Judgment Day for Fraud-on-the-Market: Reflections on Amgen and the Second Coming of Halliburton

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I. INTRODUCTION

Two years ago, in Amgen Inc. v. Connecticut Retirement Plans and Trust Funds,¹ a solid majority of the Supreme Court held that proof of the materiality of alleged misstatements or omissions was neither necessary nor appropriate to certify a class action on behalf of investors who bought or sold in the aftermath of the falsehoods. At issue was the meaning—both substantively and procedurally—of the so-called “fraud on the market” presumption that had been established by the Court twenty-five years earlier in Basic Inc. v. Levinson,² whereby all such investors are presumed to have relied on the alleged fraud if they traded in an “efficient” market for those securities that was allegedly distorted by fraud. The majority in Amgen said that the Rule 10b-5 class certification inquiry in the face of such a presumption is limited to issues not susceptible to class-wide proof. Materiality, being a single objective inquiry, is a class-wide question and hence not directly relevant to certification. Three justices (Scalia, Thomas and Kennedy) disagreed, in two separate dissents, saying that proof of

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¹ 133 S.Ct. 1184 (2013). The majority opinion was written by Justice Ginsburg.
materiality is a condition precedent to earning the presumption of reliance, without which certification necessarily fails because commonality unravels.

But this seemingly technical procedural issue exposed something far more fundamental. The two dissents suggested that Basic may have been wrongly decided in 1988, and Justice Alito joined the majority but wrote a cryptic concurrence saying that the Basic presumption might have a shaky foundation that warrants future reconsideration. The defense bar wasted no time in taking up the four justices’ invitation and sought review in a case that had already been up once to the Court, Erica P. John Fund v. Halliburton Co., now asking that Basic be overruled. Certiorari was granted in November 2013, generating substantial buzz as to what would happen next.

This surely was portentous, the possible death of a cause of action that has been the centerpiece of private securities litigation for the last forty years. Just in the last fifteen, private securities class actions (the vast majority of which are fraud-on-the-market) produced for investors more than $70 billion in settlements; in ten of those years, plaintiffs’ attorneys’ fees alone totaled more than $17 billion. On the defense side, these cases are just as big a revenue source for lawyers, if not bigger, and it is not hard to imagine some large law firm securities litigators who feared for their practices and privately prayed that these kinds of cases somehow survive.

In June 2014, the Court gave its answer in Halliburton II: Basic does survive, if largely as a matter of stare decisis. Whatever doubts were raised about the fraud-on-the-market theory were not enough to overcome

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3 Shortly after Amgen, the Fifth Circuit held that Amgen and the Court’s earlier Halliburton decision together are properly read to foreclose any price distortion argument as part of the class certification decision. Erica P. John Fund v. Halliburton Co., 2013 WL 1809760 (5th Cir. 2013). The earlier decision before the Court, discussed infra, was Erica P. John Fund v. Halliburton Co., 131 S.Ct. 2179 (2011), rejecting defendants’ argument that a showing of loss causation was an essential predicate to class certification.


the strong presumption that Supreme Court precedent not be revised simply because the now-sitting justices would have decided the case differently. The Court did, however, hold that it was consistent with Basic to allow defendants to show the absence of any impact of the fraud on the market price of the issuer’s stock in order to defeat class certification, even though price impact is no different from materiality in terms of class-wide applicability.

This essay compares and contrasts Amgen and Halliburton II. Although Halliburton II is technically a unanimous decision in that all the justices favored reversing and remanding the lower court’s decision, the reality was a stark 6-3 split. Chief Justice Roberts wrote the Court’s opinion to uphold Basic. Justices Thomas, Scalia and Alito vehemently disagreed with this ruling, concurring only because of the reversal and remand on the secondary issue of price distortion. The surprise switch here was Justice Kennedy, who had joined Thomas’ dissent in Amgen but then voted with the Chief Justice to allow Basic to survive.

II. CONGRESS AND THE COURTS: SETTING POLICY FOR SECURITIES CLASS ACTIONS

We begin with Amgen’s technical-seeming issue: whether plaintiffs had to establish the materiality of the alleged lies at the class certification stage. As both sides conceded in their debate about who exactly was putting the cart before the horse,7 plaintiffs surely bear the burden of proving materiality in order to win their case. The question was when, i.e., whether it occurs pre-discovery.8 The Amgen dissenters’ main argument

7 Compare 133 S.Ct. at 1191 with id. at 1211 (Thomas, J., dissenting).
8 Materiality determinations are aided by discovery to the extent that they deal with questions like the probability of an event’s occurrence at the time of the public statements, or how seriously the issue was taken inside the company at the time. On the other hand, stock price reaction evidence—which as we will see, becomes a central issue much of the time—tends not to be. Even that, however, takes time to develop. The lower courts that
was that it is efficient to get rid of cases where the misstatements are likely to be immaterial earlier rather than later, and not unfair given the generous gift that Basic’s presumption affords the plaintiff class when materiality can be established.

But of course there is much more than just timing. Leaving materiality to trial means, in all likelihood, that a jury makes that determination instead of the judge. Materiality debates often turn on a mix of qualitative and quantitative evidence, the latter not likely to be understood particularly well by lay jurors. Defendants may reasonably suspect that they will fare better before a judge for this reason alone. Moreover, at trial there may be little to control for the trumping effect of hindsight bias—the inflated inference that because something bad happened later on, those on the inside must have suspected it all along and so bear responsibility for it.9 Given the large sums of money at stake plus the high costs of litigating just to get to trial, this fear supposedly contributes to settlement pressure, which happens almost inevitably if a class is certified and survives motions to dismiss or for summary judgment. Thus plaintiffs’ strong desire to defer as many contestable issues as possible to trial, and for defendants to fight vigorously for pre-discovery resolution of the same. Amgen was just one of many settings where defendants had pushed for such an acceleration of a merits issue, and the Court’s rejection was, for the moment, a significant strategic win for plaintiffs in countering these moves.

9 See G. Mitu Gulati et al., Fraud by Hindsight, 98 Nw. U. L. Rev. 773 (2004). This is important because the approach to materiality with respect to speculative, future-oriented events is to ask the jury to balance the probability that the event would come to pass as of the time of the fraud against its likely magnitude—essentially an expected value calculation. This test was endorsed in a separate holding in Basic. On the somewhat surprising background to the Court’s resolution of this issue, see Donald C. Langevoort, Investor Protection and the Perils of Corporate Publicity: Basic Inc. v. Levinson, in THE ICONIC CASES IN CORPORATE LAW 257 (Jonathan Macey, ed. 2008).
Given the Supreme Court’s recent pro-defendant inclinations in securities class actions and class actions generally, including another sizable win for the class action defense-side just a few weeks after *Amgen*\(^1\), this settlement-bolstering win for plaintiffs was surprising to many.\(^1\) Indeed, reading the defense-side briefs in *Amgen* gave the clear impression they thought the Court would bless this tough stance to class certification because it was sound conservative policy to do so, and they expected a majority of the justices to do so simply by adhering to that instinct.\(^2\) But they failed, with the Chief Justice as the defector from the conservative side of the Court.

