there remains the possibility that some investors may have personally heard the false statements, and can establish reliance in the traditional manner. Thus, a lack of price impact creates individualized issues. This is different from materiality because a lack of materiality destroys all plaintiffs' claims across the board.

That is what one would have expected the Court to hold. But at this point, *Halliburton II* took a surprising turn. Because even though the above explanation is simple, readily available, and congruent with *Amgen*, it is not the explanation that the Court offered. Instead, the Court wrote:

> The fact that a misrepresentation was reflected in the market price at the time of the transaction . . . is *Basic*'s fundamental premise. . . . That is why, if reliance is to be shown through the *Basic* presumption, the publicity and market efficiency prerequisites must be proved before class certification. Without proof of those

31. *Halliburton II*, 134 S. Ct. at 2410.

32. *Id.* (quoting *Basic Inc. v. Levinson*, 485 U.S. 224, 247 n. 24).

33. Donald C. Langevoort, *Judgment Day for Fraud-on-the-Market: Reflections on* Amgen *and the Second Coming of* Halliburton, 57 ARIZ. L., REV. 37, 53 (2015) (expressing hope that "*Halliburton II* will take the steam out of" efforts by defendants to convince courts that markets must be "hyper" efficient to justify application of the doctrine).

> prerequisites, the fraud-on-the-market theory underlying the presumption completely collapses, rendering class certification inappropriate.
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> But as explained, publicity and market efficiency are nothing more than prerequisites for an indirect showing of price impact. There is no dispute that at least such indirect proof of price impact is needed to ensure that the questions of law or fact common to the class will predominate. . . .
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> Our choice in this case, then, is not between allowing price impact evidence at the class certification stage or relegating it to the merits. Evidence of price impact will be before the court at the certification stage in any event. The choice, rather, is between limiting the price impact inquiry before class certification to indirect evidence, or allowing consideration of direct evidence as well. As explained, we see no reason to artificially limit the inquiry at the certification stage to indirect evidence of price impact.[34]

In this passage, the Court *avoided* the easiest argument, i.e., that the absence of price impact, unlike the absence of materiality, creates individualized issues. Instead, the Court made a procedural argument: because a trial court must, one way or another, consider evidence of price impact at class certification (by examining market efficiency and the publicity of the challenged statements), it should consider all the evidence available (except, apparently, evidence of materiality). The dog, one might say, did not bark.[35]

Which leads to the question: why?

The natural conclusion is that the Court doubts individual plaintiffs *can* bring actual reliance claims—"eyeball" reliance, as practitioners call it—based on false statements made in an open and developed market, at least not without also demonstrating price impact. That, in fact, is exactly what was argued by the *Halliburton II* plaintiff and the United States as amicus,[36] a point which the Court obliquely appeared to accept:

> [W]e held [in *Amgen*] that [materiality] should be left to the merits stage, because it does not bear on the predominance requirement

34. *Halliburton II*, 134 S. Ct. at 2416–17 (quotations, citations, and alterations omitted).

35. *See* Chisom v. Roemer, 501 U.S. 380, 406 (1991) (citing A. Doyle, *Silver Blaze*, *in* THE COMPLETE SHERLOCK HOLMES 335 (1927)).

36. *See* Brief for Respondent at 50, *Halliburton II*, 134 S. Ct. 2398 (2014) (No. 13-317) [hereinafter Brief for Respondent]; Brief for the United States as Amicus Curiae Supporting Respondent at 30, *Halliburton II*, 134 S. Ct. 2398 (2014) (No. 13-317) [hereinafter Brief for the United States].

> of Rule 23(b)(3). . . . We [] noted that a failure to prove materiality would necessarily defeat every plaintiff's claim on the merits; . . . In this latter respect, we explained, materiality differs from the publicity and market efficiency prerequisites, neither of which is necessary to prove a Rule 10b-5 claim on the merits.
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> [The plaintiff] argues that much of the foregoing could be said of price impact as well. *Fair enough*.[37]

Indeed, the seeds of such a conclusion were sown in *Amgen* itself, because in *Amgen*, the defendants offered what was essentially a truth on the market defense to the plaintiffs' allegations of materiality.[38] A truth on the market defense allows for the possibility that some investors were fooled by the false statement, even though the false statement did not impact the security's price. Yet the *Amgen* Court still held that all of the plaintiffs' claims would fail if the defendants prevailed in their argument that "the market"—meaning the market *price*—reflected the truth.[39]

If this is the correct interpretation of *Halliburton II*, it means fraud on the market is more than just an alternative mechanism for establishing reliance. It means fraud on the market is the *only* mechanism for establishing reliance, at least for securities that trade "efficiently."

IV. BACK TO BASICS

If the *Halliburton II* Court intended to imply that individual claims for reliance are not viable in the context of open-market frauds, it would be an intriguing throwback to the origins of the fraud

37. *Halliburton II*, 134 S. Ct. at 2416 (emphasis added).

