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MARKET EFFICIENCY AND FRAUD ON THE MARKET: THE DANGER OF *HALLIBURTON*

by
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The Supreme Court recently handed down its opinion in Halliburton v. Erica P. John Fund. *The case marked the first time since* Basic v. Levinson, *a quarter century ago, that the Court was directly asked to consider the viability of the fraud-on-the-market doctrine, the doctrine that has made the modern securities-fraud class action possible. The majority of the Court ultimately declined to reconsider* Basic, *and instead issued a narrow ruling rendering an already convoluted area of the law even more muddled. More troublingly, the dissenters—while willing to confront* Basic *head-on—did so primarily by questioning the economic theory underlying the fraud-on-the-market doctrine. I argue that—contrary to the arguments of the parties and of the dissenting Justices—the doctrine does not depend on the efficient-capital-markets hypothesis. It is possible to accept market efficiency and reject the fraud-on-the-market doctrine, or to reject market efficiency and accept the fraud-on-the-market doctrine. It is not only unnecessary, but also unwise for the Justices to wade into the debate over market efficiency. While market efficiency is of little relevance to the debate over the fraud-on-the-market doctrine, it is central to other contemporary legal debates of far more fundamental importance than the fraud-on-the-market doctrine. The dissenters' pronouncements on market efficiency are certain to resurface in these debates in ways the authors do not intend.*

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INTRODUCTION

In the 2014 Spring Term, the Supreme Court heard oral arguments in *Halliburton v. Erica P. John Fund*,[1] which squarely presented the question of "[w]hether the [Supreme] Court should overrule or substantially modify the holding of *Basic Inc. v. Levinson*."[2] The landmark *Basic* case[3] and the so-called "fraud on the market" (FOTM) doctrine it embraced—allowing plaintiffs in Rule 10b-5[4] securities fraud claims a presumption of reliance in class action cases involving transactions in open and devel-

[1] Halliburton Co. v. Erica P. John Fund, Inc., 134 S. Ct. 636 (2013).
[2] *See* Brief for Petitioners at i, Halliburton Co. v. Erica P. John Fund, Inc., 134 S. Ct. 2398 (2014) (No. 13-317).
[3] Basic Inc. v. Levinson, 485 U.S. 224 (1988).
[4] 17 C.F.R. § 240.10b-5 (2014).

oped securities markets[5]—have been essential to the blossoming of what is now a multi-billion dollar securities class-action industry.[6] Any serious revision of *Basic* would have represented a seismic shift, the shockwaves of which would have been felt throughout securities law.

Unfortunately, despite an increasing academic consensus that *Basic* represented a wrong turn for securities law,[7] no such shock would come. Instead, the majority opinion, authored by Chief Justice Roberts, found that Halliburton had shown no "special justification" for overturning what is by now a long-standing precedent.[8] Instead of wiping out the fraud-on-the-market doctrine altogether, Roberts sought to chart a middle course, allowing defendants the opportunity to rebut the presumption of reliance at the class-certification stage by showing that the alleged misrepresentations had no impact on the market price.[9] In addition to doing little to reduce the incidence of meritless litigation, the opinion renders an already confused area of the law even more convoluted, conflicting with recent precedent in ways the majority barely even attempts to justify.[10]

The majority opinion, while muddled, at least has the virtue of narrow application. More problematic—and the focus of this Article—is the concurrence,[11] which calls for overthrowing *Basic* altogether.[12] The call

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[5] As will be discussed *infra*, the basic intuition underlying the FOTM doctrine is that the "market" itself can fall victim to a misrepresentation, distorting the market price of a security. An individual investor may never hear of the misrepresentation but still be injured by trading in reliance on the integrity of the market price. Thus, the fraud itself is "on the market," and actual investors are injured by trading in reliance on the fraudulently distorted market.

[6] *See generally* Stephen J. Choi, *Do the Merits Matter* Less *After the Private Securities Litigation Reform Act?*, 23 J.L. ECON. & ORG. 598 (2007) [hereinafter Choi, *Do the Merits Matter*]; Stephen J. Choi, *The Evidence on Securities Class Actions*, 57 VAND. L. REV. 1465 (2004) [hereinafter Choi, *The Evidence*].

[7] *See* William W. Bratton & Michael L. Wachter, *The Political Economy of Fraud on the Market*, 160 U. PA. L. REV. 69, 72 (2011) ("The fraud-on-the-market (FOTM) cause of action just doesn't work. At least that is the consensus view among academics respecting the primary class action vehicle under the federal securities laws." (footnote omitted)). The scholarly debate over the merits and value of securities fraud actions stretches back decades. *See infra* Part II.A. Criticisms of such suits, portraying them as frivolous litigation enriching only unscrupulous plaintiffs' attorneys, has been a staple of political discourse—particularly among Republicans and Republican-leaning groups—and helped lead to the passage of the Private Securities Litigation Reform Act (PSLRA) in the 1990s. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C.); *see also* Arthur R. Miller, *The Pretrial Rush to Judgment: Are the "Litigation Explosion," "Liability Crisis," and Efficiency Clichés Eroding Our Day in Court and Jury Trial Commitments?*, 78 N.Y.U. L. REV. 982, 996–1001 (2003).

[8] Halliburton Co. v. Erica P. John Fund, Inc., 134 S. Ct. 2398, 2408 (2014).

[9] *Id.* at 2414–17.

[10] *See infra* Part III.B.2.

[11] *Halliburton*, 134 S. Ct. at 2417–18 (Thomas, J., concurring).

[12] *Id.* Though formally a concurrence, Justice Thomas's opinion has more of the character of a dissent.

for overturning *Basic* was not a surprise, given that the three concurring Justices—Thomas, Scalia, and Alito—had expressed a willingness to do so in the 2013 case *Amgen v. Connecticut Retirement Plans & Trust Funds*.[13] Also unsurprising was the form the Justices' skepticism of *Basic* took. As Justice Alito had in his concurrence in *Amgen*,[14] the concurrence in *Halliburton* argues that the economic theory supposedly underlying the FOTM doctrine—the Efficient-Capital-Markets Hypotheses (ECMH)—has "lost its luster."[15] And, indeed, the viability of the ECMH is one of the hottest issues in economics, with both the foremost defender of the theory, Eugene Fama, and the foremost critic, Robert Shiller, sharing the 2013 Nobel Prize in Economics.[16] The notion that the FOTM doctrine depends on the ECMH, and that the ECMH is controversial in ways that undermine the FOTM doctrine, has been repeated so often as to become cant.[17] It is, however, false.

The wisdom of the FOTM doctrine does not depend, fundamentally, on the resolution of the longstanding academic debates over the ECMH.[18] One may accept the ECMH and still reject the FOTM doctrine as misguided, or one may reject the ECMH and still embrace the FOTM doctrine. For so many judges to claim otherwise—including Supreme Court justices—is disheartening.

It is also deeply troubling. While the FOTM doctrine does not depend on the ECMH for its viability, a substantial number of important corporate- and securities-law doctrines do. These doctrines range from the relatively minor (i.e., insider trading rules for ERISA fiduciaries), to the major (i.e., the SEC's integrated disclosure system), to the fundamental (i.e., the federal structure of U.S. corporate law). Indeed, at the end of the day, the ECMH provides ultimate support for the default assumption in a market economy: that resources are most efficiently allocated by

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[13] *See* 133 S. Ct. 1184; *id.* at 1204 (2013) (Alito, J., concurring) ("[M]ore recent evidence suggests that the [FOTM] presumption may rest on a faulty economic premise. In light of this development, reconsideration of the *Basic* presumption may be appropriate." (citations omitted)); *id.* at 1206 (Scalia, J., dissenting) ("Today's holding does not merely accept what some consider the regrettable consequences of the four-Justice opinion in *Basic*; it expands those consequences from the arguably regrettable to the unquestionably disastrous."). In *Amgen*, Justices Thomas, Scalia, and Alito were joined by Justice Kennedy. *Id.* at 1208 n.4 (Thomas, J., dissenting) ("The *Basic* decision itself is questionable.").

[14] *See id.* at 1204 (Alito, J., concurring) (claiming that "recent evidence suggests that the [FOTM] presumption may rest on a faulty economic premise").

[15] *Halliburton*, 134 S. Ct. at 2420–21 (Thomas, J., concurring).

[16] Binyamin Applebaum, *Economists Clash on Theory, but Will Still Share the Nobel*, N.Y. TIMES, Oct. 14, 2013, at A1.

[17] *See infra* Part IV.A–B.

[18] *See* Lucian A. Bebchuk & Allen Ferrell, *Rethinking* Basic, 69 BUS. LAW. 671, 673 (2014) ("In short, the Supreme Court does not have to determine whether it finds the view associated with Eugence Fama or the view associated with Robert Shiller (both recipients of the 2013 Nobel Prize in economics for their work on the subject) more persuasive."); *infra* Part IV.C.

markets. Opponents of this assumption will undoubtedly be delighted by the opportunity to quote Thomas, Scalia, and Alito for the proposition that prices set by markets cannot be relied upon. It is supremely ironic that a group of justices normally thought of as the "conservative wing" of the Court have—in their haste to grab any stick with which to beat *Basic*—handed a heavy rhetorical bludgeon to proponents of regulatory intervention in markets.

The FOTM doctrine, as currently applied, should be overruled. The lower courts' use of "market efficiency" as the primary gatekeeper to class certification is woefully misguided, often functioning to block potentially meritorious claims while posing no obstacle to frivolous litigation.[19] Yet one need not, and should not, reject the ECMH in order to reform or reject the FOTM doctrine. Powerful legal and policy arguments exist for reaching virtually any result the justices could have desired in *Halliburton* without evaluating the ECMH at all.[20] *Basic* could be remade, or jettisoned altogether, without dragging the ECMH down with it. If the FOTM doctrine is to be rejected, it should be because it is not sound as a matter of law or public policy—not because American capital markets are too inefficient to support it.

This Article is structured as follows. Part I introduces *Basic* and the FOTM doctrine, and the role the ECMH has been thought to play in the decision. Part II explains the evolution of the securities-fraud class action following *Basic*, and discusses the criticisms of this evolution. Part III explains the Court's recent decisions in *Halliburton* and *Amgen*. Part IV explains why it is unnecessary to rebuke the ECMH to revise or overturn *Basic*. Part V argues that a judicial rebuke of the ECMH is, in fact, dangerous. Part VI evaluates the primary policy alternatives to current doctrine, as embodied in the majority position in *Halliburton*. Parts IV, V, and VI form the analytic core of this Article.

I. *BASIC V. LEVINSON* AND THE FRAUD-ON-THE-MARKET DOCTRINE

This Part traces the development of the modern securities-fraud class action and the FOTM presumption. It then introduces the Supreme Court's holding in *Basic*, and explains how the ECMH first became intertwined with the FOTM doctrine.