So why did the Chief Justice side with the majority in *Amgen*, given his defendant-friendly votes in other close fraud-on-the-market decisions like *Stoneridge*\(^3\) and *Janus Capital*?\(^4\) To me, there is a point in the opinion that was crucial to assembling that unexpected majority, one that also strongly hinted at what would happen later on in *Halliburton II*. As noted earlier, a strong thrust of the dissents was the “in terrorem” effect of class certification, impelling settlements even where merits issues like materiality and scienter are questionable—as good reason for an early assessment of materiality. This, of

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\(^1\) Comcast Corp. v. Behrends, 133 S.Ct. 24 (2013).

\(^2\) I will leave to the civil procedure experts the task of reconciling *Amgen* with the noticeably contrary trend in class action litigation that is increasingly open to some degree of “merits” inquiry. See Linda Mullenix, *Class Action Cacophony at the Supreme Court*, Nat’l L.J. (April 15, 2013), at 28. The majority and dissent in *Halliburton II* address this, with dramatically different conclusions.

\(^3\) The dissenters worked hard to find in the *Basic* opinion itself an implicit pre-certification materiality requirement, in order to make this move seem not just a simple exercise of judicial policy-making, the evidence for which did not impress the majority. In fact, the parties could not cite any instances where a court insisted on a materiality showing as crucial to class certification until the mid-2000s. If such a requirement was implicit in *Basic*, then, it lay undiscovered for a surprisingly long period of time. Unmentioned in *Amgen* is the Sixth Circuit’s opinion on remand in *Basic*, which rejected the defendants’ request for summary judgment on materiality and sent the case to the district court for trial, prior to which the case settled. See Levinson v. Basic Inc., 871 F.2d 562 (6th Cir. 1989). The court expressly affirmed the class certification even though materiality remained a live issue at trial.


course, invokes the debate that has raged well before Basic about purported class action abuses, and which led Congress to substantially reform private securities litigation in 1995. In recent years, defendants have vigorously been making the argument that Congressional action in the Private Securities Litigation Reform Act has implicitly “frozen” the outer limits of fraud-on-the-market class actions, precluding the judiciary from further expansion. This connects to the conservative critique of 10b-5 litigation generally, which despises its origins in the form of a judicially implied right rather than Congressional action, and has long claimed that these litigation scope issues are warrant legislative reform than judicial invention. The Supreme Court’s Stoneridge decision articulates the “frozen in 1995” idea explicitly.

But that is presumably a two-way street, indicating just as strongly that those doctrines that were firmly in place in 1995 are protected by that same logic. Albeit without an explicit citation to Stoneridge, the Amgen majority made much of the fact that Congress rejected efforts to overturn Basic, while at the same time making so many important substantive and procedural changes (but not to the relevant aspects of class certification) to counter settlement pressure and excessive liability. Indeed, the structure of the PSLRA makes no sense except when read as a political compromise that preserves the foundation of the fraud-on-the-market class action while making it harder for plaintiffs bring, plead and prove a successful claim through a variety of reforms. So it occupies the field, in a way that

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16 Stoneridge Inv. Partners v. Scientific-Atlanta Inc., 552 U.S. 148, 165-66 (2008)(“It is appropriate for us to assume that when [the PSLRA] was enacted, Congress accepted the §10(b) private cause of action as then defined but chose to extend it no further”). Stoneridge was addressing the extent of secondary liability in fraud-on-the-market suits.
17 133 S.Ct. at 1200-01.
18 The legislative history of the PLSRA has been thoroughly explored and makes clear that the statute was about fraud-on-the-market litigation. See, e.g., John W. Avery, Securities Litigation Reform: The Long and Winding Road to the Private Securities Litigation Reform Act of 1995, 51 Bus. Law. 355 (1996). For a contrary view of the implications of the PSLRA, see Grundfest, supra. One well-taken point made by petitioners and defense side amici in Halliburton II was that a minority in Congress
disappointed both the most insistent champions and the most strident critics of private securities litigation. When this happens, a natural conservative judicial move is to defer.

Given the well-established status of materiality as a fact question in numerous Supreme Court decisions both pre- and post-1995, the majority’s point that Congress could have adjusted the law relating to materiality and class certification determinations if it had wanted, but chose other potent reforms instead, has considerable strength. This was the pointed message of a Seventh Circuit decision rejecting the role of materiality in class certification written by Frank Easterbrook, Schleicher v. Wendt, saying that “[w]e do not think it appropriate for the judiciary to make its own further adjustments by reinterpreting Rule 23 to make likely success on the merits essential to class certification in securities-fraud suits.” It was a potent endorsement of deference to the PSLRA by a conservative scholar and judge quite expert in both the theory and practice of private securities litigation, in a case cited repeatedly by the Amgen majority.

Halliburton II, of course, involved this same separation of powers question on a much bigger scale—Basic’s very survival. In refusing to jettison Basic, the Chief Justice’s opinion in Halliburton II comes back to what Congress did and did not do in 1995, albeit within the more limited framework of stare decisis. The opinion stops short of saying that the PSLRA formally endorsed or acquiesced in Basic as a matter of law; instead, given the strong presumption of stare decisis, it is enough to say that ample opportunity was there for Congress to change the law if it wanted but that Congress chose more narrow compromise solutions instead. This might be the point that also brought Justice Kennedy over to the majority—after all, he was the author of the Stoneridge opinion, in which

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20 618 F.3d 679 (7th Cir. 2010).
the “frozen in 1995” idea was first expressed. In any event, deference to the political process seems especially important to the outcomes in both cases.

III. Materiality, Price Distortion and Corrective Disclosure

The disagreement in Amgen was about whether an early showing of materiality in an evidentiary hearing should be the price plaintiffs have to pay for Basic’s generous presumption of reliance and the class certification that readily follows. The majority said no, and a year later largely restated that conclusion in Halliburton II in ruling that plaintiffs did not have to show price distortion either in order to gain the presumption. But then—strangely, perhaps—the Court shifted ground in Halliburton II to say that defendants could raise a “no impact” defense in order to defeat class certification. Logically, those two aspects of Halliburton II seem inconsistent, the latter holding better seen as a pragmatic compromise to make the reaffirmance of Basic more palatable to securities class action critics and capture as large a majority of the Court as possible.

Here again, we start with Amgen. Materiality is a deceptively simple idea, describing that which reasonable investors likely consider

22 Justice Thomas’ “concurrence” in Halliburton II questions whether stare decisis should play such a strong role when what is at issue is of the Court’s own making (an implied private right of action) rather than a matter of statutory interpretation. As a result, he was unpersuaded that Congressional inaction in 1995 was relevant. On the wholly inconsistent case law on legislative acquiescence, see William N. Eskridge, Jr., Interpreting Legislative Inaction, 87 Mich. L. Rev. 67 (1988).