38. For example, they claimed that analysts who "scrutinized Amgen's business" had not been fooled, *see* Brief for Defendants-Appellants at 8, Conn. Ret. Plans & Trust Funds v. Amgen Inc., 660 F.3d 1170 (No. 09.56965), (9th Cir. 2011), and pointed out that the truth could have been inferred by a diligent perusal of a particular announcement that the FDA had placed in the Federal Register, Brief for Petitioners at 50, Amgen Inc. v. Conn. Ret. Plans & Trust Funds, 133 S. Ct. 1184 (2013) (No. 11-1085). They did not, however, contend either that their misstatements were per se immaterial, or that countervailing information was widely available to investors generally.

39. Significantly, a similar idea is built into the securities laws themselves. Section 18 of the Securities Exchange Act provides a private right of action based on false statements in SEC filings, but requires plaintiffs to demonstrate *both* actual reliance, *and* that the false statement impacted the market price, before they can bring a claim. 15 U.S.C.A. § 78r (West 2015). Individual reliance, absent price impact, is not enough. This was, in fact, one of the arguments advanced by the defendants in *Halliburton II*, and *Basic* before that: to allow plaintiffs to allege reliance via fraud on the market would undermine the more restrictive requirements of Section 18. *See Halliburton II*, 134 S. Ct. at 2409.

on the market doctrine. In a 1982 article,[40] Professor Daniel Fischel advocated replacing the traditional reliance inquiry with fraud on the market, and in his formulation—if the "market" itself was not "fooled"—no investor would have a claim, even if he or she actually relied on the false statement. As he put it,

> Suppose that an investor, after reading a false statement, believes that a particular investment offers a superior rate of return and invests accordingly. The market, however, ignores the false statement so that it has no effect on the market price. . . . If there has been no fraud on the market . . . investors have not been induced to invest by any fraudulent conduct of the defendant. The law has never compensated for injury where the so-called reasonable man—in this case the market—has not been misled. Such investors earned the market rate of return and are entitled to no more.[41]

Thus, in Fischel's view, an investor who purchased at an undistorted price could not have experienced any injury, because she would have received fair value for her investment. The market's accurate valuation of the security would break any chain of causation between the original misstatement and the injury suffered by the investor.[42]

Both the *Halliburton II* plaintiff, and the United States as amicus, advanced a similar argument. Each contended that in the absence of price impact, there could be no individual claims because no investor would be able to prove "loss causation."[43] Loss causation, an independent element of Section 10(b), requires the investor to show that the fraud caused her injuries. In open market frauds, this generally occurs when the truth is disclosed and the market adjusts to the new information by "correcting" the price of the stock. If the market is never misled, any subsequent drops in stock price cannot be attributed to corrections of the original false information, and investors cannot incur compensable losses. Or more simply, if the market price was undistorted, the investor by definition got what she paid for.

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40. Daniel R. Fischel, *Use of Modern Finance Theory in Securities Fraud Cases Involving Actively Traded Securities*, 38 BUS. LAW. 1 (1982).

41. *See id.* at 14–15.

42. *See id.* at 15 (arguing that there can be no causal connection between the harm and the false statement "by definition" where "the market price was not affected").

43. Brief for Respondent, *supra* note 36, at 50; Brief for United States, *supra* note 36, at 30.

Yet this narrow view of compensable losses overlooks the fact that the "market" price reflects the different judgments and expectations of heterogeneous investors regarding the relative weight to put on different types of information,[44] and a multiplicity of judgments on this point may still be rational. To borrow Fischel's terminology, the "market" is not a single reasonable man, but thousands of them. Investors who do not rely on any information at all—index investors, for example—may be said to have accepted the market's judgment of value and, in the absence of price distortion, to have gotten precisely what they paid for.[45] But investors who evaluate stock information individually form their own assessments of the value of publicly available information. Among other things, they may reach varying, but still rational, conclusions as to the likelihood of different outcomes, and they may weight information differently based on their own personal risk tolerances. Some may be willing to tolerate a high-risk investment with a high potential payoff; others may prefer a low-risk investment with a low potential payoff. The two investments might have identical expected values (and thus identical stock prices), but investors with lower risk tolerances suffer a real harm when a stock turns out to be riskier than they expected, and prices drop as a result.

Imagine, for example, a company has a new drug application pending before the FDA. If the drug is approved, the stock price will soar; if the drug is rejected, the company will be worthless. The "market" will value the stock at some formula representing the expected value of the future sales balanced against the risk of non-approval. But this price masks a variety of risk tolerances. Some investors may only invest if they believe that approval is all but certain; others may be diversified and thus indifferent to risk; still others may be risk-seeking. If the company fraudulently inflates its chances of approval, then *even if the market as a whole is not fooled*, investors who directly relied on the misstatements may have been fraudulently induced to assume a *risk* they did not intend to assume, and should be entitled to recover if they suffer damages when the risk materializes.[46]

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44. Cox, *supra* note 13, at 15.