A. *Origins of the Securities-Fraud Class Action*

In an effort to bolster investor confidence following the market crash of 1929, Congress passed the Securities Act of 1933 (1933 Act),[21] creating

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[19] *See infra* notes 115–17and accompanying text.

[20] *See infra* Part IV.

[21] Securities Act of 1933 (1933 Act), Pub. L. No. 73-22, 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a–77aa (2012)).

an elaborate system of registration and disclosure of information to investors.[22] The next year, Congress passed the Securities Exchange Act of 1934 (1934 Act),[23] which largely addressed the problem of stock market manipulation and fraud.[24] Section 10(b) of the 1934 Act[25] serves as a catchall provision making it "unlawful for any person . . . [t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance" in violation of rules promulgated by the SEC.[26] The SEC duly promulgated Rule 10b-5,[27] which lumps together into a brief, all-encompassing rule prohibitions on market manipulation and on material misrepresentations or omissions, categorizing them all as species of "fraud" or "deceit."[28]

Unsurprisingly, this parsimonious statutory and regulatory framework, covering a vast array of potential activities, has yielded an almost common-law style interpretive approach by courts.[29] Most fatefully, although neither Rule 10b-5 nor the underlying statutes create an express private cause of action, courts have recognized an implied cause of action since the mid-1940s.[30] Because they are dealing with an implied cause of

[22] *See id.* §§ 6–10; *see also* John C. Coffee, Jr. & Hillary A. Sale, Securities Regulation: Cases and Materials 93 (11th ed. 2009).

[23] Securities Exchange Act of 1934 (1934 Act), Pub. L. No. 73-291, 48 Stat. 881 (codified as amended at 15 U.S.C. §§ 78a–78oo).

[24] Section 2 of the 1934 Act declares that "[n]ational emergencies, . . . which burden interstate commerce and adversely affect the general welfare, are precipitated, intensified, and prolonged by manipulation and sudden and unreasonable fluctuations of security prices." *Id.* § 2 (codified at 15 U.S.C. § 78b(4)). For a detailed discussion of the legislative history of the 1934 Act, see generally Steve Thel, *The Original Conception of Section 10(b) of the Securities Exchange Act*, 42 Stan. L. Rev. 385 (1990).

[25] 15 U.S.C. § 78j.

[26] *Id.*

[27] 17 C.F.R. § 240.10b-5 (2014).

[28] Rule 10b-5 reads, in its entirety: "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) [t]o employ any device, scheme, or artifice to defraud, (b) [t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) [t]o engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." *Id.*

[29] *See* Louis Loss, Commentary, *The Assault on Securities Act Section 12(2)*, 105 Harv. L. Rev. 908, 910–11 (1992) (suggesting that, because courts have essentially created a new federal tort from Rule 10b-5, "one should not be shocked to see them invoking *Erie*-resistant federal common law in order to invent appropriate qualifications of the new tort"); *see also* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 737 (1975) ("When we deal with private actions under Rule 10b-5, we deal with a judicial oak which has grown from little more than a legislative acorn.").

[30] The first court to recognize a private cause of action under 10b-5 was apparently the Eastern District of Pennsylvania. Kardon v. Nat'l Gypsum Co., 69 F. Supp. 512, 514 (E.D. Pa. 1946) ("[T]he mere omission of an express provision for

action, and lack any controlling statutory guidance, courts have invoked common law tort principles to define the contours of the resulting actions.[31] The elements for 10b-5 securities fraud claims were derived by analogy to the common law tort of fraud.[32] As a result, in addition to the requirements of scienter and materiality, courts have also required showings of justifiable reliance,[33] economic loss, and loss causation.[34] The extent to which the courts have stumbled to this result can be gleaned from the fact that there are, including *Halliburton*, at least 29 Supreme Court

civil liability is not sufficient to negative what the general law implies."). Within five years, Louis Loss could say that the *Kardon* court's recognition of an implied cause of action "has . . . been followed in almost two score other cases" and "[n]o judge has expressed himself to the contrary." LOUIS LOSS, SECURITIES REGULATION 1049–50 (1951). The Supreme Court ultimately recognized an implied private cause of action without discussion in *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6, 13 n.9 (1971), and by 1983 described its existence as "beyond peradventure." Herman & MacLean v. Huddleston, 459 U.S. 375, 380 (1983); *see also* Basic Inc. v. Levinson, 485 U.S. 224, 230–31 (1988) ("Judicial interpretation and application, legislative acquiescence, and the passage of time have removed any doubt that a private cause of action exists for a violation of § 10(b) and Rule 10b-5, and constitutes an essential tool for enforcement of the 1934 Act's requirements.").

[31] *See* Loss, *supra* note 29, at 910 ("In the common law tradition, the courts have read into rule 10b-5 not only scienter, but also the additional elements of justifiable reliance and causation. It should come as no surprise . . . that the courts have added flesh to the bare bones of 10b-5.").

[32] *See* Jeffrey L. Oldham, Comment, *Taking "Efficient Markets" out of the Fraud-on-the-Market Doctrine After the Private Securities Litigation Reform Act*, 97 NW. U. L. REV. 995, 1003 (2003) ("Derived primarily from the common law of fraud, the basic elements of a Rule 10b-5 cause of action have become materiality, scienter, reliance, and loss causation." (footnotes omitted)).

[33] *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 206 (1976).

[34] Halliburton Co. v. Erica P. John Fund, Inc., 134 S. Ct. 2398, 2407 (2014) ("To recover damages for violations of section 10(b) and Rule 10b-5, a plaintiff must prove (1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation." (quoting Amgen Inc. v. Conn. Ret. Plans & Trust Funds, 133 S. Ct. 1184, 1192 (2013) (internal quotation marks omitted))); *see also* Matrixx Initiatives, Inc. v. Siracusano, 131 S. Ct. 1309, 1317 (2011). The term "loss causation" is a fraught one. In common-law deceit, the alleged harm to the plaintiff is usually manifest, and loss causation usually functions simply to ensure that the fraud was the proximate or "legal" cause of the harm. Dura Pharm., Inc. v. Broudo, 544 U.S. 336, 342 (2005). Thus, if the plaintiff were fraudulently induced to enter into a contract to paint a house, but was killed by bees on the way home from signing the contract, loss causation would not be established. Many early securities-law cases echoed this notion of proximate causation in defining loss causation. *See* RESTATEMENT (SECOND) OF TORTS § 548A (1977). More recently, courts have held the loss-causation requirement to mean more in the 10b-5 context—namely, that plaintiffs must demonstrate that the alleged misrepresentation or manipulation had a *market impact* that caused them harm. *See Dura Pharm.*, 544 U.S. at 342–43. This latter sense is the sense in which this Article uses the term.

opinions interpreting and defining the scope of private actions under section 10(b).[35]

Though traditionally treated as separate elements, reliance and loss causation are both generally considered relevant to the question of whether the defendant's fraud can be considered an actual "cause" of any injury to the plaintiff.[36] The requirement of actual, justifiable reliance is thus often referred to as "transaction causation,"[37] and asks whether the defendant's fraud caused the plaintiff to enter into the relevant transaction in the first place.[38] This question is distinct from the element of "loss causation," which, in a 10b-5 case, usually asks whether the defendant's conduct had a market impact that resulted in loss to the plaintiff.[39] In a common-law fraud case, satisfaction of the reliance element shows the causal connection between the fraud and the transaction, whereas satisfaction of the loss-causation element shows the causal connection between the transaction and the injury to the plaintiff. Together, the two elements link together to form a chain demonstrating the causal connection between the fraud and the injury to the plaintiff.[40]

Prior to the adoption of the FOTM doctrine, the reliance—that is, transaction causation—element in a typical 10b-5 claim required each plaintiff to show actual eyeball or eardrum reliance—that he or she actually saw or heard the allegedly fraudulent statement, and decided to buy

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[35] *See* Joseph A. Grundfest, *Damages and Reliance Under Section 10(b) of the Exchange Act* 15 (Stanford Law Sch. & Rock Ctr. for Corporate Governance, Working Paper Series No. 150, 2013) (collecting cases).

[36] *Halliburton Co. v. Erica P. John Fund, Inc.*, 131 S. Ct. 2179, 2184 (2011) ("[P]roof of reliance ensures that there is a proper 'connection between a defendant's misrepresentation and a plaintiff's injury.'" (quoting Basic Inc. v. Levinson, 485 U.S. 224, 243 (1988))).

[37] *Dura Pharm.*, 544 U.S. at 341; *Erica P. John Fund*, 131 S. Ct. at 2186.

[38] *See* PROSSER AND KEETON ON THE LAW OF TORTS § 105, at 728 (W. Page Keeton et al. eds., 1984).

[39] *Dura Pharm.*, 544 U.S. at 345; Robbins v. Koger Props., Inc. 116 F.3d 1441, 1447 (11th Cir. 1997); *see also* 9 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 4405–07 (3d ed. 1992).

[40] *See* List v. Fashion Park, Inc., 340 F.2d 457, 462 (2d Cir. 1965), *cert. denied sub nom.* List v. Lerner, 382 U.S. 811 (1965) ("The reason for [the reliance] requirement . . . is to certify that the conduct of the defendant actually caused the plaintiff's injury."). One might wonder why loss causation alone should not be enough. After all, a buyer is arguably "injured" when she receives a good that is of less value to her than she was led to believe, even if she would have still purchased it had she known the truth. Say, for example, a good is being sold for $5, and the buyer's subjective utility from buying the good is actually $6. Because of the seller's misrepresentation, however, the buyer believes the good's subjective utility to her is $10. Traditionally, when dealing with sales of real goods, the law refuses to recognize this $4 difference as a compensable harm to the plaintiff. After all, the thinking goes, the plaintiff still benefits from the transaction in that her utility from the real good she purchased was greater than the price she paid. As I will argue below, though, this reasoning is inapt when discussing purchases of securities. *See infra* notes 219–26 and accompanying text.

or sell the relevant security in reliance upon it.[41] At the same time, loss causation was a more generalized question of whether the plaintiff "would not have suffered a loss if the facts were what he believed them to be," usually because the stock would not have fallen in value had the fraudulent statements been true.[42]

B. *The Fraud-on-the-Market Doctrine*

While the impulse to borrow from the common law in this context is understandable, there are significant differences between shares trading on a national securities exchange and consumer goods purchased in face-to-face transactions. These differences mean that common-law doctrine does not always map cleanly onto securities-fraud actions. As a result, while the general outlines of securities-fraud actions are borrowed by analogy from the common law, courts have occasionally struggled to adapt the elements of securities fraud to cope with these differences.[43] Perhaps the most controversial of these "adaptations" has been the adoption of the FOTM doctrine—the doctrine at issue in *Halliburton*.