23 Basic permits a rebuttable presumption of reliance upon a showing that an investor traded during the relevant class period (i.e., after the misrepresentation but before correction), that the trading was on an “efficient” market, and that there was a material, public misstatement that distorted the market price. This presumption of reliance, in turn, has been seen as essential to a finding of commonality under Rule 23(b)(3) of the Federal Rules of Civil Procedure to justify class certification.
important, i.e., relevant to the value of the issuer’s securities. When plaintiffs bring a securities class action, the pleadings inevitably claim that the truth withheld from investors was very important. Apart from disputing what the truth was (a pure fact question) or whether it was fully appreciated by the defendant (a scienter inquiry) the most common response by the defense is a “truth on the market” defense: that the market already knew the truth, so that whatever the defendant said was unimportant even if it was false. This can be established qualitatively, by calling market participants as witnesses and demonstrating, through contemporaneous publicity or published research, that there was an adequate understanding of the true state of affairs to disregard management’s supposed deception. The latter appears to be what defendants were anxious to do in Amgen.

As one can imagine, however, this kind of evidence is normally countered by plaintiffs’ own experts and publicity survey. For some time now, the question of whether there is a noticeable stock price reaction to the alleged misstatement has been considered the best test to resolve contests between fraud-on-the-market and truth-on-the-market. Where a corporate lie is particularly dramatic and credible—false corporate “news”—we can expect a visible and prompt price reaction, usually on the upside. Indeed, that intuition is the basis of the fraud-on-the-market presumption. And that stock price distortion—often measurable via an event study—would tell us nearly everything necessary for plaintiffs to succeed or fail. The reaction itself suggests that the information is material, and that distortion triggers Basic’s presumption of reliance. The amount of the price distortion in turn might also be a good measure of damages. Indeed, it was this promise of a rigorous, unified, empirical approach to materiality, reliance and causation via the event study tool that early on made the fraud-on-the-market theory

24 Matrixx Inc. v. Siricusano, 131 S.Ct. 1309 (2011)(rejecting a claim that statistically insignificant instances of harmful effects from a new drug were necessarily immaterial).
appealing even to fairly conservative judges and academics, a story I have explored in more depth elsewhere.  

But the simplicity was an illusion. As was the case in Amgen, the typical fraud-on-the-market case does not involve a single dramatic lie. Rather, it involves a narrative that begins when the issuer is doing reasonably well. Gradually, however, things start turning bad and eventually the issuer is forced to reveal its troubles (or the market simply figures it out), at which point the stock price is much lower than it was during the good times. Plaintiffs will work to show that management knowingly or recklessly concealed those troubles. But concealment is not necessarily unlawful (another one of Basic’s fundamental lessons) and so there will have to be a showing that particular misstatements or actionable omissions, usually half-truths, distorted the stock price. For a variety of reasons, finding measurable distortion is often hard. First, the alleged lies come out in dribs and drabs, with mainly incremental effect, and allegedly have the effect to preventing a decline in the stock price, not actually pumping it up. Second, these alleged lies are often coupled with lots of other information about the issuer, some of which may have been accurate. There is simply no way of measuring distortion with precision in settings

28 See Langevoort, Basic at Twenty, supra, at 163-64. The seminal work here is Daniel Fischel, Use of Modern Financial Theory in Securities Fraud Cases Involving Actively Traded Securities, 38 Bus. Law. 1 (1982); see also Frank H. Easterbrook & Daniel Fischel, Optimal Damages in Securities Cases, 58 U. Chi. L. Rev. 611 (1985); Daniel Fischel, Efficient Capital Markets, the Crash, and Fraud on the Market Theory, 74 Cornell L. Rev. 907 (1989). Easterbrook and Fischel gather these ideas together in their classic book THE ECONOMIC STRUCTURE OF CORPORATE LAW (1991). Credit for this law and economics vision is also due to Judge Patrick Higginbotham, who introduced this kind of analysis to the fraud-on-the-market case law, even before Easterbrook and Fischel, in In re LTV Sec. Litig., 88 F.R.D. 134 (N.D. Tex. 1980). Judge Higginbotham, later promoted to the Fifth Circuit, had a significant impact on the law since then as well.


like these. Often there is no visible change in stock price at all, on which defendants seize for their truth-on-the-market defense.

Well before Basic, plaintiffs responded to this difficulty by turning attention not to the date(s) of the alleged lie(s) but rather the event of corrective disclosure—when the truth was later on brought home to the market. When there was a big stock price drop after such disclosure, plaintiffs would argue by backwards induction that this was the drop was a good measure of the cumulative extent of the original distortion (and the right measure of damages as well). But once the inquiry extends to a potentially lengthy period of time between the original lie and the corrective disclosure, it is likely that there will be many intervening or supervening events that also make their way into the correction, making it hard—if not impossible—to disentangle all the effects with any econometric rigor. The case law in this area exploded in the aftermath of the Supreme Court’s Dura Pharmaceuticals decision, with its insistence that plaintiffs put forth persuasive evidence of a price correction attributable to the fraud in order to establish “loss causation,” as is their statutory burden after the PSLRA.

Exploring how the courts have responded to all this is beyond the scope of my article; it is by all accounts a doctrinal and practical mess. Courts vary considerably in how much they demand of plaintiffs, with many cases insistent that if plaintiffs cannot show with convincing evidence that there was either a price distortion at the time of the fraud or a deflation in price later on due to the revelation of the truth (not some separate causal

34 See Fisch, supra; Langevoort, Basic at Twenty, supra, at 178-89.
event), they lose. Of course, if this burden is imposed only at the trial on
the merits, it may be largely illusory for the reasons discussed earlier—the
case will be settled before then. In response, urged on by defendants, more
aggressive courts began finding ways to accelerate this inquiry, taking us to
the present controversies. As an effort to weed out these cases, class
certification was appealing because it would permit an early evidentiary
hearing, going well beyond the pleadings. The Supreme Court tried to shut
the door on using class certification to do this, first holding that loss
causation is not an appropriate certification inquiry in the first iteration of
Halliburton,36 then holding the same with respect to materiality in Amgen.37

Even though plaintiffs won considerable (but again, perhaps
momentary) strategic victories in these two cases, this kind of pre-discovery
skirmishing resembled the game of whack-a-mole in the way that these
issues keep reappearing under different labels.38 For example, in a
controversial series of opinions pioneered by then Judge Alito in the Third
Circuit,39 where there is no stock price reaction to a misrepresentation or
omission (or to the corrective disclosure when that is used for backwards
inference), the information can be deemed immaterial as a matter of law and