45. Jill E. Fisch, *Cause for Concern: Causation and Federal Securities Fraud*, 94 IOWA L. REV. 811 (2009).

46. *See id.* at 854. Individuals who allege that their broker violated their duties by recommending "unsuitable" securities have a similar argument: The securities may have been

This issue has repeatedly arisen in the context of claims brought under Section 11 of the Securities Act[47] for fraudulent misrepresentations in connection with mutual funds. Open-ended mutual fund shares are priced based on the market value of the securities they hold; thus, so long as their holdings are accurately valued, the shares are priced correctly. Nonetheless, in many cases, plaintiffs have alleged that funds fraudulently misrepresented their investment strategy, choosing high-risk investments over low-risk ones. In these cases, investors incurred losses when the strategies failed to pay off. Though the shares were priced "correctly" in the sense that risk and reward were properly balanced, investors nonetheless claimed they had been injured because they had been fraudulently induced to assume a greater degree of risk than they intended. Currently, courts disagree as to whether damages are recoverable under such circumstances.[48]

Just prior to the Supreme Court's decision in *Halliburton II*, the district court in *In re BP p.l.c. Securities Litigation*[49] had occasion to recognize this distinction between eyeball reliance and fraud on the market reliance. In that case, the plaintiffs claimed BP inflated its stock price by misrepresenting its safety protocols. Eventually, BP's statements were proved to be false (and investors were harmed) when the Deepwater Horizon exploded, sending the company's stock price plummeting. But the market's reaction to the explosion—i.e., disclosure of the inadequacy of BP's safety precautions—was far more extreme than it would have been had BP told the truth before the explosion. In other words, the price reaction to the explosion included *both* the market's revised assessment of the value of BP's safety protocols, *and* the market's assessment of harm to the company as a result of the explosion.[50] Had the truth been disclosed before the explosion, there would have likely been a stock price drop, but it would have been far less dramatic than it was when 62,000 barrels of

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properly priced based on risk versus reward, but they were not appropriate for an investor with the plaintiff's specific risk tolerances. Norman S. Poser, *Liability of Broker-Dealers for Unsuitable Recommendations to Institutional Investors*, 2001 BYU L. REV. 1493.

47. 15 U.S.C.A. § 77k (West 2015).

48. *Compare In re* Charles Schwab Corp. Securities Litig., 257 F.R.D. 534 (N.D. Cal. 2009) *with In re* State Street Bank and Trust Co. Fixed Inc. Funds Inv. Litig., 774 F. Supp. 2d 584 (S.D.N.Y. 2011).

49. 2014 U.S. Dist. LEXIS 69900 (S.D. Tex. May 20, 2014), *aff'd Ludlow v. BP, P.L.C.,* 2015 U.S. App. LEXIS 15938 (5th Cir. Tex. Sept. 8, 2015).

50. Fisch, *supra* note 45, at 849.

oil were gushing into the ocean every day for months on end. The difference, essentially, was between an ex ante warning of *increased* risk of an explosion—more likely, but not certain to occur—and the ex post *materialization* of that risk.

The question before the court in *BP* was, which damages were recoverable by the plaintiffs? Could the plaintiffs recover damages associated both with the fraudulently described safety measures *and* their consequence (the explosion)? Or were plaintiffs limited to damages associated solely with the misrepresentations concerning safety?[51]

In the district court's view—later affirmed by the Fifth Circuit[52]—plaintiffs proceeding under a fraud on the market theory were entitled only to damages equal to the amount by which the stock was inflated before the explosion. But plaintiffs who had made their own risk assessments by directly relying on BP's misstatements were entitled to recover for the "consequential" damages of the explosion, because these investors had been fooled into assuming a risk they had sought to avoid.[53]

The court's analysis in this regard was unique. First, the court implicitly offered a rationale for allowing investors to recover damages even when a lie did not impact prices, namely, that investors are entitled to set their own risk tolerances, and these judgments are worthy of the securities laws' respect. Second, and perhaps more strikingly, the court explicitly held that *damages* in a Section 10(b) action should vary depending on the plaintiffs' theory of reliance.

In fact, the proper measure of damages in a Section 10(b) fraud on the market case is very uncertain because most Section 10(b) cases settle or are dismissed before definitive court determinations are made. When the issue arises, courts typically recite that the proper measure of damages is the price paid relative to the value received,[54] a formulation that would seem to exclude damages for the portion of a stock price drop solely attributable to the ex post materialization of a concealed risk. But plaintiffs typically argue that the value of the security should be measured after the risks materialize and the full truth is revealed to investors, and courts have at least allowed for the

51. *BP*, 2014 U.S. Dist. LEXIS, at *82–84.
52. *Ludlow v. BP, P.L.C.*, 2015 U.S. App. LEXIS 15938 (5th Cir. Tex. Sept. 8, 2015).
53. *See id.* at *87–88.
54. Rosado v. China N. E. Petrol. Holdings, Ltd., 692 F.3d 34, 38 (2d Cir. 2012).

possibility that damages for risk materialization may be appropriate.[55] Several circuits have permitted the element of *loss causation* to be satisfied through risk materialization as well,[56] which suggests that damages may follow. Thus, although there is extensive academic commentary on the subject of the proper measure of fraud on the market damages,[57] there is little definitive caselaw.[58]

From some policy perspectives, the distinction drawn by the *BP* court was sound. Markets only become efficient through active trading, i.e., the trades of investors who examine publicly available information and make individual investment decisions. "Passive" investors, those who rely solely on indices or other broad trading strategies, do not trade based on new information and thus contribute nothing to market efficiency—they free-ride on the efforts of traders who analyze firm-specific information. "Active" investors may therefore have the strongest claim to recover damages caused by fraud, as many commenters have argued.[59]