1. *Theoretical Underpinnings of the Fraud-on-the-Market Doctrine*

Prior to the adoption of the FOTM doctrine, the requirement of individual reliance made class certification in securities-fraud cases virtually impossible. This was for two reasons. First, many investors would not have actually read or heard the allegedly fraudulent statement—very few investors actually wade through corporate disclosures.[44] Second, the need to *show* that each individual investor read or heard the statement would cause individual issues to predominate, rendering class certification inappropriate.[45]

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[41] Prior to *Basic*, the Supreme Court had already created exceptions to the general rule of actual, justifiable reliance. Perhaps the most noteworthy exception is that plaintiffs need not demonstrate reliance in 10b-5 cases involving material omissions. Affiliated Ute Citizens v. United States, 406 U.S. 128, 153–54 (1972). In such cases, the notion of reliance is necessarily hypothetical, so the Court held that proof of materiality—that a reasonable investor would have considered the information withheld to be important to the investment decision—can also function to establish a presumption of reliance. *Id.*

[42] LHLC Corp. v. Cluett, Peabody & Co., 842 F.2d 928, 931 (7th Cir. 1988).

[43] *See* Loss, *supra* note 30, at 817 ("[T]he courts have repeatedly said that the fraud provisions in the SEC statutes are not limited to circumstances which would give rise to a common-law action for deceit."); Note, *The Reliance Requirement in Private Actions Under SEC Rule 10b-5*, 88 HARV. L. REV. 584, 585 (1975) ("[T]he courts have gone beyond the common law in defining the nature, scope, and requirements of the federal action under rule 10b-5.").

[44] *See* Amgen Inc. v. Conn. Ret. Plans & Trust Funds, 133 S. Ct. 1184, 1208 (2013) (Thomas, J., dissenting) ("[I]n a modern securities market many, if not most, individuals who purchase stock from third parties on an impersonal exchange will be unaware of statements made by the issuer of those securities.").

[45] *Id.* at 1209 ("*Basic*'s fraud-on-the-market presumption is highly significant because it makes securities-fraud class actions possible by converting the inherently

As early as the 1960s, near the high point of judicial romanticism about "private attorneys general,"[46] a treatise suggested that a requirement of actual eyeball or eardrum reliance was both impractical and theoretically unnecessary in cases of misrepresentations involving open-market transactions.[47] The treatise went on to argue that "a 10b-5 reliance requirement in open market transactions could be satisfied by showing that an investor who traded with reference to market price and conditions could be treated as indirectly relying on a misrepresentation which affected the market."[48]

This prescription came long before the ECMH began to infiltrate the legal academy. Early courts embracing the FOTM doctrine treated it as a straightforward story of indirect reliance: Some market participants hear and rely upon the misrepresentation. These participants' trading activity affects the price in a measurable way. The plaintiff then reasonably relies on the price set by the market.[49] This theory of indirect reliance suggests two potential approaches to the FOTM presumption.[50] First, courts could presume only that the plaintiff reasonably relied on the market price, and still require the plaintiff to demonstrate market impact—that "the market price was in fact artificially affected by false information"[51]—in order to connect reliance on the market to the underlying misrepresentation. Alternatively, courts could presume both reasonable reliance *and* market impact, as long as the plaintiff can establish that the alleged misrepresentation was "material."[52] As the first circuit court to recognize the

individual reliance inquiry into a question common to the class, which is necessary to satisfy the dictates of Rule 23(b)(3).").

[46] *See* J. I. Case Co. v. Borak, 377 U.S. 426, 430 (1964); James D. Cox et al., *SEC Enforcement Heuristics: An Empirical Inquiry*, 53 DUKE L.J. 737, 739 (2003) (describing the Warren Court's "flattering, if not romantic, vision of the plaintiff as a 'private attorney general' who provides the invaluable service of supplementing the SEC's own enforcement efforts"). *See generally* Jeremy A. Rabkin, *The Secret Life of the Private Attorney General*, 61 LAW & CONTEMP. PROBS. 179 (1998).

[47] *See* Oldham, *supra* note 32, at 1006–07.

[48] 5 ALAN R. BROMBERG ET AL., BROMBERG AND LOWENFELS ON SECURITIES FRAUD, § 7:468 (2014); *see also* Daniel R. Fischel, *Use of Modern Finance Theory in Securities Fraud Cases Involving Actively Traded Securities*, 38 BUS. LAW. 1, 9 (1982).

[49] Blackie v. Barrack, 524 F.2d 891, 907 (9th Cir. 1975) ("[An investor] relies generally on the supposition that the market price is validly set and that no unsuspected manipulation has artificially inflated the price, and thus indirectly on the truth of the representations underlying the stock price—whether he is aware of it or not, the price he pays reflects material misrepresentations.").

[50] A third approach—eliminating reliance as an element—is discussed in Part VI. *See infra* notes 306–07 and accompanying text.

[51] Fischel, *supra* note 48, at 13.

[52] Courts will consider information material "if there is a substantial likelihood that a reasonable shareholder would consider it important" in making the investment decision. TSC Indus. v. Northway, Inc., 426 U.S. 438, 449 (1976). The intuition underlying this second approach is that when there is "proof that the deception was material . . . [there] is persuasive circumstantial evidence that a sufficient number of traders in the market did indeed rely." Note, *supra* note 43, at 593. The logic is that if

FOTM theory explicitly, the Ninth Circuit adopted the second of these approaches.[53] In the years prior to *Basic*, other circuit courts followed suit.[54] Allegations of a "material" misrepresentation would suffice to forge both links in the chain of indirect reliance: (1) a fraudulent distortion in the market price due to some market participants' reliance on the material misrepresentation, and (2) the plaintiffs' reasonable reliance on this distorted market price.[55]

The FOTM doctrine, in pre-*Basic* judicial practice, plainly relied on the uncontroversial notion that stock prices reflect and respond to information in some fashion. Early decisions, however, rarely made mention of the ECMH and did not claim that the FOTM presumption would be appropriate only if markets were infallible.[56] The most influential attempt to link the FOTM doctrine to the ECMH came not from a court, but from an article by Professor Daniel Fischel in 1982.[57] Fischel described "[a]n efficient capital market [as] one in which the price of stock at a given time is the best estimate of what the price will be in the future."[58] In practice, when the current price of a stock is the best estimate

the plaintiffs can establish materiality—that a reasonable investor would have found the misrepresentation important—then it is safe to assume that the misrepresentation actually affected the market price. Thus, reliance on the market price can be presumed to be indirect reliance on the misrepresentation.

[53] *Blackie*, 524 F.2d at 906 (stating that "causation is adequately established in the impersonal stock exchange context by proof of purchase and of the materiality of [the alleged] misrepresentations," and that "[m]ateriality circumstantially establishes the reliance of some market traders"). The *Blackie* court also held that the FOTM presumption could be rebutted if the defendant showed *either* (1) that the particular plaintiff did not actually rely on the misrepresentation—no reliance; or (2) that an insufficient number of traders actually relied on it to cause a change in the stock price—no loss causation. *Id.* As we will see, the Supreme Court in *Amgen* made it clear that plaintiffs need not show either materiality or loss causation at the class-certification stage.

[54] *See, e.g.*, Peil v. Speiser, 806 F.2d 1154, 1161 (3d Cir. 1986); Panzirer v. Wolf, 663 F.2d 365, 367 (2d Cir. 1981).

[55] Most recently, in *Halliburton*, the majority described *Basic* as incorporating "two constituent presumptions: First, if a plaintiff shows that the defendant's misrepresentation was public and material and that the stock traded in a generally efficient market, he is entitled to a presumption that the misrepresentation affected the stock price. Second, if the plaintiff also shows that he purchased the stock at the market price during the relevant period, he is entitled to a further presumption that he purchased the stock in reliance on the defendant's misrepresentation." Halliburton Co. v. Erica P. John Fund, Inc., 134 S. Ct. 2398, 2414 (2014).

[56] I was able to find only a single district court opinion, *In re* LTV Sec. Litig., 88 F.R.D. 134, 142–45 (N.D. Tex. 1980), discussing the ECMH in the context of the FOTM doctrine, pre-*Basic*.

[57] Fischel, *supra* note 48, at 9–10. While several other commentators also recognized the potential relationship between FOTM and ECMH, Fischel's article proved to be a watershed. Michael A. Lynn, Note, *Fraud on the Market: An Emerging Theory of Recovery Under SEC Rule 10b-5*, 50 GEO. WASH. L. REV. 627, 649 (1982); Note, *The Fraud-on-the-Market Theory*, 95 HARV. L. REV. 1143, 1154–56 (1982).

[58] Fischel, *supra* note 48, at 4 n.9. To put it in the language of statistics, the price of a stock in an efficient market is a martingale.

of the future price of the stock, it means that the price reflects all available "information" about that stock.[59]

Fischel argued that the ECMH supported the FOTM doctrine in two ways. First, the ECMH allowed Fischel to put a more scientific gloss on the Ninth Circuit's intuition that "[m]ateriality circumstantially establishes the reliance of some market traders," and that the reliance of some market traders would affect the price, thereby establishing loss causation.[60] If the semi-strong form of the ECMH is accepted, all new public material information, including misrepresentations, will by definition rapidly be reflected in the stock price.[61] Second, if markets are efficient, it is perfectly reasonable—and desirable as a matter of public policy—for individual investors to rely on the market price.[62] Because information in prospectuses, earnings reports, press releases, and other types of corporate disclosures will already be reflected in the market price, there is no reason investors should read them, or that the law should encourage them to do so. In fact, "investors would be wasting their money by doing so."[63]

[59] Eugene F. Fama, *Efficient Capital Markets, A Review of Theory and Empirical Work*, 25 J. Fin. 383, 383–84 (1970). In principle, the ECMH can come in three forms—weak, semi-strong, and strong—depending on the type of "information" that can be considered as "fully reflected" in the price of the stock. *Id.* Weak-form efficiency implies that prices fully reflect any information contained in the past movement of the stock price itself. *Id.* at 388. Thus, "an investor cannot enhance his/her ability to select stocks by knowing the history of successive prices and the results of analyzing them all possible ways." James H. Lorie et al., The Stock Market: Theories and Evidence 56 (2d ed. 1985). Weak-form efficiency is also known as the "random walk" hypothesis, because it suggests that successive price movements are independent of each other, and thus will appear random. Fama, *supra*, at 386–87. Semi-strong form implies that prices fully reflect any information that is publicly available and quickly adjust to reflect any new publicly available information—including potential fraudulent misrepresentations. *Id.* at 388. At its limit, this suggests "that efforts to acquire and analyze [public] knowledge cannot be expected to produce superior investment results." Lorie, *supra*, at 56. Strong form implies that even *non*public information—information known to *any* market participant—will be fully and quickly reflected in the price. Jonathan R. Macey & Geoffrey P. Miller, *Good Finance, Bad Economics: An Analysis of the Fraud-on-the-Market Theory*, 42 Stan. L. Rev. 1059, 1077 (1990). With certain caveats, discussed *infra*, empirical studies have tended to confirm the weak and semi-strong form versions of the ECMH. *See, e.g.*, West v. Prudential Sec., Inc., 282 F.3d 935, 938 (7th Cir. 2002) ("[F]ew propositions in economics are better established than the quick adjustment of securities prices to public information."); *In re* LTV, 88 F.R.D. at 144 ("[T]ests of market efficiency show that stock prices adjusted quickly to public announcements concerning the company: the collective action of a sufficient number of market participants buying or selling the stock causes a very rapid, if not virtually instantaneous, adjustment in price." (internal quotation marks omitted)).