37 Technically, price distortion might be seen as different from both materiality and loss
causation, though this did not persuade the Fifth Circuit in Halliburton II. See note --- supra.
38 Still uncertain, for example, is the extent of plaintiffs’ pleading burden with respect to
price distortion and loss causation. Even summary judgment is a possibility, notwithstanding the highly disputed factual nature of these issues. See In re Williams Co. Sec. Litig., 558 F.3d 1130 (10th Cir. 2009). The court found a way to summary judgment via Daubert. The district court, properly in the Tenth Circuit’s view, excluded the plaintiff’s expert evidence entirely for failing to make the necessary scientific showing for admissibility; thus there was no factual contest any more. In sum, Williams concedes the likelihood of serious fraud closely connected with the reasons companies typically go bankrupt—hidden financial weakness—and yet dismissed the class action in its entirety.
39 E.g., In re Burlington Coat Factory Sec. Litig., 114 F.3d 1410, 1425 (3d Cir. 1997); for
perhaps the most notorious example, not by Alito, see In re Merck & Co. Sec. Litig., 432
F.3d 261 (3d Cir. 2005), which uses immateriality as a matter of law even though there
clearly was a later corrective reaction to the news once it became salient enough.
Compare, e.g., Greenhouse v. MCG Capital Corp., 392 F.3d 650 (4th Cir. 2004). See
generally Stefan Padfield, Who Should Do the Math? Materiality Issues in Disclosure that
Require Investors to Calculate the Bottom Line, 34 Pepperdine L. Rev. 927 (2007).
the case dismissed for that reason alone, quite apart from class certification.\textsuperscript{40}

If read strictly, this is a troubling doctrine.\textsuperscript{41} The question of why there was no immediately visible stock price reaction is factually complex. Sometime reactions to information are delayed because of the subtlety of the disclosure or its “buried” nature, even in well-developed markets. Sometimes there is no reaction because, as noted earlier, the alleged fraud diffuses a price reaction that would have occurred in the absence of the fraud, and there is no obvious corresponding correction event because the information has already leaked into the market or because the correction has been bundled with other good news about the issuer. While there will be some cases where the mix of qualitative and qualitative evidence of truth-on-the-market is strong enough to justify pre-discovery dismissal,\textsuperscript{42} most are likely to involve substantial ambiguity.

So what this is really all about is the burden of palpable uncertainty,\textsuperscript{43} which takes us to \textit{Halliburton II}. Having determined that making plaintiffs show price impact at the class certification stage would be an inappropriate burden, the majority then allows defendants to raise the issue as a matter of a defense to certification. Why? The Court concedes that this is a class-wide issue, but (a) finds it the true predicate for the presumption of reliance for which the agreed-upon certification prerequisites (efficiency and publicity) are just indirect proxies; and (b) the issue tends to come up anyway in the course of assessing market efficiency.\textsuperscript{44} Defendants must be frustrated at the first of these claims,

\textsuperscript{40} That could be an explanation for Justice Alito’s choice to concur rather than dissent in \textit{Amgen}: he may have been convinced that class certification is not the right place to deal with these issues because there are other pre-discovery opportunities for dismissal when price distortion isn’t obvious.

\textsuperscript{41} See James D. Cox, \textit{Understanding Causation in Private Securities Lawsuits: Building on Amgen}, 66 Vand. L. Rev. 1719 (2013); Langevoort, Basic at Twenty, supra, at 189-91.


\textsuperscript{43} See John C. Coffee, Jr., \textit{Causation by Presumption?}, 60 Bus. Law. 533 (2005).

\textsuperscript{44} After \textit{Halliburton I} and \textit{Amgen}, this was clearly a defense side strategy of choice. See Lassaad Turki & Mark Allen, \textit{Amgen—What Has Not Been Said So Far!}, 45 Sec. Reg. & L. Rep. (BNA) 1046 (June 3, 2013); see also Mukesh Bajaj & Sumon C. Mazumdar,
because it would seem to suggest that what is so fundamental to earning the presumption should be plaintiffs’ affirmative burden. The second is curious because only some cases—and as we shall see shortly, perhaps many fewer in the future—seriously contest efficiency.

The reality is that *Halliburton II* is choosing a middle ground policy: price distortion as an early stage, judge-made determination, but with the burden on the defendants. In this sense, the Court is clearly back-tracking on both *Amgen* and *Halliburton I*. How much this matters will depend on how lower courts structure and manage the inquiry. If the approach to loss causation is any indication (and the proof as to loss causation tends to be the same as proof of distortion), this could turn out to be defendant-friendly—the simple absence of statistically significant price movement at the key points in time as sufficient to shift the burden to plaintiffs to explain. On the other hand, we have to remember, as Justice Ginsburg’s concurring opinion stresses, that the Court solidly rejected putting the burden on plaintiffs, suggesting that it would be inappropriate to draw an inference of non-impact too easily. And—importantly—we also have to keep in mind that this is a binary question: simply was there impact, not how large was the distortion (which is inevitably the much harder inquiry). We will dig more deeply into all this shortly.

### III. On What? Efficiency, Reliance and Rebuttability

I have written at length elsewhere about the confusion *Basic* created in trying to explain the precise nature of the presumed reliance and how and why this relates to market efficiency, as have others. Neither *Amgen* nor

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45 See Langevoort, *Basic at Twenty*, supra, at 166-78.
Halliburton II blows away the fog, though the latter is a welcome advance on the efficiency issue.

Market efficiency is the idea that as a result of competitive research by market professionals and other mechanisms, “news” about an issuer (or indeed any other material public information) will be promptly incorporated into its stock price, so that traders thereafter cannot reasonably expect to profit from such news.47 It follows that most traders should not even try—they can and should “free ride” on the professionals’ work by simply assuming that the consensus price is the best publicly-available estimate of the security’s value. Index funds are commonly given as a good example of a rational, low-cost investment strategy in response to market efficiency.48

Basic’s muddle was this. There are plenty of free-riders in the market who can reasonably say that they buy or sell without researching the company because they are relying on the market to do the work for them (the image of the market as the investors’ “unpaid agent,” referred to in both Basic and Halliburton II). But there are just as many, if not more, who try to identify mispricing opportunities—stocks that seem undervalued or overvalued—and hence are not trusting the market to have gotten the valuation right. Of course some of these do the research and actually rely on the misinformation, but not all. Any presumption based simply on the

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46 E.g., Cox, supra (though seeing in both the majority opinion in Amgen and Justice Scalia’s dissent a route toward a more coherent theory).

47 Actually, it starts simply from the empirical observation that after a prompt period of adjustment to news, there are no significant cumulative abnormal returns—the price is as likely to go up as down—so that we can fairly say that the information has been impounded in the stock price. The precise mechanisms of market efficiency remain contested. See Ronald Gilson & Reinier Kraakman, The Mechanisms of Market Efficiency Twenty Years Later: The Hindsight Bias, 28 J. Corp. L. 715 (2003). This is the notion of “informational” efficiency. “Fundamental” efficiency is an inference—that as a result of the forces that produce informational efficiency, it is more likely that the price reflects the stock’s intrinsic value. Because there is no way of determining with precision what the intrinsic value is, fundamental efficiency is not directly testable.

assumption of passive free-riding will be necessarily over-inclusive, which raises disturbing questions about excessive liability as a result, because each and every class member is entitled to damages.