But in *BP*, the court did more than simply announce that damages would be measured differently for active and passive investors. Instead, it denied class certification on the ground that distinguishing between the two groups for damages purposes would cause individualized issues to predominate over common ones.[60] And even assuming all investors were passive, the court held that plaintiffs had the burden of coming forward with a mechanism for segmenting the damages caused solely by the misstatements (the only damages to which the class would be entitled) from the consequential damages of the explosion, if only to demonstrate that such calculations would not

55. Hubbard v. BankAtlantic Bancorp, Inc., 688 F.3d 713, 728 n.27 (11th Cir. 2012); *see also Ludlow*, 2015 U.S. App. LEXIS 15938, at *36.

56. *See, e.g.*, Lentell v. Merrill Lynch & Co., 396 F.3d 161 (2d Cir. 2005).

57. Frederick C. Dunbar & Arun Sen, *Counterfactual Keys to Causation and Damages in Shareholder Lawsuits*, 2009 WIS. L. REV. 199; Bradford Cornell & R. Gregory Morgan, *Using Finance Theory to Measure Damages in Fraud on the Market Cases*, 37 UCLA L. REV. 883 (1990); Bradford Cornell & James C. Rutten, *Collateral Damage and Securities Litigation*, 2009 UTAH L. REV. 717.

58. The problem is made more difficult by the likelihood that the concealment of a fraud allows it to worsen and increases the likelihood of larger damages. For example, had BP admitted the flaws in its safety protocols, either the market—or regulators—would likely have forced the company to fix them before the incident occurred.

59. *See* Jill E. Fisch, *Confronting the Circularity Problem in Private Securities Litigation*, 2009 WIS. L. REV. 333, 348; A. C. Pritchard, Stoneridge Investment Partners v. Scientific-Atlanta: *The Political Economy of Securities Class Action Reform*, 2007-08 CATO SUP. CT. REV. 217, 237–38.

60. *See BP*, 2014 U.S. Dist. LEXIS 69900, at *88–90.

require individualized inquiries.[61] Because the plaintiffs could not satisfy this burden, the class was not certified.[62] In other words, the court used the distinction between "actual" reliance damages and fraud on the market damages as a backdoor mechanism for shifting the burden of establishing price impact onto the plaintiffs at class certification.

But it is not clear that *BP* is consistent with *Halliburton II*. If *Halliburton II* eliminates eyeball reliance as a basis for a claim, then there can be no distinction between eyeball reliance and fraud on the market reliance in terms of damages calculations, and the existence—or not—of eyeball reliance cannot defeat class certification. But this puts us back where we started: if individualized reliance does not create a viable basis for a claim in the open market context, why is price impact appropriate for determination at class certification? And if the answer is simply administrative convenience—the expert analysis will be before the court anyway—then perhaps *BP* was correct to demand a damages methodology, because that, too, is closely related to the price impact dispute that the Supreme Court has now authorized for resolution as part of the Rule 23 inquiry.

V. *HALLIBURTON II*'S IMPLICATIONS

The above analysis may seem like an angels-on-pinheads debate. Most investors employ fraud on the market theories when pursuing claims for open-market frauds. Cases are likely few and far between where the market remains unmoved by a fraud, and yet an investor—one with sufficient resources to file a lawsuit—is able to demonstrate actual reliance.[63] So if there are not likely to be many situations in which an investor has a viable claim in the absence of price impact, what difference does all of this make?

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61. The court believed this result was mandated by *Comcast Corporation v. Behrend*, 133 S. Ct. 1426 (2013), which overturned a lower courts' certification order on the ground that plaintiffs had failed to establish that there existed a common methodology for determining damages across all class members. Most courts, however, have held that, *Comcast* notwithstanding, failure to establish a common damages methodology, standing alone, should not defeat class certification. *See, e.g.*, Butler v. Sears, Roebuck & Co., 727 F.3d 796, 801–02 (7th Cir. 2013); Roach v. T.L. Cannon Corp., 778 F.3d 401, 408 (2d Cir. 2015).

62. *See BP*, 2014 U.S. Dist. LEXIS 69900, at *90.

63. As described above, *see supra* note 59, more recent studies suggest that sophisticated players cannot consistently correct the pricing mistakes of novices. Moreover, investors with the resources and losses to make an individual lawsuit worthwhile are likely to be institutions or wealthy individuals with access to expert market analysis.

Most obviously, it may make a difference in "opt out" litigation. Though investors rarely file open-market Section 10(b) claims on their own, there is an increasing tendency for institutional investors to opt out of fraud on the market class actions and seek individual recoveries.[64] These investors continue to press fraud on the market theories of reliance, but they may additionally allege "actual" reliance. And now that *In re BP p.l.c. Securities Litigation* has held that "actual" reliance claims are more valuable than fraud on the market claims, investors have very strong additional incentives both to opt-out of fraud on the market class actions, and to allege actual reliance. Yet if *Halliburton II* prohibits eyeball reliance allegations, investors may be stymied in this attempt.