[60] Blackie v. Barrack, 524 F.2d 891, 906 (9th Cir. 1975).

[61] *See supra* note 59.

[62] Fischel, *supra* note 48, at 4 ("Because the market price itself transmits all available information, investors have no incentive to study other available data.").

[63] *Id.*

It is often forgotten that Fischel went beyond simply endorsing the usual story of indirect reliance and concluding that reliance should be presumed in cases involving efficient markets. He instead argued that "[t]he logic of the fraud on the market theory dictates that the reliance requirement as conventionally interpreted be discarded altogether."[64] An investor trading on an open market cannot *not* rely on a misrepresentation if that misrepresentation alters the market price. Indeed, the main thrust of his article was that abstract legal definitions of "materiality" are unnecessary, and that it is simply the absence or presence of a price reaction that tells us whether information is new and material, and whether the plaintiff suffered an injury.

As a result, Fischel argued for a wholesale rejection of the analogy to common law fraud, concluding that "there is no need in a securities fraud case for separate inquiries into materiality, reliance, causation, and damages" and that the only inquiry "in open-market transactions should be whether the market price was in fact artificially affected by false information."[65] As we will see, the Supreme Court has not taken up the offer to completely reimagine the securities-fraud class action. Fischel's article did, however, help to create the general—and misleading—impression that the FOTM doctrine depended in some essential way on acceptance of the ECMH.[66]

2. Basic Inc. v. Levinson

The Supreme Court finally took up the question of the FOTM doctrine in *Basic Inc. v. Levinson*. Former shareholders sued Basic and its board of directors, alleging that they violated section 10(b) and Rule 10b-5 by falsely denying the existence of merger negotiations.[67] They certified a class of investors who had sold their stock after the first denial of the merger negotiations, but prior to the announcement of the merger, permitting a presumption of reliance.[68] The Sixth Circuit affirmed, rely-

[64] *Id.* at 11.

[65] *Id.* at 13.

[66] One lower court, writing after *Basic*, has summarized the supposed role of the ECMH in the FOTM doctrine as follows: "First, the efficient capital market hypothesis allows a court to assume that any material misrepresentation made by an issuer of securities will quickly and accurately be reflected in the market price of that issuer's securities, so long as the market involved is an 'efficient' one. Next, it is presumed reasonable for an investor to rely on the integrity of the market price of any such security. And finally, because an investor who trades in a particular security can be presumed to have done so based on the market price of that security, if that market price reflects some misrepresentation made by the issuer of the security, the trader can be deemed to have relied on the misrepresentation itself." *In re* Seagate Tech. II Sec. Litig., 843 F. Supp. 1341, 1355 (N.D. Cal. 1994) (citations omitted). As we will see, none of these conclusions depends on the detailed accuracy of the ECMH as a description of actual markets. *See infra* Part IV.

[67] Basic Inc. v. Levinson, 485 U.S. 224, 228 (1988).

[68] *Id.*

ing on the FOTM theory and noting that *Basic* stock traded "in an impersonal, efficient market."[69]

The Supreme Court addressed two questions: (1) whether the alleged misstatements could potentially be material, and (2) whether a FOTM presumption of reliance was appropriate.[70] After determining that preliminary merger negotiations could be material,[71] the Court took up the FOTM theory. As a first step, the Court recommitted itself to the proposition that "reliance is an element of a Rule 10b-5 cause of action."[72] The Court then adopted the FOTM doctrine, holding that a presumption of reliance was appropriate in cases involving "an open and developed securities market."[73] The Court first noted that "[r]ecent empirical studies have tended to confirm . . . that the market price of shares traded on well-developed markets reflects all publicly available information, and, hence, any material misrepresentations."[74] The Court then went on to state that "[a]n investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price."[75] The Court then joined these two propositions to conclude that "[b]ecause most publicly available information is reflected in market price, an investor's reliance on any public material misrepresentations . . . may be presumed for purposes of a Rule 10b-5 action."[76] Practical concerns of evidence and procedure also motivated the Court's conclusions. The Court emphasized that presumptions are not a matter of theoretical principle alone, but arise "out of considerations of fairness, public policy, and probability, as well as judicial economy," suggesting that a presumption of reliance may be preferable to requiring statutorily

[69] Levinson v. Basic Inc., 786 F.2d 741, 751 (6th Cir. 1986).

[70] *Basic*, 485 U.S. at 230.

[71] *Id.* at 239–41.

[72] *Id.* at 243. In doing so, the Court declined to follow Fischel's advice to dispense with the traditional elements of fraud altogether in favor of an exclusive focus on loss causation through market impact. *See supra* note 48 and accompanying text.

[73] *Basic*, 485 U.S. at 241, 245–47.

[74] *Id.* at 246.

[75] *Id.* at 247.

[76] *Id.* The Court provided three examples of how the presumption could be rebutted. First, the defendant can show that "the 'market makers' were privy to the truth," which would demonstrate "that the market price would not have been affected by their misrepresentations," breaking the "causal connection." *Id.* at 248. Second, the defendant can show "truth" on the market—that "news" of the misrepresentation leaked out and "dissipated the effects of the misstatements," again breaking the connection. *Id.* at 248–49. Finally, the defendant could show that the individual plaintiff was not "relying on the integrity of the market," but "sold his shares nevertheless because of other unrelated concerns." *Id.* at 249. As will be discussed *infra*, this third method of rebuttal may not be coherent—unlike in face-to-face markets, a stock trader can be injured even in the absence of reliance as long as the market price has been distorted.

favored plaintiffs "to show a speculative state of facts" at such an early stage in the proceedings.[77]

The plurality opinion explicitly disclaimed any reliance on the ECMH, stating that they "d[id] not intend conclusively to adopt any particular theory of how quickly and completely publicly available information is reflected in market price[s]"[78] and claiming that the Court "need not determine by adjudication what economists and social scientists have debated through the use of sophisticated . . . analysis and the application of economic theory."[79] Justice White in dissent, however, refused to accept this disclaimer, and insinuated that the FOTM doctrine rose or fell with the ECMH.[80] Many scholars, especially in the immediate aftermath of the decision, tended to agree with White.[81]

Justice White, however—though correct that the Court was unwise to wade into academic economic debates—was wrong in suggesting that the Court's reasoning depended in any essential way on the ECMH. As is developed below, the *Basic* plurality was entirely correct in stating that "[f]or purposes of accepting the presumption of reliance in this case, we need only believe that market professionals generally consider most publicly announced material statements about companies, thereby affecting stock market prices."[82] Furthermore, none of the economic developments calling into question the ECMH call into question the validity of this modest belief.[83]

II. THE SECURITIES CLASS ACTION EXPLOSION

The Supreme Court's embrace of the FOTM presumption removed the longstanding reliance obstacle to class certification and led to an ex-

[77] *Id.* at 245. One scholar goes so far as to argue that "*Basic* cannot be understood except by appreciating that the Court's response is far more a lesson in civil procedure than financial economics." Donald C. Langevoort, Basic *at Twenty: Rethinking Fraud on the Market*, 2009 WIS. L. REV. 151, 158. Even if this is an overstatement, it is clear the Court was alert to considerations of what kinds of evidence a plaintiff can and should be expected to present at class certification.

[78] *Basic*, 485 U.S. at 248 n.28.

[79] *Id.* at 246–47 n.24.

[80] *Id.* at 253–54 (White, J., dissenting).

[81] *See* Edward S. Adams & David E. Runkle, *Solving a Profound Flaw in Fraud-on-the-Market Theory: Utilizing a Derivative of Arbitrage Pricing Theory to Measure Rule 10b-5 Damages*, 145 U. PA. L. REV. 1097, 1109 (1997) ("The Court based its adoption of the fraud-on-the-market theory on its implicit assumption of the validity of the principles underlying the ECMH . . . . Although the Court did not state its acceptance of the ECMH by name, the Court unmistakably stated its acceptance of the ECMH in substance . . . ."); Macey & Miller, *supra* note 59, at 1077 ("Despite this disclaimer, the Court was adopting the semi-strong version of the efficient capital markets hypothesis, whether it was aware it was doing so or not."); *see also* Charles R. Korsmo, *Mismatch: The Misuse of Market Efficiency in Market Manipulation Class Actions*, 52 WM. & MARY L. REV. 1111, 1128–31 (2011).

[82] *See Basic*, 485 U.S. at 247 n.24.

[83] *See infra* Part IV.A.

plosion of securities-fraud litigation.[84] Securities class actions have become a major industry. More than 3,000 securities fraud class actions were filed between 1997 and 2012, leading to settlements in excess of $73 billion.[85] Total fee awards to plaintiffs' attorneys in these actions totaled nearly $17 billion in the decade from 1997 to 2007, with fees paid to defense lawyers estimated to be in the same range.[86] To give a sense of the prominence of securities-fraud class actions on the federal docket, it is worth noting that they have, at times, constituted nearly half of all class actions pending in federal courts.[87]

A. *The Debate over the Merits of Securities-Fraud Class Actions*

There are powerful theoretical and empirical reasons to regret the proliferation of securities-fraud class actions as a matter of public policy. As a theoretical matter, it has long been argued by economics-oriented scholars that the "out of pocket" damages measure used in securities-fraud cases largely result in wealth transfers among innocent investors.[88]

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[84] The number of suits filed nearly tripled in the three years after *Basic*, and "continued to rise dramatically over the next fifteen years." Langevoort, *supra* note 77, at 179; *see* Vincent E. O'Brien, *The Class-Action Shakedown Racket*, WALL ST. J., Sept. 10, 1991, at A20 (counting section 11 actions as well).

[85] *See* Grundfest, *supra* note 35, at 1; CORNERSTONE RESEARCH, SECURITIES CLASS ACTION FILINGS: 2012 YEAR IN REVIEW 3 fig. 2 (2012), http://securities.stanford.edu/research-reports/1996-2012/Cornerstone-Research-Securities-Class-Action-Filings-2012-YIR.pdf.