But this is not the only, or even the standard, justification for a presumption of reliance. Midway through Basic—and again in both Amgen and Halliburton II—there is a subtle shift to the idea of reliance on “price integrity” for what is being presumed. An investor assumes that the market price is undistorted by fraud, even if he or she thinks the stock may be under- or over-valued. Here, active as well as passive investors would be entitled to the presumption, even in the absence of actual reliance, which is how Basic had generally been understood by commentators and applied by the courts. In Halliburton II, the Chief Justice says that “value investors” may think they can beat the market but are still assuming that the price will eventually adjust in the direction of their prediction because of the forces of market efficiency.

Yet the muddle doesn’t end here, because rational investors would never assume that prices have integrity. Sadly, corporate fraud is not uncommon; one recent estimate suggests that the probability of any given public company engaging in fraud in a particular year is as much as 14.5%. In an efficient market, the residual fraud risk is priced, not assumed away.

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50 133 S.Ct. at 1192-93.
51 See, e.g., Fischel, Crash, supra.
54 But because diversified traders can gain as well as lose from fraud (if they are sellers at an inflated price), this market risk may not be all that great. See sources cited in note infra.
What *Basic* did, as much as anything, is create an *entitlement* to an undistorted stock price via, as I have described it, an act of juristic grace. The most straight-forward way of articulating this—advocated by Easterbrook and Fischel, for example—would be to jettison reliance entirely and give investors a right to recover whenever they show price distortion that harmed them. This is a pure causation approach, and there is a fascinating back story to *Basic* here. Private correspondence between Justices Blackmun and Brennan while *Basic* was being drafted shows Blackmun stubbornly insisting that “transactional reliance” has to be preserved and a simple causation approach rejected. Their main point of disagreement has to do with whether a trader who was committed to selling without regard to the price (their hypothetical is someone who decides to divest immediately the shares of a company doing business in South Africa) is harmed by fraud-induced price distortion: Brennan’s causation approach says yes, Blackmun’s transactional approach says no. Blackmun does edit the opinion in a couple of places to accommodate Brennan’s preferred locution of “price reliance,” though still unconvinced that there is much substance to the distinction. Brennan disagrees (and is not sure that Blackmun yet understands his point) but finally gives up, willingly

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55 Langevoort, *Basic at Twenty*, supra, at 161. A pre-*Basic* recognition of this is Lipton v. Documation Inc., 734 F.2d 740, 748 (11th Cir. 1984)(“The theory . . . actually facilitates Congress’ intent . . . by enabling a purchaser to rely on an expectation that the securities markets are free from fraud.”) *Basic* cites Lipton, with a page cite to this quote but not the quote itself. 485 U.S. at 246.

56 See note --- supra; see also Fisch, Halliburton, supra.

57 A copy of these letters is on file with the author. The phrase “transactional reliance,” referring to Blackmun’s insistence that actual reliance is essential, seems to be Brennan’s. He distinguishes this from his preferred idea of “price reliance.” See Letter of January 22, 1988, from Brennan to Blackmun, at 1 (“I fear that the Court’s opinion may be read as approving transactional reliance rather than price reliance”) (on file with the author). Adam Pritchard uncovered this correspondence in the course of his historical research, and I am grateful to him for copies. For previous use of this correspondence, see Langevoort, *Basic at Twenty*, supra, at 153 n.9, 157 n.25, 160 n.38; Goldberg & Zipursky, supra; see also STEPHEN Choi & A.C. PRITCHARD, SECURITIES REGULATION: CASES AND ANALYSIS 324-25 (2005).

58 See Letter of January 25 from Blackmun to Brennan, at 1. I suspect that these edits and additions were the reason *Basic* is so hard to understand as to reliance—it tries to reconcile the price and transactional ideas (while clearly preserving the latter) without recognizing the underlying tension.
concurring because he realizes that once the presumption is invoked, the possibility that anyone will try to rebut it and challenge individualized reliance will be rare.\textsuperscript{59} Largely, he was right. But Blackmun’s insistence on maintaining transactional reliance as the basis for the presumption leaves the decision incoherent and unsatisfying.\textsuperscript{60}

Consider the important case of the index fund.\textsuperscript{61} Index funds are the poster children for passive low-cost investment, compelled to buy or sell stocks solely to maintain a weighted average of the chosen market index. They thus seem to fit perfectly within the free-riding vision.\textsuperscript{62} But these investors are entirely insensitive to information insofar as their entire methodology is just to mirror the index. Even if told the truth about a particular issuer, they would still have to buy or sell to conform to the index. So why aren’t they just like the investor who committed to divest from South Africa?

There is no obvious answer, although a possible way out of the muddle would be to see the entitlement to undistorted stock prices as granted to the market generally. If so, then there might be a number of different ways to rely that are within the zone of protection. One is through

\begin{itemize}
\item \textsuperscript{59} See Letter of January 27 from Brennan to Blackmun (“The difference between us is now clear. In my view, the market relies on the defendant’s misstatement, and plaintiffs are defrauded because they are forced to act through the market. Your view requires that in addition plaintiffs specifically depend on the integrity of the market, that is, that the market is fair.”) Whether he was aware of it or not, Brennan was channeling Easterbrook and Fischel in these comments.
\item \textsuperscript{60} My point here goes solely to the effort to describe the presumption in reliance terms. To me, Basic would make a great deal of sense in terms of conferring an entitlement to rely on the integrity of the market, which I think was what Brennan (and Easterbrook and Fischel) were reaching for. For an elaboration of the economic justification for protecting reliance of this sort, see Zohar Goshen & Gideon Parchomovsky, \textit{The Essential Role of Securities Regulation}, 55 Duke L.J. 711, 771-80 (2006). Brennan does use the term “price reliance”, but it is clear from the analysis in his letters that what he really meant was “price dependency,” since traders in an organized market have no choice but to accept the prevailing market price.
\item \textsuperscript{61} See Cox, supra; see also Richard A. Booth, \textit{Index Funds and Securities Fraud Litigation} (Jan. 2012), available at http://papers.ssrn.com=1996587.
\item \textsuperscript{62} For cases including index investors within the presumption of reliance, see, e.g., In re Lehman Bros. Sec. Litig., 2013 WL 440622 (S.D.N.Y. 2013).
\end{itemize}
passivity, assuming that the market is doing the best possible job of valuation in light of the entitlement. This might include index funds even if their actual decisions are information-less, though this is still not entirely clear.\footnote{Index investing relies more heavily on portfolio diversification than any strong assumption of market efficiency to deal with issuer-specific risk.} Another is through active investing, either through actual reliance on the misinformation in question or an investment strategy that seeks to beat the market but nonetheless utilizes the prevailing market price as an informational component of the investment decision. In other words, the presumption is properly given to any active or passive purchaser or seller during the class period to whom the integrity of the stock price could be relevant, i.e., who would not necessarily have made the same investment decision had the truth been revealed. That is essentially the approach used recently to justify a disqualification of a plaintiff from taking advantage of \textit{Basic}'s presumption of reliance where the purchaser was a sophisticated active investor with a valuation model that incorporated a set of factors entirely separate from what the issuer was concealing from the market.\footnote{See Gamco Investors v. Vivendi S.A., 2013 WL 765122 (S.D.N.Y. 2013).} The court suggested that this was an extremely rare holding, in no way suggesting that active traders are normally disqualified from the presumption of reliance.