But to the extent *Halliburton II* does imply that eyeball reliance claims may not be pursued in efficient markets, its greatest impact is likely to be felt in the gap between *fact* and *evidence*. There may be few cases where *in fact* investors actually relied on false statements that had no price impact, but investors may often find it easier to *prove* actual reliance over price impact.

For example, as described above, courts have been willing to assume that in markets designated as "efficient," even very obscure and piecemeal bits of information offset the impact of much more prominent misstatements.[65] If courts use artificial rules of thumb to "find" the existence of an offset, investors may prefer to simply allege actual reliance. This is particularly so given *Halliburton II*'s apparent relaxation of the definition of market efficiency, allowing a greater variety of markets to be included in the category. But if *Halliburton II* is taken to mean that actual reliance claims are not viable, even investors who are capable of demonstrating actual reliance may be left without any remedy at all.[66]

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64. Joshua H. Vinik, *Why institutional investors are opting out of class-action litigation*, PENSIONS & INVEST. (July 25, 2009), *available at* http://www.pionline.com/article/20110725/PRINT/307259985/why-institutional-investors-are-opting-out-of-class-action-litigation.

65. *See* text accompanying notes 22–24.

66. State law may potentially provide more expansive remedies than those that might be available under Section 10(b). However, assuming state law would yield a different result (states often look to federal law to define common law fraud claims, *see, e.g.*, King Cnty. v. IKB Deutsche Industriebank AG, 708 F. Supp. 2d 334, 338 n. 25 (S.D.N.Y. 2010)), even investors who claim actual reliance may want to coordinate their lawsuits with any pending federal class actions to save on discovery costs. If they do so, under the Securities Litigation Uniform Standards Act, 15 U.S.C.A. § 78bb (West 2015), they will be forbidden from advancing state law claims. Indeed, even investors who *do not* wish to coordinate with a federal class action may find it impossible to advance state law claims so long as a federal class action is pending. *See*

Similar mischief may result from the price impact inquiry mandated by *Halliburton II* at class certification. Theoretically, there are only three reasons why a public false statement would not influence a security's price: First, the statement was immaterial in and of itself (which courts are not permitted to consider), second, the market already knew the truth (which again, per *Amgen Inc. v. Conn. Ret. Plans & Trust Funds*, courts may not consider),[67] or third, the market was simply not that efficient in the first place (an issue that, by hypothesis, has already been resolved in plaintiffs' favor by the time the price impact inquiry arises). Thus, the available tools for examining price impact at the class-certification stage are sharply, and artificially, circumscribed.[68]

The Supreme Court (and, in 1982, Fischel) seized upon "event studies"—a type of statistical analysis that is used to identify abnormal stock price movements—as a mechanism for identifying price impact. But, as multiple scholars have elsewhere explored,[69] event studies are quite limited, and are frequently misunderstood, even by courts that employ them.[70] For example, if the defendant conceals bad news rather than inventing fictional good news, the market will assume its existing valuation is correct, and there will be no price movement for the event study to detect. If multiple pieces of news are released simultaneously, event studies cannot shed light on which exerted a pull on the stock's price because they lack the capacity to distinguish multiple causes occurring simultaneously.[71] So

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Benjamin P. Edwards, *Disaggregated Classes*, 9 VA. L. & BUS. REV. 305 (2015).

67. *See* Aranaz v. Catalyst Pharm. Partners Inc., 2014 U.S. Dist. LEXIS 136684 (S.D. Fla. Sept. 29, 2014).

68. Moreover, as the Supreme Court recognized in *Halliburton I*, the existence of a price *drop* when the truth is revealed cannot be reliably used to determine whether there was price impact at the time of the initial misstatement. *See Halliburton I*, 131 S. Ct. 2179, 2186 (2011); *see also* Donald C. Langevoort, *Compared to What? Econometric Evidence and the Counterfactual Difficulty*, 35 J. CORP. L. 183 (2009).

69. *See, e.g.*, Jill E. Fisch, *The Trouble With Price Distortion After* Halliburton, 90 WASH. U. L. REV. 895, 919–20 (2013); Alon Brav & J.B. Heaton, *Event Studies in Securities Litigation: Low Power, Confounding Effects, and Bias* (Social Science Electronic Publishing, Inc. 2015).

70. Fisch, *supra* note 69, at 919–20.

71. Recent research suggests that some companies intentionally release negative news in a manner designed to mask stock price effects. *See, e.g.*, Ed DeHaan et al., *Market (In)Attention and the Strategic Scheduling and Timing of Earnings Announcements*, (Social Science Electronic Publishing, Inc. 2015), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2545966; At least some of this behavior is apparently designed to thwart shareholder litigation. *See* Michael Furchtgott & Frank Partnoy, *Disclosure Strategies and Shareholder Litigation Risk*. , (Social Science Electronic Publishing, Inc. 2015), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2585267.

a qualitative assessment of market reaction (in addition to event studies' "quantitative" assessment) is often a critical component of the price impact inquiry, and yet this is precisely what courts are forbidden to examine at class certification. As a result, the opportunity for error and confusion is vast,[72] which may create further scenarios in which individual investors believe their only hope for recovery is an "actual" reliance claim.[73]