[86] *See* U.S. CHAMBER INST. FOR LEGAL REFORM, SECURITIES CLASS ACTION LITIGATION: THE PROBLEM, ITS IMPACT, AND THE PATH TO REFORM 17, 19 (July 2008), http://ilr.iwssites.com/uploads/sites/1/SecuritiesBooklet.pdf (citing John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 COLUM. L. REV. 1534, 1546 n.38 (2006)).

[87] Coffee, *supra* note 86, at 1539 tbl. 1 (showing securities-fraud class actions making up over 47% of all pending class actions in federal court from 2002 to 2004). More recent data suggest that securities-fraud class actions currently constitute a significantly smaller proportion of the current federal court docket. *See* Grundfest, *supra* note 35, at 1 n.6.

[88] *See, e.g.*, RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 459–60 (6th ed. 2003) ("People who buy the stock during [the period of the fraudulent distortion] will be hurt, but the sellers will be benefitted . . . ."); Bratton & Wachter, *supra* note 7, at 73 ("Real-world FOTM actions proceed on an enterprise-liability theory with corporate—as opposed to individual—defendants funding the compensation; investor 'victims' are accordingly compensated from the pockets of other innocent investors."); Coffee, *supra* note 86, at 1558 ("Often shareholders will belong to both the plaintiff class that sues and the residual shareholder class that bears the cost of the litigation. . . . Thus, they are effectively making wealth transfers to themselves, in effect shifting money from one pocket to another, minus the high transaction costs of securities litigation."); Frank H. Easterbrook & Daniel R. Fischel, *Optimal Damages in Securities Cases*, 52 U. CHI. L. REV. 611, 651 (1985) ("[A]ftermarket [trading] entails offsetting gains and losses."); Donald C. Langevoort, *Capping Damages for Open-Market Securities Fraud*, 38 ARIZ. L. REV. 639, 646 (1996) ("In any non-privity fraud case, each loser—the buyer or seller disadvantaged by the fraud—is balanced by another winner: the person on the other side of the trade.").

For every investor who buys at a fraudulently inflated price, another has sold at the same inflated price. In theory, an uninformed investor is as likely to profit as to suffer a loss from any given misrepresentation, and a diversified investor should come out roughly even over the long term.[89] This does not suggest that securities fraud is not harmful,[90] only that securities class actions constitute an especially crude deterrence device, with damages calculated in a manner unrelated to actual social harm, that are ultimately paid by people other than the actual wrongdoers.

In addition to these theoretical concerns, a large empirical literature has explored the extent to which securities class actions are merit driven, or may to a large extent consist of frivolous claims brought to extract nuisance settlements. Securities-fraud class actions are a particularly likely setting for nuisance litigation. Nuisance suits may be profitable whenever defendants are risk-averse or face asymmetric litigation costs.[91] As Janet Cooper Alexander summarized the economic arguments, "high litigation costs and uncertainty about trial outcomes can lead to the settlement of frivolous suits."[92] Securities class actions are costly to defend and pose at least a possibility—even if it is a low probability—of catastrophic damages.[93] The risk of nuisance settlements is likely exacerbated by the ubiquity

[89] *See* Janet Cooper Alexander, *Rethinking Damages in Securities Class Actions*, 48 STAN. L. REV. 1487, 1502 (1996) ("The chance of being on the losing or winning side of a transaction when the stock price is distorted by a securities violation can be assumed to be random."); Richard A. Booth, *The Future of Securities Litigation*, 4 J. BUS. & TECH. L. 129, 139 (2009) (Booth notes that losses for diversified investors should "wash out over time. In other words, a diversified investor is likely to gain from the timely sale of an overpriced stock about as often as she loses from the untimely purchase of an overpriced stock." (footnote omitted)).

[90] The social losses from securities fraud include allocative inefficiencies resulting from distorted prices and precaution costs from investors seeking to protect themselves against fraud rather than relying on corporate disclosures. Paul G. Mahoney & Mark Weinstein, *The Appraisal Remedy and Merger Premiums*, 1 AM. L. & ECON. REV. 239, 239–42 (1999); Grundfest, *supra* note 35, at 58 & n.334.

[91] *See, e.g.*, Lucian Arye Bebchuk, *Suing Solely to Extract a Settlement Offer*, 17 J. LEGAL STUD. 437, 437 (1988); John C. Coffee, Jr., *Rescuing the Private Attorney General: Why the Model of the Lawyer as Bounty Hunter Is Not Working*, 42 MD. L. REV. 215, 230–31 (1983); Jill E. Fisch, *Class Action Reform: Lessons from Securities Litigation*, 39 ARIZ. L. REV. 533, 535–36 (1997); D. Rosenberg & S. Shavell, *A Model in Which Suits Are Brought for Their Nuisance Value*, 5 INT'L REV. L. & ECON. 3, 3 (1985).

[92] Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497, 502 n.10 (1991).

[93] *See, e.g.*, *id.* at 505 (describing the ability of "unscrupulous plaintiffs to extort nuisance-value settlements for frivolous claims"); Choi, *Do the Merits Matter*, *supra* note 6, at 598–99 ("Many argue that at least some class actions are initiated in expectation of a nuisance settlement, paid by the defendants to avoid the distraction of litigation, high defense attorney fees, and the negative publicity surrounding a securities lawsuit."); Choi, *The Evidence*, *supra* note 6, at 1469 ("Getting rid of even frivolous litigation is not cost-free. If a court is unable to verify whether litigation is meritorious at the start of the litigation, a class action suit may last a considerable amount of time. During this time, defendants will incur attorneys' fees as well as the distraction of dealing with discovery (including lengthy depositions of the top officers) and

of liability insurance for directors and officers that will pay some or all of the costs of a settlement, but will not pay if the defendants are found culpable at trial.[94] Furthermore, pervasive agency problems between plaintiffs' attorneys and the shareholders who are nominally the plaintiffs could lead to the filing of value-destroying nuisance suits, so long as the prospect of a settlement is reasonably strong.[95]

A number of theoretical and empirical inquiries have attempted to estimate the merits of securities-fraud class actions, with mixed results.[96] Several highly influential early studies found that the merits seem to mat-

negative publicity affecting relations with both customers and suppliers. Settling even nuisance litigation allows a company to avoid such costs."); Coffee, *supra* note 91, at 271 (noting that corporate defense counsel often claims "that the corporation is better served even in a frivolous case by settling quickly rather than by expending time and effort litigating to a successful conclusion"); *see also* Robert D. Cooter & Daniel L. Rubinfeld, *Economic Analysis of Legal Disputes and Their Resolution*, 27 J. ECON. LIT. 1067, 1084 (1989).

[94] *See, e.g.*, Alexander, *supra* note 92, at 550 (arguing that "[t]he existence and operation of insurance and indemnification may be the most important factor in creating a system of settlements that do not reflect the merits"); Choi, *The Evidence*, *supra* note 6, at 1469 ("[M]any companies have liability insurance policies for their directors and officers, many of which will not pay if the directors or officers are found culpable at trial . . . . Rather than face this prospect (even if unlikely), directors and officers will often settle, relying on the directors and officers (D&O) liability insurers to pay most, if not all, of the settlement award."); Roberta Romano, *The Shareholder Suit: Litigation Without Foundation?*, 7 J.L. ECON. & ORG. 55, 57 (1991) ("[A]ll states permit corporations to purchase D&O liability insurance for their executives, and policies can cover losses that cannot be indemnified. Policies routinely exempt losses from adjudication of dishonesty, but if a claim is settled, courts prohibit insurers from seeking an adjudication of guilt and thereby avoiding the claim's payment."); *see also* Securities Litigation Reform: Hearing Before the H. Subcomm. on Telecomm. & Fin. of the Comm. on Energy & Commerce, 103d Cong. 468 (1994) (statement of Marc E. Lackritz, President, Securities Industry Association (citing O'Brien, *supra* note 84, at A20 (claiming that 96% of securities class action suits were settled out of court and that merits had little effect on settlement value little, perhaps because of insurance coverage))).

[95] Randall S. Thomas & Robert B. Thompson, *Empirical Studies of Representative Litigation*, *in* RESEARCH HANDBOOK ON THE ECONOMICS OF CORPORATE LAW 152, 155 (Claire A. Hill & Brett H. McDonnell eds., 2012) ("[I]f suits were being driven too much by lawyer interests, representative litigation could result in the attorney initiating suits with little merit, settling strong suits for too little, and structuring the settlement so that the costs are not borne by the actual wrongdoers."); Randall S. Thomas & Robert B. Thompson, *A Theory of Representative Shareholder Suits and Its Application to Multi-Jurisdictional Litigation*, 106 NW. U. L. REV. 1753, 1762 (2012) ("Shareholder suits under both state and national law are most frequently representative, meaning that the typical case involves one named plaintiff and, importantly, one or more law firms for that prospective representative seeking to speak for a large body of shareholders. This can lead to litigation agency costs, for example, if agents bring what are perceived as strike suits or settle meritorious suits too cheaply." (footnote omitted)).

[96] For excellent summaries of this literature, see generally Choi, *The Evidence*, *supra* note 6; Charles R. Korsmo & Minor Myers, *The Structure of Stockholder Litigation: When Do the Merits Matter?* 75 OHIO ST. L.J. 5 (2014).

ter little,[97] while more recent studies have tended to be more equivocal.[98] The Supreme Court itself has frequently expressed concern over the potential for "vexatious" securities-fraud litigation, recently suggesting that such actions "can be employed abusively to impose substantial costs on companies and individuals whose conduct conforms to the law."[99]

B. *Subsequent Judicial Action: The Requirement of an "Efficient" Market*

While Congress would eventually attempt to stanch the flood of securities class actions that followed *Basic* by passing the Private Securities

[97] *See, e.g.*, Alexander, *supra* note 92, at 524–68; Reinier Kraakman et al., *When Are Shareholder Suits in Shareholder Interests?*, 82 GEO. L.J. 1733, 1734 n.5 (1994); Romano, *supra*, note 94, at 55–56.

[98] *See, e.g.*, Choi, *The Evidence*, *supra* note 6, at 1477; James D. Cox, *Making Securities Fraud Class Actions Virtuous*, 39 ARIZ. L. REV. 497, 503–04 & n.24 (1997); James D. Cox et al., *Does the Plaintiff Matter? An Empirical Analysis of Lead Plaintiffs in Securities Class Actions*, 106 COLUM. L. REV. 1587 (2006); Joel Seligman, Commentary, *The Merits Do Matter*, 108 HARV. L. REV. 438, 448–57 (1994); Stephen J. Choi & Adam C. Pritchard, *SEC Investigations and Securities Class Actions: An Empirical Comparison* 27 (N.Y. Univ. Sch. of Law, Research Paper No. 12-022, 2014), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2109739 ("Our results suggest that private plaintiffs' attorneys, if anything, are more likely to pursue disclosure violations compared with the SEC."). *See generally* Quinn Curtis & John Morley, *An Empirical Study of Mutual Fund Excessive Fee Litigation: Do the Merits Matter?*, 30 J.L. ECON. & ORG. 275, 277, 280 (2014) ("[T]here appears to be a growing consensus that the relationship [between merits and outcomes in class actions] is reasonably strong."); Grundfest, *supra* note 35, at 55–57.