That is all background now, given \textit{Halliburton II}'s endorsement of \textit{Basic}'s presumption. The Chief Justice gets caught up in much the same muddle as did Justice Blackmun twenty six years earlier—the inability to articulate exactly what the uninformed investor is reasonably relying upon in a way that does not simply revert to pure causation (and hence the system of “investor insurance” that everyone seems to want to avoid). This is the focus of Justice Thomas’ dissenting concurrence, and there is some force to his critique.

The most enlightening conceptual contribution made by the majority opinion in \textit{Halliburton II} is on market efficiency. Certiorari was granted largely in response to the question Justice Alito posed in \textit{Amgen}: do developments in our contemporary understanding of stock market
efficiency—particularly skepticism about how efficient they really are—call into question Basic’s fundamental assumptions? The Chief Justice says no, or at least not enough to overcome the stare decisis presumption. He does so by stressing that the efficiency question is not meant to be particularly rigorous—“generalized” efficiency is sufficient, not some idealized vision of hyper-efficiency. On this, he is clearly right.65

I have explored the reasons for this in depth elsewhere,66 too, and so will be relatively brief. The contemporary understanding of financial markets makes clear that perfect efficiency is just an ideal; all markets fall short, some more than others.67 Informational efficiency (i.e., how quickly information is impounded in price so that subsequent price moves return to random) varies based on how widely followed the issuer is as well as the nature of the information. Obscure information is impounded more slowly than salient information, even for blue-chip issuers. And sentiment-based investors (noise traders) can sometimes move prices away from fundamental value for sustained periods of time, producing both underreaction and overreaction to both news and pseudo-news before the forces of efficiency cause a correction.68

None of this, however, undermines a presumption of reliance that is based either on the relative wisdom of passivity or an entitlement to assume stock price integrity. Finance experts have hardly backed off the suggestion that index investing and other passive strategies are wise for most investors, even if the face of market imperfections.69 Index strategies remain popular,

65 Indeed, one might reasonably jettison the entire efficiency inquiry. See Bebchuk & Ferrell, supra. This the Court does not do, though perhaps it comes close.
66 See sources cited in note – supra. Ironically, my work was cited extensively by Justice Thomas for the opposite conclusion.
69 See Malkiel, supra.
and profits from active trading strategies as elusive as ever.\textsuperscript{70} Stock price integrity is a worthy policy goal even in the face of (inevitably) imperfect efficiency. The key question in assessing the presumption of reliance is whether the market segment in which the securities are traded is such that it has \textit{sufficient} efficiency properties to make us reasonably confident that misinformation is likely to distort the stock price.\textsuperscript{71} \textit{Most all well-organized markets meet this condition.} Efficiency, in other words, should just be a proxy for those markets in which passive investing is reasonable.

In recent years, Unfortunately, defendants have had a fair amount of success in persuading courts that the efficiency inquiry should be much more demanding than this. Perhaps the best known case along these lines is \textit{In re PolyMedica Securities Litigation},\textsuperscript{72} a First Circuit decision that seems to insist on proof of immediate price reaction to all material information in order to justify a finding of sufficient efficiency. Building on this, particularly after \textit{Amgen}, the defense-side was continuing the class certification battle as to price distortion by using the apparent absence of evidence of distortion as proof that for the issuer in question, its market must thus not be efficient—raising something that clearly is a certification issue.\textsuperscript{73} (The Chief Justice recognizes this strategy in \textit{Halliburton II} when he says that price distortion is usually before the court in class certification anyway\textsuperscript{74}).

Hopefully, \textit{Halliburton II} will take much of the steam out of this effort by its emphasis on “general” market efficiency rather than hyper-

\textsuperscript{70} See Gilson & Kraakman, supra.
\textsuperscript{71} See Langevoort, Basic at Twenty, supra, at 161-62; Macey et al., supra, at 1021 (“The legal system should not withhold redress from an injured plaintiff simply because he owns the security of a corporation traded in a market considered by some court to be ‘inefficient’”); Bradford Cornell & James C. Rutten, Market Efficiency, Crashes and Securities Litigation, 81 Tul. L. Rev. 443, 456 (2006)(efficiency inquiry with respect to the presumption of reliance should be a relative one, and not overly demanding); Fischel, supra (discussing efficiency implications of market volatility for Basic’s presumption).
\textsuperscript{72} 432 F.3d 1 (1st Cir. 2005).
\textsuperscript{73} See Langevoort, Basic at Twenty, supra, at 168-77; more recently, see Meyer v. Greene, 710 F.3d 1189 (11th Cir. 2013) and sources cited in note -- supra.
\textsuperscript{74} There is some irony here because if the efficiency inquiry should be less demanding, as the opinion suggests, we should see less of an effort to prove non-efficiency.
efficiency. PolyMedica justified its more demanding standard by saying that Basic was ambiguous on the subject, explicitly disregarding a footnote in Basic that seemed to say that the inquiry should not be overly demanding.\textsuperscript{75} Halliburton II, on the other hand, quotes and highlights that very same footnote. There is a consensus in Halliburton II to reject any “binary” vision of market efficiency (i.e., that markets are either efficient or not, as opposed to a continuum of relative efficiency). That is all well and good. But this strongly cautions against putting too much emphasis on the efficiency determination for class certification, because the judge must inevitably answer the question of sufficient efficiency as yes or no. The factors that courts have used previously (the so-called Cammer factors) create an illusion that there is a scientific way of answering that question, when there really is not.\textsuperscript{76} The risk here is that the courts will defer too much to the econometricians.

From here on out, all that should be necessary to establish efficiency is a showing that the company’s stock price generally responds to new information within a reasonable period of time—even if not immediately or fully. That should not be all that hard. In the course of this inquiry, it is important to avoid allowing defendants to cherry-pick instances of no price reaction. There can be many reasons for no-reaction or under-reaction in generally efficient markets, including that the market had figured out the essential truth on its own without waiting for corrective disclosure from the issuer, or that the significance of the information was hard to glean from the particular disclosure in question. Both common sense and economic theory suggest that it will be the rare well-organized market that is not generally efficient.

IV. PRICE DISTORTION: DIGGING MORE DEEPLY

\textsuperscript{75} 432 F.3d at 10-12.
\textsuperscript{76} See Langevoort, Basic, supra at 169-73; see also Bebchuk & Ferrell, supra.
The fraud-on-the-market theory was devised to create a form of corrective justice—compensating investors for real losses. It might also have beneficial effects in terms of deterring fraud, but that has always been secondary. Justice Blackmun’s stubborn insistence that the reliance requirement be preserved by making the presumption rebuttable underscores this, and neither Amgen nor Halliburton II lets go of that obsession.