Finally, it is worth noting that although Fischel equated reliance with price impact, he also believed price impact would replace the materiality inquiry entirely. In his view, information that impacts stock price is material by definition; once price impact has been detected, any inquiry into materiality is at an end. Yet the judiciary has been unwilling to relinquish control over materiality determinations, and in *Basic v. Levinson*, the Supreme Court adopted a test for materiality that makes no reference to price impact at all.[74] As a result, courts

72. Such confusion was recently demonstrated by the district court in *Halliburton* itself. After the Supreme Court's decision in *Halliburton II*, the plaintiffs renewed their class certification motion before the district court. They alleged that certain false statements were repeated from July 1999 through mid-2001, and that the truth was gradually revealed in a series of corrective disclosures from June 2001 through December 2001. The district court accepted the argument that if the corrective disclosures did not cause a detectable price drop, that itself was evidence that the original false statements had not caused any inflation. *Erica P. John Fund, Inc. v. Halliburton Co.*, 2015 U.S. Dist. LEXIS 97464, *31 (N.D. Tex. July 25, 2015). Even accepting this debatable premise, however, the district court was unable to find a way to apply it. The court held that out of the several disclosures alleged, only the final one, issued on December 7, 2001, caused Halliburton's stock price to fall, and issued an order purporting to "grant[] in part Plaintiffs' Motion for Class Certification, only with respect to the alleged corrective disclosure of December 7, 2001." *Erica P. John Fund, Inc. v. Halliburton Co.*, 2015 U.S. Dist. LEXIS 97464, *96 (N.D. Tex. July 25, 2015). This, of course, is meaningless; the plaintiffs had sought certification of a class of *persons* who had purchased Halliburton stock between July 1999 and December 2001, and the court's order shed no light on whether this motion was granted or denied, or even whether the false statements issued from July 1999 through mid-2001 were deemed to have impacted Halliburton's price in a situation where some disclosures caused a price drop, and others did not. In other words, having wandered down the garden path of corrective disclosures as evidence of price impact, the court appears to have forgotten the reason for its journey.

73. If a court determines that a defendant has "disproved" price impact at class certification, an investor advancing an individual claim would presumably not be bound by that determination, and could continue to press for a fraud on the market presumption of reliance outside the class-action context. However, as a practical matter, individual investors may believe that a court, having made a determination of no price impact at class certification, will be reluctant to disturb that finding in an individual proceeding. This, in fact, is exactly what occurred in *In re Moody's Corp. Secs. Litig.*, 2013 U.S. Dist. LEXIS 122449, at *27 (S.D.N.Y. Aug. 22, 2013).

74. The *Basic* test for materiality looks to whether the information "would have been viewed by the reasonable investor as having significantly altered the total mix of information made available." *Basic v. Levinson,* 485 U.S. 224, 231–32 (1988).

today frequently base materiality determinations solely on their own intuitions as to what a reasonable investor would—or should—consider when making an investment decision.[75] In some cases, courts have actively rejected evidence of price impact in favor of their own materiality determinations.[76] This approach to materiality is inconsistent with a requirement that reliance be equated with price impact. Either the market is the final arbiter of what an investor values, or it is not; otherwise, investors are caught in a "heads I win, tails you lose" trap, where price impact may be ignored or required precisely as needed to reject a claim.

VI. WHITHER CLASS CERTIFICATION

Ultimately, *Halliburton II* was an exercise in baby-splitting. The Court based its decision *not* on the existence (or lack thereof) of individualized issues, but on its dissatisfaction, procedurally, with conducting only half an inquiry into price impact at the class-certification stage. The Court reasoned that as long as "indirect" measures of price impact (efficiency and publicity) were to be considered at class certification, it was only fair to consider certain "direct" measures as well.

But the better question might be, why even consider the indirect measures? The efficiency inquiry will be revisited by a jury on the merits,[77] and if the evidence is sufficiently clear one way or the other, the matter can be resolved via summary judgment. In other words, the question of market efficiency *is itself* common to the class. So why is

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75. David A. Hoffman, *The "Duty" to Be a Rational Shareholder*, 90 MINN. L. REV. 537 (2006).

76. For example, in *Greenhouse v. MCG Capital Corp.*, 392 F.3d 650 (4th Cir. 2004), the defendant company's stock price dropped upon disclosure that its CEO had never graduated college. The Fourth Circuit nonetheless held that the information was not material in light of his other accomplishments. *See id.* at 658. Similarly, in *In re Merck & Co. Securities Litigation*, 432 F.3d 261 (3d Cir. 2005), the Third Circuit held that a company's accounting methodology was not material, because the company's stock price did not react when the method was first disclosed in the footnotes to the corporate financial statements. *See id.* at 269. In so doing, the court ignored the fact that the stock price plummeted when the methodology was more accessibly publicized in a Wall Street Journal article a few months later. *See id.* at 265. Most recently, in *Police Ret. Sys. v. Intuitive Surgical, Inc.*, 759 F.3d 1051 (9th Cir. 2014), the Ninth Circuit held that courts should decide whether statements are immaterial "puffery"—incapable of being relied upon by rational investors—without considering whether such statements did, in fact, impact stock prices. *See id.* at 1060. In other words, the court implicitly concluded that statements may be deemed immaterial as a matter of law even in the face of evidence that a significant segment of the market actually relied upon them.