[99] Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 313 (2007); *see also* Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S. 148, 163 (2008) (noting the possibility that "plaintiffs with weak claims [can] extort settlements from innocent companies"); Dura Pharm., Inc. v. Broudo, 544 U.S. 336, 347 (2005) (The Court claimed a pleading requirement that could be satisfied by a mere allegation of price inflation "would permit a plaintiff 'with a largely groundless claim to simply take up the time of a number of other people, with the right to do so representing an *in terrorem* increment of the settlement value, rather than a reasonably founded hope that the [discovery] process will reveal relevant evidence.'" (alteration in original) (quoting Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 741 (1975))); Cent. Bank v. First Interstate Bank, 511 U.S. 164, 189 (1994) (noting that plaintiffs can force defendants "to expend large sums even for pretrial defense and the negotiation of settlements"); Va. Bankshares, Inc. v. Sandberg, 501 U.S. 1083, 1096 (1991) (finding that a new theory of liability "would threaten just the sort of strike suits and attrition by discovery that *Blue Chip Stamps* sought to discourage"); Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 479 (1977) (noting the "danger of vexatious litigation which could result from a widely expanded class of plaintiffs under Rule 10b-5" (quoting *Blue Chip Stamps*, 421 U.S. at 740) (internal quotation marks omitted)); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 214–15 n.33 (1976) (claiming that "the inexorable broadening of the class of plaintiff who may sue in this area of the law will ultimately result in more harm than good"); *Blue Chip Stamps*, 421 U.S. at 739 (1975) (noting that the expansion of civil liability under 10(b) can "lead to large judgments, payable in the last analysis by innocent investors, for the benefit of speculators and their lawyers" (quoting SEC v. Tex. Gulf Sulphur Co., 401 F.2d 833, 867 (2d Cir. 1968) (Friendly, J., concurring)) (internal quotation marks omitted)).

Litigation Reform Act (PSLRA) over President Clinton's veto,[100] the federal courts also searched for ways to stem the tide.

No longer able to argue against the FOTM presumption in general after *Basic*, defendants at the crucial class-certification stage seized upon the Court's language about "open and developed" markets, and began arguing that the market for the particular security at issue was not sufficiently efficient to support the presumption in the individual case.[101] Beleaguered courts in search of some gatekeeping requirement accepted this invitation, and began to formulate "tests" for the required level of efficiency. Demonstrating the requisite degree of market efficiency rapidly became one of the major hurdles for securities-fraud plaintiffs seeking to certify a class, and the question of market efficiency quickly took on a significance that would not have been readily apparent from a reading of the language of the plurality opinion in *Basic*.

Though a lower-court consensus emerged that a showing of market efficiency was required to invoke the FOTM presumption, courts have not followed a uniform practice in their approach to determining whether a market is sufficiently efficient.[102] Among the earliest—and still prob-

[100] Private Securities Litigation Reform Act of 1995, Pub. L. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C.). The PSLRA, with its overt skepticism of securities class actions, heightened pleading standards, and lead-plaintiff provisions, casts doubt on the *Basic* Court's assumption that private class actions are a legislatively favored remedy for securities fraud, suggesting that greater judicial scrutiny would be appropriate. The initial bill, H.R. 10, was drafted by then-Congressman (and later SEC Chairman) Christopher Cox and would have undone *Basic* altogether. *See* Common Sense Legal Reforms Act of 1995, H.R. 10, 104th Cong. § 204 (1995).

[101] Langevoort, *supra* note 77, at 166–67.

[102] In *Basic* itself, the relevant stock was traded on the New York Stock Exchange (NYSE) and the Court did not discuss either a market-efficiency requirement or whether the stock in question met any particular efficiency threshold. Basic Inc. v. Levinson, 485 U.S. 224, 227–28, 248–50 (1988). Some lower courts have accordingly assumed market efficiency when the relevant security trades on a major exchange like the NYSE or National Association of Securities Dealers Automated Quotations (NASDAQ). *See, e.g.*, Anderson v. Transglobe Energy Corp., 35 F. Supp. 2d 1363, 1369 (M.D. Fla. 1999) (finding, without analysis, that a stock listed on the NASDAQ and several Canadian exchanges traded in an efficient market); Levine v. Metal Recovery Techs., Inc., 182 F.R.D. 102, 107–08 (D. Del. 1998) (finding, without analysis, that a stock listed on the NASDAQ Small Cap Market traded in an efficient market). Other courts have argued that market efficiency cannot be assumed based on the exchange on which a security is traded—it is the market for the individual security itself that must be efficient. *See, e.g.*, O'Neil v. Appel, 165 F.R.D. 479, 504 (W.D. Mich. 1996); Cammer v. Bloom, 711 F. Supp. 1264, 1281–83 (D.N.J. 1989). Some courts have extended the FOTM presumption to initial public offerings (IPOs) and securities traded in over-the-counter markets. *See, e.g.*, Endo v. Albertine, 863 F. Supp. 708, 726 (N.D. Ill. 1994) (extending the FOTM presumption to IPOs); *Cammer*, 711 F. Supp. at 1283–88 (extending the FOTM presumption to securities traded in over-the-counter markets). *But see In re* Initial Pub. Offerings Sec. Litig., 471 F.3d 24, 42 (2d Cir. 2006) (finding that "the market for IPO shares is not efficient"); Freeman v. Laventhol & Horwath, 915 F.2d 193, 199 (6th Cir. 1990) (finding that "a primary market for newly issued municipal bonds [as a matter of law] is not efficient" (quoting *In re* Bexar

ably most widely used—tests for market efficiency was a multi-factor test formulated by a New Jersey district court in *Cammer v. Bloom*.[103] The so-called "*Cammer* factors" have proved influential, with courts sometimes adding additional factors of their own.[104] The result has been "an ad hoc approach informed by expert testimony, but in fact largely unconstrained."[105]

A related question is *when* the showing of market efficiency should be required. Although *Basic* itself involved class certification, consensus was slow to materialize as to whether the FOTM presumption—and the associated inquiry into market efficiency—needed to be settled at that stage of the litigation. Courts were torn between the necessity of deciding the presumption of reliance in order to satisfy Federal Rule of Civil Procedure 23, and the Supreme Court's admonishment against conducting fact-intensive, merits-related inquiries at the class-certification stage.[106] Furthermore, market efficiency is a factual question that is itself common to the class, lending the proceedings something of a "chicken and egg" flavor. Over the past decade, however, a consensus has emerged that a district court must, before certifying a class, make a determination that each of the Rule 23 requirements has been met, even if a Rule 23 requirement overlaps with a merits issue.[107] If the plaintiff seeks to invoke

Cnty. Health Facility Dev. Corp. Sec. Litig., 130 F.R.D. 602, 607 (E.D. Pa. 1990) (internal quotation marks omitted))). Still others have suggested that a slow market reaction to obscure news could call into question the efficiency of even heavily traded blue-chip stocks. *See In re* Merck & Co. Sec. Litig., 432 F.3d 261, 269–70 (3d Cir. 2005) (suggesting that if Merck's common stock was slow to respond to confusing revenue data, it would demonstrate an inefficient market, and thus be grounds for denial of class certification).

[103] The *Cammer* court set forth five factors that could be indicative of market efficiency: (1) "average weekly trading volume"; (2) number of securities analysts following the stock; (3) number of market makers and arbitrageurs; (4) status as an S-3 filer; and (5) responsiveness of the market price to "unexpected corporate events or financial releases." 711 F. Supp. at 1286–87.

[104] *See, e.g.*, Unger v. Amedisys Inc., 401 F.3d 316, 323 (5th Cir. 2005) (considering additional factors, including market capitalization and bid–ask spread).

[105] Langevoort, *supra* note 77, at 167, 168 ("[W]ading into the mind-numbing data defendants (and thus plaintiffs as well) often put forward in their expert reports creates the illusion that there is a bright-line distinction."); *see also* Paul A. Ferrillo et al., *The "Less Than" Efficient Capital Markets Hypothesis: Requiring More Proof from Plaintiffs in Fraud-on-the-Market Cases*, 78 ST. JOHN'S L. REV. 81, 83 (2004); 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, 319–20 (2002); Grundfest, *supra* note 35, at 63–64.

[106] *See* Eisen v. Carlisle & Jacquelin, 417 U.S. 156, 177–78 (1974).

[107] *See In re Initial Pub. Offerings*, 471 F.3d at 42; *Unger*, 401 F.3d at 319; Blades v. Monsanto, 400 F.3d 562, 575 (8th Cir. 2005); *In re* Polymedica Corp. Sec. Litig., 432 F.3d 1, 5–6 (1st Cir. 2005); Gariety v. Grant Thornton, LLP, 368 F.3d 356, 366 (4th Cir. 2004) ("[T]he factors spelled out in Rule 23 must be addressed through findings, even if they overlap with issues on the merits."); Szabo v. Bridgeport Machs., Inc., 249 F.3d 672, 676 (7th Cir. 2001) ("[A] judge should make whatever factual and legal inquiries are necessary under Rule 23," even if "the judge must make a preliminary

the FOTM presumption, this requirement necessarily entails judicial scrutiny of efficiency claims at the class-certification stage, a fact-intensive inquiry that can entail lengthy discovery.[108]

In its most recent case on the topic before *Halliburton*, the Supreme Court described the operation of the FOTM doctrine as follows:

> The fraud-on-the-market premise is that the price of a security traded in an efficient market will reflect all publicly available information about a company; accordingly, a buyer of the security may be presumed to have relied on that information in purchasing the security.
>
> . . . .
>
> Thus, where the market for a security is inefficient . . . , a plaintiff cannot invoke the fraud-on-the-market presumption.[109]

Current practice, then, when the plaintiffs rely on the FOTM presumption, is for district courts to perform a searching and relatively wide-ranging inquiry into market efficiency prior to certifying a class. In a climate of widespread concern over the costs and efficacy of securities litigation, this inquiry is one of the primary gatekeepers to class certification.[110] Because the overwhelming majority of securities class actions settle if a class is certified,[111] the need for a gatekeeping requirement of some sort is apparent, and may help explain the recent consensus.[112]

Market efficiency, however, makes for a woefully unreliable gatekeeper. The fundamental problem is that the efficiency of the relevant

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inquiry into the merits."); Newton v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 259 F.3d 154, 166–67 (3d Cir. 2001).