Much contemporary legal scholarship has been critical of fraud-on-the-market as a compensatory device, however. The arguments are by now familiar enough that we can summarize here, too. First, fraud produces windfall gains for many investors along with losses—indeed, putting aside insider trading in its various forms, the marketplace losses and gains are roughly equal. Active traders are as likely to be winners as losers. Compensating for the losses while ignoring the gains, even for the same investor, leads to systematic overcompensation over time. Second, because payments in judgment or settlement come from either a liability insurance policy or the company itself, investors themselves are funding these payouts, directly or indirectly—the so-called “circularity” argument. (We have known for some time that payouts by individual wrongdoers, i.e., senior company managers, are extremely uncommon). Together, these points argue that the fraud-on-the-market system is a very costly, and

77 See Goldberg & Zipursky, supra.
80 See Michael Klausner et al., How Protective is D&O Insurance in Securities Class Actions—An Update, 26 PLUS J., no. 5 (May 2013).
somewhat unnecessary, pocket-shifting mechanism that resembles an investor insurance policy.

While this argument has substantial traction, the main counterpoint is that the injuries are real when investors trade at distorted prices, and simply can’t be assumed away by hoping that the victims will make up their losses elsewhere.81 Fraud causes injury to everyone who trades at a distorted price without regard to whether there was psychologically meaningful reliance—essentially the idea that Justice Brennan was pushing on Justice Blackmun. One can then add on the deterrence argument: price distortion is a social harm with many serious externalities,82 and has to be policed. The fraud-on-the-market class action is put forth by its proponents as practically necessary, if not conceptually clean, for achieving both of these objectives.83 I tend to agree, though not as enthusiastically as some others.

In this debate, two less familiar points are worth making about price distortion. In theory, all plaintiffs should ever recover is the amount of the price distortion at the time of the fraud (the conventional out-of-pocket measure), so long as the truth was revealed before the plaintiff unwound its position. But for a variety of reasons, litigants and courts long ago shifted focus to corrective disclosure as the key to damages,84 rather than price distortion per se. Dura solidified this by stressing loss causation, making

81 See Thomas A. Dubbs, A Scotch Verdict on “Circularity” and Other Issues, 2009 Wis. L. Rev. 455; see also Goldberg & Zipursky, supra; Fisch, Confronting Circularity, supra; Cox & Thomas, supra.
84 The key step here came when courts abandoned a strict out-of-pocket measure in favor of a modified one that used the corrective disclosure date as a baseline for computing damages, thereby making it closer to a rescission remedy. E.g., Harris v. American Inv. Co., 523 F.2d 220, 226 (8th Cir. 1975), cert. denied, 423 U.S. 1054 (1976).
corrective disclosure even more central to the assessment of plaintiffs’ injuries. As we have seen, this has made a mess of loss causation and damage measurements, and inspired the procedural moves designed to weed out the speculative cases (and most cases are at least somewhat speculative) early on.

Ironically, in the Blackmun-Brennan correspondence while Basic was being written, Blackmun says that while he wants to avoid any discussion of damages in the opinion, he agrees that the strict out-of-pocket measure (which Brennan sees as the necessary corollary to his “price reliance” approach\(^{85}\)) makes more sense than a rescissionary one that would give the full merger value to the former Basic shareholders. Had that impression made its way into the Basic opinion, the history of loss causation and the emphasis on corrective disclosure under Rule 10b-5 might have taken a completely different turn. Only price distortion would have been important.

Halliburton II now makes proof of price impact (or its absence) as a key step in the litigation process, early on and before a judge. But what is this inquiry, really? My sense from the oral argument is that the justices seemed to think—and counsel did little to discourage it—that event studies are a clean and simple way to answer the narrow and specific distortion question. Sadly, that is far from so. We have already seen the challenge when the effect of the alleged lie is to lull investors into thinking that nothing has changed about the company’s fundamentals, when change is indeed occurring. We will see how courts approach this and other conceptual challenges, hopefully remembering that the burden is clearly on the defendants and that the task is simply to estimate whether there was

\(^{85}\) Letter of January 25, 1988, from Blackmun to Brennan, at 2 (“I had not thought the opinion supported an argument for receiving the merger price . . . an argument we both agree is largely implausible, but because it has not been briefed or discussed, we should not presume to reject it out of hand here”) (on file with author). See also Letter of January 27, 1988, from Brennan to Blackmun (“if [there is no rebuttal and] the measure of damages is ultimately resolved as the difference between the price actually received and the price that would have been received had the market been fair, my view and your view will lead to identical results, although by somewhat different routes”).
price impact or not, not to quantify the extent of the distortion (which is usually a much harder task). Event studies may help, but there is no reason in the class certification inquiry to limit evidence to those, especially in “confirmatory lie” cases. Courts should be open to all probative evidence on that question—qualitative as well as quantitative—aided by a good dose of common sense.\textsuperscript{86} If the facts at issue appear to be material, one can fairly presume that their misrepresentation or omission would necessarily distort the market price unless the market somehow already knew the truth.\textsuperscript{87} The latter is entirely possible under the right circumstances, but defendants’ burden to show.

No doubt defendants will push against this, trying to fit into the evidentiary hearing on impact nearly the entirety of their merits defenses. After all, price distortion is the difference between the price that prevailed and the price had there been no fraud (i.e., had the truth been told). So is it open to defendants at class certification to argue that the company told what it believed to be the truth, so that therefore there was no price distortion?\textsuperscript{88} That, of course, is the heart of the merits, and something no econometrician could possibly address. There is no indication that the Court contemplates this, but given the centrality of price distortion, defendants will presumably seek as capacious a scope to it as possible.

\textsuperscript{86} For a description of the modern quantitative toolkit, which is by no means limited to event studies, see Bebchuk & Ferrell, supra. See also Esther Bruegger & Frederick Dunbar, \textit{Estimating Financial Fraud Damages with Response Coefficients}, 35 J. Corp. L. 11 (2009).

\textsuperscript{87} This would resemble the separate presumption created to address reliance in Affiliated Ute Citizens v. U.S., 406 U.S. 128 (1972).