77. *See* Wal-Mart Stores, Inc. v. Dukes, 131 S. Ct. 2541, 2552 n.6 (2011).

efficiency appropriate for consideration at class certification in the first place?

This problem is actually a specific instance of a broader theoretical uncertainty in class-action procedure. Class certification is appropriate when the questions raised are "capable of classwide resolution,"[78] but whether a question is capable of class-wide resolution depends on the level of generality at which the question is posed.[79] The initial question of *which* questions must be considered is not one that can be answered by resort to abstractions, but only via a functional analysis of Rule 23's commonality and predominance inquiries.

The most basic justification for the commonality/predominance aspects of Rule 23 is that courts must protect plaintiffs by ensuring that they are not bound by a judgment in a proceeding where their interests were not represented.[80] If class members differ from each other, they may benefit from different (or conflicting) forms of relief, or factual determinations adverse to the named plaintiffs may not fairly apply to the class as a whole. In the Section 10(b) context, for example, courts might fear that if the class is improperly certified and a jury later determines the market was not efficient, the class may lose on the merits, which will then be res judicata even against absent class members who may have had viable "eyeball reliance" claims.[81]

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78. *Id.* at 2551.

79. Richard A. Nagareda, *Class Certification in the Age of Aggregate Proof*, 84 N.Y.U. L. REV. 97, 131–32 (2009). The case of *Brown v. Kelly*, 609 F.3d 467 (2d Cir. 2010), is instructive. There, the plaintiffs sought class certification on their claims that the City of New York had violated their constitutional rights and engaged in malicious prosecution and false imprisonment by arresting them under a statute that had been declared unconstitutional years earlier. The City argued that individualized determinations would be required regarding the circumstances of each arrest; the Second Circuit rejected that argument, on the ground that merely the question whether the circumstances of each arrest *was relevant* was itself a question common to the class. *See id.* at 485–86.

80. *See, e.g.*, Amchem Prods. v. Windsor, 521 U.S. 591, 621 (1997); Gen. Tel. Co. of the Southwest v. Falcon, 457 U.S. 147, 160–61 (1982). Because Rule 23 is generally viewed as a mechanism for protecting absent class members from binding adverse determinations, courts frequently note that there is a certain fox-guarding-henhouse quality to allowing defendants to challenge certification. *See, e.g.*, Eggleston v. Chicago Journeymen Plumbers' Local 130, 657 F.2d 890, 895 (7th Cir. 1981); Coffin v. Bowater Inc., 229 F.R.D. 397, 408 n.13 (D. Me. 2005).

81. Another justification is to protect *courts* from being forced to undertake a variety of unwieldy, individualized determinations as a result of an insufficiently cohesive class. But market efficiency, or its lack, does not create this kind of risk. If there is a danger that a lack of market efficiency will cause the action to devolve into individualized inquiries, that danger persists even after a judge makes a preliminary efficiency determination, precisely because the jury may revisit the question. And because all other aspects of the Section 10(b) action—materiality, falsity, scienter, and the like—are common across class members, there is little risk

Yet it is doubtful whether investors need this kind of protection. When it comes to securities class actions, there is a well-developed "market" for opt-outs. Investors who are capable of opting out (in the sense that their losses are large enough to make an individual action economically feasible) are likely to be well counseled about the benefits and drawbacks of proceeding individually. As a result, it is unlikely that any plaintiff will be unfairly bound by an adverse judgment. If the question of price impact—including efficiency and publicity—is entirely left in jurors' hands, investors are well positioned to decide whether to roll the dice on an unfavorable decision. And if a jury finds in the class's favor and concludes the market was efficient, there was, in hindsight, no need for a judge's interference in the first place.[82]

The true rationale for requiring an efficiency determination at class certification, then, likely lies in a desire to protect *defendants*, rather than plaintiffs. But, at least as a theoretical matter, defendants should not need such protection, because they can challenge market efficiency and price impact before the fact-finder. Therefore, courts could only be protecting defendants against the fact-finder itself—protection against the risk that the fact-finder (namely, a jury) will reach an incorrect determination,[83] or, relatedly, the risk that the sheer unpredictability of the fact-finder's determination will lead to increased discovery costs and a coerced settlement on a meritless claim.

To the extent courts explicitly articulate their distrust of juries in the context of class certification, they typically declare that

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of accidentally embroiling a court in a morass of individualized issues that could have been avoided but for certification.