[108] *See, e.g.*, *In re Initial Pub. Offerings*, 471 F.3d at 41–42; *Unger*, 401 F.3d at 322; *Gariety*, 368 F.3d at 366. The 2003 amendments to Rule 23 made two relevant changes. First, they eliminated the provision from prior Rule 23(c)(1)(C) allowing "conditional" certification of classes. FED. R. CIV. P. 23 advisory committee's note (2003). Second, Rule 23(c)(1)(A) was altered, replacing the requirement to certify a class "as soon as practicable" with an instruction to certify "at an early practicable time." *Id.* The advisory committee's notes state that "[a] court that is not satisfied that the requirements of Rule 23 have been met should refuse certification until they have been met," and instruct courts that "[i]t is appropriate to conduct controlled discovery into the 'merits,' limited to those aspects relevant to making the certification decision on an informed basis." *Id.*

[109] Amgen Inc. v. Conn. Ret. Plans & Trust Funds, 133 S. Ct. 1184, 1190, 1199 (2013).

[110] *See* Douglas C. Conroy & Johanna S. Wilson, *Class Actions: Evening the Playing Field: Stress-Testing the Efficient Market Hypothesis*, 38 SEC. REG. & L. REP. (BNA) 1127 (2006).

[111] Richard Nagareda, *Class Certification in the Age of Aggregate Proof*, 84 N.Y.U. L. REV. 97, 99 (2009); *see also* Oscar Private Equity Invs. v. Allegiance Telecom, Inc., 487 F.3d 261, 266–67 (5th Cir. 2007) (referring to class certification as the "signal event of the case," conferring "*in terrorem* power" on the plaintiffs); West v. Prudential Sec., Inc., 282 F.3d 935, 937 (7th Cir. 2002) ("[V]ery few securities class actions are litigated to conclusion . . . .").

[112] *Prudential*, 282 F.3d at 937 ("[R]eview [of the district court's interpretation of the FOTM approach] may be possible only through the Rule 23(f) device.").

market bears little or no relation to the merits of the underlying claim. As is discussed further below,[113] even a minimally developed market that would not pass the *Cammer* test—let alone perfectly satisfy the ECMH—can be distorted by fraudulent misstatements. Likewise, not all misstatements will move the market price even if the market is highly efficient.[114]

Under some circumstances, market efficiency makes for a positively perverse filter, posing no obstacle to claims most likely to be frivolous, while blocking potentially meritorious claims. Most problematically, trade-based market manipulations—where a manipulator attempts to move the price by engaging in trading activity—are most likely to succeed in thinly traded, inefficient stocks, and would be functionally impossible in a large, highly efficient stock.[115] Yet claims of trade-based manipulation of a penny stock would be blocked by the efficiency requirement, while highly implausible claims that, say, IBM's stock had been manipulated would sail through class certification.

More generally, substantial evidence exists that it is smaller firms trading in inefficient markets that are most likely to be affected by fraudulent misstatements.[116] Yet the efficient-market requirement blocks class actions in cases involving such firms. Meanwhile, the market-efficiency requirement poses little obstacle to securities-fraud claims against large firms on national exchanges. Yet these firms—with deep pockets and high, asymmetric costs of defending themselves—are precisely the kind of firms most likely to be targeted by nuisance suits. The market efficiency requirement encourages suits against large companies, while discouraging suits against smaller ones where fraud is more likely.[117]

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[113] *See infra* notes 115–16 and accompanying text.

[114] *See* Bebchuk & Ferrell, *supra* note 18, at 690 ("[T]he focus on market conditions in general . . . leads to a serious problem of over- and underinclusion.").

[115] *See* Fezzani v. Bear, Stearns & Co., 716 F.3d 18, 21 n.2 (2d Cir. 2013); Korsmo, *supra* note 81, at 1143–51 (explaining the conditions for a successful market manipulation).

[116] *See, e.g.*, Rapp, *supra* note 105, at 322–23 (arguing that "it is in . . . small companies, traded over the counter or on non-traditional exchanges, that the kinds of fraud Rule 10b-5 was designed to avert are most likely to occur"); FINAL REPORT OF THE ADVISORY COMMITTEE ON SMALLER PUBLIC COMPANIES TO THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION 139 (Apr. 23, 2006), http://www.sec.gov/info/smallbus/acspc/acspc-finalreport.pdf (noting that "small firms consistently have more misstatements and restatements of financial information, nearly twice the rate of large firms").

[117] More subtly, it encourages investors to rely on statements regarding small, inefficiently traded companies, where reliance is less likely to be reasonable, and discourages reliance on statements regarding large, efficiently traded companies, where reliance is more likely to be reasonable. An investor in a small company who hopes to be able to recover for securities fraud will be forced to show actual reliance, thus increasing the incentive to rely, whereas an investor who relies in an efficient market will be forced to share his recovery with investors who did not rely, thus decreasing the incentive to rely. *See* Paul G. Mahoney, *Precaution Costs and the Law of Fraud in Impersonal Markets*, 78 VA. L. REV. 623, 662–70 (1992).

III. *AMGEN* AND *HALLIBURTON*

A. Amgen

Given the shortcomings of the market efficiency as a gatekeeper—and in particular its failure to screen out frivolous claims against large publicly traded firms—defendants in securities-fraud cases have repeatedly pressed to expand the showings required from plaintiffs prior to class certification. One such argument was at issue in *Amgen*. In the *Amgen* litigation, Connecticut Retirement Plans and Trust Funds (Connecticut Retirement) sought to certify a securities-fraud class action against Amgen, alleging material misstatements that allegedly inflated Amgen's stock price by approximately nine percent.[118] Connecticut Retirement sought to invoke the FOTM presumption of reliance.[119]

Amgen conceded market efficiency, but argued that Connecticut Retirement should be required to prove—not merely allege—the materiality of the alleged misstatements prior to class certification.[120] Amgen argued that if the alleged misstatements were not material, the market price could not have been affected by them, and thus the plaintiffs could not be said to have relied upon them by relying on the market price.[121] As a result, Amgen argued, the notion of indirect reliance that underlies the FOTM presumption is severed in the absence of materiality. Thus, Amgen claimed, until materiality is proven, a court cannot be assured that individual reliance will not be an issue, rendering class treatment unavailable under Rule 23(b)(3) on the grounds that common issues will not "predominate."[122]

A six-justice majority, however, rejected Amgen's argument. The Court's opinion, authored by Justice Ginsburg, makes a straightforward argument. The relevant issue under Rule 23(b)(3), the Court noted, is simply whether the plaintiffs' claims are susceptible to common proof, without raising a welter of individual issues.[123] Materiality is a common issue.[124] Furthermore, materiality is an essential element on the merits. A

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[118] Amgen Inc. v. Conn. Ret. Plans & Trust Funds, 133 S. Ct. 1184, 1190–91 (2013); Brief for Respondent in Opposition at 3, *Amgen,* 133 S. Ct. 1184 (No. 11-1085).

[119] *Amgen*, 133 S. Ct. at 1190.

[120] *Id.* at 1190–91.

[121] *Id.* at 1191, 1205 (Scalia, J., dissenting) ("Of course it makes no sense to 'presume reliance' on the misrepresentation merely because the plaintiff relied on the market price, *unless* the alleged misrepresentation would likely have affected the market price—that is, unless it was material.").

[122] *Id.* at 1195. (majority opinion)

[123] *Id.* at 1191 ("Rule 23(b)(3) requires a showing that *questions* common to the class predominate, not that those questions will be answered, on the merits, in favor of the class.").

[124] *Id.* ("Because materiality is judged according to an objective standard, the materiality of Amgen's alleged misrepresentations and omissions is a question common to all members of the class Connecticut Retirement would represent. The

finding that the alleged misstatements were immaterial would instantly end the case, rendering all other questions moot.[125] As a result, whether individual questions predominate can never turn on the question of materiality.[126] If the plaintiffs *can* prove materiality, then the FOTM presumption of reliance is appropriate, and individual questions of reliance will not predominate. If the plaintiffs *cannot* prove materiality, reliance becomes an individual question, but it also becomes a moot question, because the case is over.[127]

On the narrow 23(b)(3) issue, the result of *Amgen* is coherent[128] and probably correct, if you accept *Basic* as settled law. As a practical matter, however, the entire notion that materiality will ultimately be decided on the merits borders on the fanciful, given that securities-fraud claims almost universally settle once a class has been certified.[129] Thus, there may be something to be said for Justice Scalia's argument in dissent. In keeping with the common-law-style development of securities-fraud law, Scalia suggests that *Basic* need not and should not be read to lead to such an infelicitous result.[130] Instead, he suggests that *Basic* established not just a

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alleged misrepresentations and omissions, whether material or immaterial, would be so equally for all investors composing the class.").

[125] *Id.* ("[A] failure of proof on the issue of materiality would end the case, given that materiality is an essential element of the class members' securities-fraud claims.").

[126] *Id.* ("In no event will the individual circumstances of particular class members bear on the inquiry.").

[127] This feature distinguishes materiality from other circumstances the Court has required plaintiffs to establish at class certification, such as that they bought or sold during the period of the alleged misrepresentation, or market efficiency itself. *See* Erica P. John Fund, Inc. v. Halliburton Co., 131 S. Ct. 2179, 2185 (2011). If the named plaintiff did not purchase or sell during the class period, that does not end the case on the merits, it simply renders the named plaintiff an inappropriate member of the class and, thus, an inappropriate class representative. A new plaintiff may still be substituted. Likewise, if market efficiency cannot be established, under current doctrine, the case does not fail on the merits. The plaintiffs can still attempt to show individual reliance. *Id.*

[128] Interestingly, while Justice Scalia joined Justice Thomas' dissent, he did not join the essential portion of the dissent that challenged the majority's reasoning. In his own separate dissent, Scalia described the majority's reasoning as "logical[] enough"—a fairly glowing endorsement by his standards. *Amgen*, 133 S. Ct. at 1204–05 (Scalia, J., dissenting).

[129] Out of approximately 4,000 securities-fraud suits filed since passage of the PSLRA, fewer than two dozen have proceeded to trial. *See* RENZO COMOLLI ET AL., RECENT TRENDS IN SECURITIES CLASS ACTION LITIGATION: 2012 FULL-YEAR REVIEW 38–39 (Jan. 29, 2013), http://www.nera.com/content/dam/nera/publications/archive2/PUB_Year_End_Trends_2012_1113.pdf.