\textsuperscript{88} Imagine, for example, that plaintiffs allege two confirmatory lies that prevented the market from reflecting the truth about the issuer’s prospects. Defendants’ merits defense is that at the time those disclosures were made, there was no corporate scienter (i.e., the disclosures, even if inaccurate, were made in good faith). A stock price drop occurs later on, but defendants claim that this was a result of a prompt revelation of the truth when company officials learned it. Perhaps that is what Justice Ginsburg was getting at in her concurring opinion, which raised the possibility of the need for limited discovery in sorting through all the relevant price impact issues at class certification.
Indeed, this may well expose an underappreciated counterfactual difficulty about the nature of securities fraud in the first place. Securities regulation imposes only a limited duty on issuers and their managers to reveal the truth—much can lawfully be concealed if the issuer prefers, especially with respect to forward-looking information. That is a central point made in Basic. However, if the issuer chooses to comment on a matter, it must do so truthfully. Hence there is a large category of cases where it is ambiguous what is meant by comparing the price that prevailed at the time of the fraud with the price that would have prevailed in the absence of the fraud. Is it the world where there simply was no lie or half-truth (but in which the issuer could have kept quiet about the truth) or are we assuming a (legally non-existent) duty to reveal everything? This is a very tricky inquiry, but note that investors deserve little or no recovery for reliance on price integrity when the former is the right way of posing the question.

Imagine, for example, a company that falsely states that things are going smoothly for its flagship product when they really are not. If the market price was $20 per share at the time, such an announcement would have little effect on the price to the extent that the information just confirms prior market expectations. Had the truth been told, assume that the price would have dropped to $15. Should post-fraud purchasers receive $5 per share? Only if we are confident that the right counterfactual is revelation of the truth. If the more plausible counterfactual is instead that the issuer chose (lawfully) to stay silent, those purchasers would presumably have paid $20 for the stock even absent the fraud, and thus suffered no real economic harm. In other words, the assumption that there are causal losses to purchasers or sellers whenever there are material lies or omissions is not necessarily true. Whenever the issuer had no legal duty to reveal the truth, harm follows only when the effect of the lie or half-truth was to prevent

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discovery of the truth. As tricky and important as this inquiry is,\textsuperscript{90} it is ignored entirely by contemporary doctrine, which simply assumes the truth-telling counterfactual by focusing solely on the market effects associated with discovering the truth later on. In sum, we cannot say as confidently as we do that fraud necessarily means investor injury in a setting that presumes reliance on “price integrity.”\textsuperscript{91}

V. Conclusion

In his dissent in the \textit{Amgen} case, which very much foreshadowed his dissenting concurrence in \textit{Halliburton II}, Justice Thomas traced the history of the fraud-on-the-market prior to \textit{Basic} by reference to two “signposts,”\textsuperscript{92} one of which was the seminal Ninth Circuit case of \textit{Blackie v. Barrack} in 1975.\textsuperscript{93} That was a fruitless effort in terms of reading \textit{Blackie} to say that materiality was crucial to class certification—it holds no such thing—but also ironic. \textit{Blackie} justified the fraud-on-the-market presumption entirely in pragmatic terms. While it expresses an intuition about organized markets and the importance of price integrity, the main idea is simple: without class certification there will be no practicable mechanism to address demonstrable harm from securities fraud. Candidly admitting that its approach risked over-inclusion in the plaintiff class, the court reminded its readers that the securities statutes were to “be liberally construed to effectuate its remedial purposes, and that that purpose may be served only by allowing an over-inclusive recovery to a defrauded class if the

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\textsuperscript{90} It is of course hard to think through whether the company would have been able to stay silent on a matter in the face of shareholder, analyst and financial press scrutiny. Typically, the half-truth is designed to throw these groups off their guard.

\textsuperscript{91} This, of course, is in addition to any doubts that we may have based on the possibility of sentiment-driven overreactions to disclosures. See Langevoort, \textit{Animal Spirits}, supra; Cornell & Rutten, supra, at 463-68.

\textsuperscript{92} 133 S.Ct. at 1213-14.

\textsuperscript{93} 524 F.2d 891 (9th Cir. 1975).
unavailability of the class device renders the alternative a grossly under-inclusive recovery.” 94

Basic starts out saying much the same thing, stressing that presumptions exist mainly to do justice, but then wanders into the efficient markets discussion as if it offers a better way of understanding reliance in modern financial markets. It doesn’t, generating the uncertainty about class certification that eventually led to Amgen and Halliburton I and II. Blackie’s argument was always the better one, and the fraud-on-the-market theory would have been on more solid ground (if no less controversial) had that reasoning prevailed.

Today the Supreme Court is no long enamored with the “liberally construed” rhetoric, 95 which naturally invites those dissatisfied with how things have turned out to question the premises on which the fraud-on-the-market presumption rests. Still, as a result of Halliburton II, Basic lives on. To the Chief Justice and his majority, fundamental changes to the availability of class action relief for alleged securities fraud should be legislative (and hence political), not judicially-wrought. By situating the issue as one of stare decisis—and thus triggering something of a light-touch rational basis review of Basic—the Court’s opinion will hardly satisfy those who, like the dissenters, who find Basic’s reasoning contrived and its failure to take on the hard policy issues underlying securities class actions frustrating.

Along with others, 96 my work was cited repeatedly in Justice Thomas’ concurring dissent in Halliburton II, and I concede that I still find the reliance narrative in both Basic and Halliburton II puzzling and not particularly persuasive, for many of the reasons Thomas points out. Yet I think Thomas’ ultimate conclusion is wrong, and that keeping Basic in place was the right thing to do, both legally and conceptually. My view is

94 Id. at 906 n.22.
96 Particularly work by Jim Cox and Lynn Stout.
ultimately much closer to Justice Brennan’s, who worked hard behind the scenes many years ago to articulate an approach to fraud-on-the-market that had little or nothing to do with reliance (for more conservative readers, substitute Easterbrook and Fischel). We would have been better off had he succeeded. As Brennan, Easterbrook and Fischel saw, however, that expansive approach to who can recover needs to be balanced with caution about the total size of the recovery, to avoid the bias toward over-compensation that characterizes the current doctrinal framework. All of this has long suggested—to me and many others—that Congress should revisit the entire remedial approach in the fraud-on-the-market setting, enabling private litigation but making it more clearly a deterrence-based mechanism. Whether Congress is inclined toward a sensible, balanced approach to the serious problem of securities fraud is in doubt, however.

In the meantime, we will have to wait and see how lower courts react to the many possible implications of Amgen and Halliburton II. While it need not (and probably should not) be, the price distortion inquiry may well turn to be another thicket where polarized views about the desirability of fraud-on-the-market continue to affect outcomes. The game of whack-a-mole plays on.

97 See Donald C. Langevoort, *Capping Damages for Open Market Securities Fraud*, 38 Ariz. L. Rev. 639 (1996); Donald C. Langevoort, *Reading Stoneridge Carefully: A Duty Based Approach to Reliance and Third Party Liability Under Rule 10b-5*, 158 U. Pa. L. Rev. 2125 (2010); see also Janet Cooper Alexander, *Rethinking Damages in Securities Class Actions*, 48 Stan. L. Rev. 501 (1996). There are many possible approaches, from damage caps or disgorgement measures to what is effectively a *qui tam* procedure. As suggested earlier, much judicial misunderstanding could have been avoided had *Basic* endorsed a strict price distortion approach to damages, as both Justices Blackmun and Brennan seemed to want. But unwinding the post-*Dura* loss causation to get to that simple approach would, at this point, be very hard.