82. Moreover, if the court is truly concerned about "binding" absent class members to an adverse determination in the absence of market efficiency, there are better solutions than to require an efficiency determination at the class-certification stage. For example, the court could try the issue of efficiency first, and either decertify the class if efficiency is lacking, or certify the class only as to the remaining elements under Rule 23(c)(4). Alternatively, the court could allow absent plaintiffs to bring their own lawsuits on direct reliance theories in the event of an adverse efficiency determination. It is relatively common for plaintiffs to discard theories of recovery that require individualized determinations to allow for class-wide adjudication; when they do, courts sometimes (though not always) allow absent class members to take a second bite at the apple with individualized claims, so long as they do not seek to re-litigate issues that were adjudicated in the class proceeding. *See* Robert H. Klonoff, *The Decline of Class Actions*, 90 WASH. U. L. REV. 729, 785–86 (2013).

83. Richard A. Nagareda, *Class Settlement Pressure, Class-wide Arbitration, and CAFA*, 106 COLUM. L. REV. 1872, 1892–94 (2006).

certification is improper for an "immature" tort.[84] The "immature" tort is a set of novel legal and factual claims (usually arising in the context of mass torts, such as tobacco) that the court believes are better adjudicated on an individual basis so the parties can develop their understanding of the claims' merits and the likelihood of the plaintiffs' success.[85] But whatever merits of the immature tort theory,[86] it has no application in the fraud on the market context, where the legal and factual bases for the claims are exceedingly well developed.

As for the notion that class certification puts unwarranted settlement pressure on defendants because of the unpredictability of the verdict, the extent to which courts may consider the possibility under Rule 23 is a matter of some controversy.[87] Several courts have deemed consideration of "blackmail" settlements to be a legitimate part of the class-certification inquiry, and have responded either by holding plaintiffs to a high burden of proof in establishing that Rule 23's requirements are met,[88] or by giving the possibility its own independent weight.[89] At the same time, however, a preliminary merits inquiry would seem to contravene Supreme Court pronouncements regarding the proper scope of Rule 23.[90] And whatever the status of this debate in general, in both *Amgen* and *Halliburton II*, the Court explicitly *rejected* the argument that securities class-action procedures

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84. Elizabeth J. Cabraser, *The Class Action Counterreformation*, 57 STAN. L. REV. 1475, 1481–82 (2005).

85. *See id.*

86. Some courts have explicitly rejected the theory. *See, e.g.*, Klay v. Humana, Inc., 382 F.3d 1241, 1272 (11th Cir. 2004).

87. *Compare In re* Rhone-Poulenc Rorer Inc., 51 F.3d 1293 (7th Cir. 1995), *with* Klay v. Humana, Inc., 382 F.3d 1241 (11th Cir. 2004); *see also* Joshua P. Davis & Eric L. Cramer, *Antitrust, Class Certification, and the Politics of Procedure*, 17 GEO. MASON L. REV. 969 (2010). Significantly, in *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541 (2011), and *Comcast Corporation v. Behrend*, 133 S. Ct. 1426 (2013)—two of the Supreme Court's most recent decisions tightening standards for class certification—the Court made no mention of the need to protect defendants.

88. Castano v. Am. Tobacco Co., 84 F.3d 734, 747 (5th Cir. 1996).

89. Newton v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 259 F.3d 154, 167 n.8 (3d Cir. 2001).

90. *See* Eisen v. Carlisle & Jacquelin, 417 U.S. 156, 177–78 (1974); Amgen Inc. v. Conn. Ret. Plans & Trust Funds, 133 S. Ct. 1184, 1195 (2013). Some courts and commenters have recommended that class certification be denied when it results in the creation of liability that Congress likely did not anticipate. This is most likely to occur when claims are subject to statutory damages; in that context, Congress may not have intended to create the kind of massive liability that results from aggregation. If so, the class-action procedure is itself at odds with congressional intent. *See* Nagareda, *supra* note 82, at 1885–87. This concern, however, only applies to certain kinds of statutes, and has no application in the securities context, where Congress unquestionably anticipated—and legislated for—class-action remedies. *See Halliburton II*, 134 S. Ct. 2398, 2413 (2014) (recognizing that Congress enacted the PSLRA to shape and reform securities class actions).

should be modified to avoid unwarranted settlement pressure on the grounds that Congress has already designed a variety of alternative screening mechanisms to reduce the possibility of frivolous lawsuits.[91]

Thus, if settlement pressures are off the table as part of the Rule 23 inquiry, the more theoretically sound conclusion may be that not only should courts *not* consider price impact at class certification, but also that they should not stand sentry over the efficiency determination—at least so long as plaintiffs have enough evidence of efficiency to avoid summary judgment. Yet despite the *Halliburton II* Court's recognition that settlement pressures are not an appropriate Rule 23 consideration, it did not dig deeper and connect fraud on the market class certification to the underlying purposes of Rule 23.

VII. CONCLUSION

In *Halliburton II*, the Court started from the proposition that efficiency is suitable for examination at the class-certification stage. With that premise in hand, the remaining issues—materiality, price impact, and so forth—became matters of line-drawing. And one cannot help but suspect that the (purported) ease with which plaintiffs obtain class certification in securities cases helped to dictate the line the Court drew.[92] Unfortunately, this particular line is both impractical and theoretically unsound, and will likely lead to inconsistencies going forward.

91. *See Amgen*, 133 S. Ct. at 1200–01; *Halliburton II*, 134 S. Ct. at 2413.
92. Langevoort, *Judgment Day*, *supra* note 33, at 46–47.