[130] *Amgen*, 133 S. Ct. at 1206 (Scalia, J., dissenting) ("It does an injustice to the *Basic* Court to presume without clear evidence—and indeed in the face of language to the contrary—that it was establishing a regime in which not only those market class-action suits that have earned the presumption of reliance pass beyond the crucial certification stage, but *all* market-purchase and market-sale class-action suits do so, no matter what the alleged misrepresentation.").

rule for substantive liability, but also a rule for "the question whether certification is proper."[131]

The outcome of *Amgen* was important in its own right, even if not particularly surprising. The more important question was one that was not before the Court: the continuing vitality of *Basic* and the FOTM presumption itself. Both of the dissents expressed misgivings about *Basic* and the FOTM doctrine. Justice Scalia's separate dissent denigrated the FOTM doctrine indirectly, and primarily rhetorically. He referred to the FOTM rule as being "found nowhere in the United States Code or in the common law of fraud or deception," and described it as having been "invented" by the *Basic* Court.[132] He ended his dissent by declaring that the majority's "holding does not merely accept what some consider the regrettable consequences of the four-justice opinion in *Basic*; it expands those consequences from the arguably regrettable to the unquestionably disastrous."[133] Despite these decidedly negative characterizations of *Basic*, Justice Scalia nonetheless relies on a detailed examination of the holding in *Basic* and describes his analysis as rooted "in the opinion of *Basic*."[134] Despite his evident misgivings, nowhere does Scalia's separate dissent directly call for revisiting the holding of *Basic*. At one point, he even twits the majority's holding as "do[ing] an injustice to the *Basic* Court."[135] Nonetheless, Justice Scalia certainly implied that he would welcome an opportunity to overturn *Basic* altogether.

The principal dissent, authored by Justice Thomas and joined by Justice Kennedy in full and Justice Scalia in part, echoed the somewhat derogatory tone of Scalia's dissent in describing *Basic*. Thomas emphasized that "four Justices of a six-Justice Court created the fraud-on-the-market presumption" and describes FOTM as "a judicially invented doctrine based on an economic theory."[136] Unlike Scalia, however, Thomas then went beyond using belittling language, declaring that:

> The *Basic* decision itself is questionable. Only four Justices joined the portion of the opinion adopting the fraud-on-the-market theory. Justice White, joined by Justice O'Connor, dissented from that section, emphasizing that "[c]onfusion and contradiction in court rulings are inevitable when traditional legal analysis is replaced with economic theorization by the federal courts" and that the Court is "not well equipped to embrace novel constructions of a statute based on contemporary microeconomic theory." Justice White's

[131] *Id.* at 1205.
[132] *Id.* at 1204.
[133] *Id.* at 1206.
[134] *Id.* at 1205.
[135] *Id.* at 1206.
[136] *Id.* at 1212–13 (Thomas, J., dissenting).

concerns remain valid today, but the Court has not been asked to revisit *Basic*'s fraud-on-the-market presumption.[137]

Moreover, Justice Alito, who joined the majority opinion, wrote a separate concurrence explicitly declaring that "reconsideration of the *Basic* presumption may be appropriate."[138] Justice Alito gave as the reason for his desire to revisit *Basic* that "[a]s the dissent observes, more recent evidence suggests that the [FOTM] presumption may rest on a faulty economic premise."[139]

The dissenting (and concurring) justices in *Amgen* were hardly the first to claim that the FOTM doctrine depends for its vitality on the ECMH. Justice White suggested as much in his dissent in *Basic* itself,[140] as have a long line of courts and academic commentators, before and after *Basic*.[141] Nor were the *Amgen* justices the first to suggest that developments

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[137] *Id.* at 1208 n.4. (alteration in original) (citations omitted) (quoting Basic Inc. v. Levinson, 485 U.S. 224, 252–53 (1988) (White, J., concurring and dissenting)).

[138] *Id.* at 1204 (Alito, J., concurring).

[139] *Id.* (citing Langevoort, *supra* note 77, at 175–76).

[140] *Basic,* 485 U.S. at 253 (White, J., concurring and dissenting) (criticizing the Court for adopting the FOTM doctrine without expertise in the "efficient-capital-market hypothesis").

[141] *E.g.*, Conn. Ret. Plans & Trust Funds v. Amgen, Inc., 660 F.3d 1170, 1173 (9th Cir. 2011), *aff'd*, 133 S. Ct. 1184 (2013) ("[The FOTM] doctrine, first approved by the Supreme Court in *Basic*, rests on the efficient-capital-market hypothesis: The price of a stock traded in an efficient market fully reflects all publicly available information about the company and its business." (citation omitted)); *In re* DVI, Inc. Sec. Litig., 639 F.3d 623, 631 (3d Cir. 2011) ("The Supreme Court appears to have endorsed the semi-strong version of the efficient capital market hypothesis."); Schleicher v. Wendt, 618 F.3d 679, 685 (7th Cir. 2010) ("[T]he fraud-on-the-market doctrine rests on the semi-strong form [of the ECMH]."); ATSI Commc'ns, Inc. v. Shaar Fund, Ltd., 493 F.3d 87, 100 n.4 (2d Cir. 2007) ("The efficient capital market hypothesis, as adopted by the Supreme Court, posits that 'the market price of shares traded on well-developed markets reflects all publicly available information.'" (quoting *Basic*, 485 U.S. at 246)); Raab v. Gen. Physics Corp., 4 F.3d 286, 289 (4th Cir. 1993) (claiming that the FOTM presumption assumes "the market price has internalized all publicly available information"); Freeman v. Laventhol & Horwath, 915 F.2d 193, 197 (6th Cir. 1990) ("The fraud on the market theory rests on the assumption that the price of an actively traded security in an open, well-developed, and efficient market reflects all the available information about the value of a company."); *In re* Fed. Home Loan Mortg. Corp. (Freddie Mac) Sec. Litig., 281 F.R.D. 174, 177 (S.D.N.Y. 2012) ("The fraud on the market theory is based on the semi-strong form of market efficiency."); Camden Asset Mgmt., L.P. v. Sunbeam Corp., No. 99-CV-8275, 2001 WL 34556527, at *5 (S.D. Fla. July 3, 2001) ("[The ECMH] has been a staple of the legal canon ever since a divided Supreme Court embraced the soundness of the hypothesis in the course of applying the 'fraud on the market' rationale . . . ."); Ravens v. Iftikar, 174 F.R.D. 651, 663 (N.D. Cal. 1997) ("[T]he efficient capital markets hypothesis allows a court to assume that any material misrepresentation made by an issuer of securities will quickly and accurately be reflected in the market price of that issuer's securities . . . ."); *In re* LTV Sec. Litig., 88 F.R.D. 134, 144–45 (N.D. Tex. 1980); Adams & Runkle, *supra* note 81, at 1109 ("The Court based its adoption of the fraud-on-the-market theory on its implicit assumption of the validity of the principles underlying the ECMH . . . . Although the Court did not state its acceptance of the ECMH by

in economics have called into question the ECMH in ways that undercut the logic of the FOTM doctrine. Again, Justice White suggested the possibility in his *Basic* dissent,[142] and while the lower courts have generally kept their skepticism in check, an increasing number of academic commentators have picked up and built upon Justice White's objections.[143]

Of course, it is the views of the justices that carry the greatest import, as they are the ones in a position to act on their skepticism by revisiting *Basic*. Hot on the heels of *Amgen*, they had an opportunity to do just that.

B. Halliburton

In November of 2013, the Supreme Court agreed to hear *Halliburton v. Erica P. John Fund* in the Spring Term.[144] The first question presented in the petition for writ of certiorari was "[w]hether this Court should overrule or substantially modify the holding of *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), to the extent that it recognizes a presumption of classwide reliance derived from the fraud-on-the-market theory."[145] Thus, a full reconsideration of *Basic* appeared to be imminent, though the petitioner also presented a second question, "[w]hether, in a case where the plaintiff invokes the presumption of reliance to seek class certification, the defendant may rebut the presumption and prevent class certification by introducing evidence that the alleged misrepresentations did not distort the market price of its stock."[146] This question presented the Court with an "out," as the petitioners noted that it could be answered in the affirmative "[e]ven if the Court is not inclined to overrule *Basic*."[147]

1. Background

Erica P. John Fund is the lead plaintiff in a securities class action against Halliburton and its CEO, alleging several instances of misrepresentations relating to the financial condition of the company.[148] The Supreme Court had already been involved in this case once before on a related issue. The Fund invoked the FOTM presumption of reliance. Under existing Fifth Circuit precedent at the time, the plaintiff was re-

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name, the Court unmistakably stated its acceptance of the ECMH in substance . . . ."); Fischel, *supra* note 48, at 9–10; Macey & Miller, *supra* note 59, at 1077 ("Despite this disclaimer, the Court was adopting the semi-strong version of the efficient capital markets hypothesis, whether it was aware it was doing so or not."); Note, *supra* note 57, at 1155–56; Lynn, *supra* note 57, at 649.

[142] *Basic*, 485 U.S. at 254 (White, J., concurring and dissenting) (noting that "the economists' theories which underpin the fraud-on-the-market presumption . . . may or may not prove accurate upon further consideration").

[143] *See supra* note 81 and accompanying text.

[144] Halliburton Co. v. Erica P. John Fund, Inc., 134 S. Ct. 636 (2013).

[145] Petition for a Writ of Certiorari at i, Halliburton Co. v. Erica P. John Fund, Inc., 134 S. Ct. 2398 (2014) (No. 13-317).

[146] *Id.*

[147] *Id.* at 4.

[148] *Id.*

quired to establish loss causation at the class-certification stage in order to invoke FOTM.[149] The Fund failed to do so, and thus was denied class certification on the grounds that individual questions of reliance would predominate. The Fifth Circuit affirmed.[150] The Supreme Court, however, granted certiorari and reversed, holding that it is not necessary for plaintiffs to establish loss causation at class certification.[151] Loss causation—usually involving the question of whether disclosure of the misrepresentation caused a price drop—is itself susceptible to common proof, and "addresses a matter different from whether an investor relied on a misrepresentation, presumptively or otherwise, when buying or selling a stock."[152] An investor may have "purchased the stock at a distorted price, and thereby presumptively relied on the misrepresentation reflected in that price" yet "not be able to prove loss causation."[153]

Of course, the obvious question arising from this reasoning is whether the defendant can defeat application of the FOTM presumption by showing that the market price was not, in fact, distorted.[154] Halliburton sought to make this argument before the Supreme Court the first time around, but the Court declined to consider the issue, as the circuit court had not addressed it. As a result, the opinion was confined to loss causation.[155] On remand, Halliburton directly raised the market-impact argument, seeking to introduce, at class certification, evidence establishing that the alleged misrepresentations had no market impact. The district court rejected the argument summarily and again certified a class.[156] On appeal, just after the Supreme Court handed down the *Amgen* opinion, the Fifth Circuit affirmed the class certification.[157] The Court of Appeals held that market impact is akin to materiality in that, while market impact is not an "element" of securities fraud, the absence of a market impact would doom all potential class members' claims together. Thus, as

[149] *See* Oscar Private Equity Invs. v. Allegiance Telecom, Inc., 487 F.3d 261, 267 (5th Cir. 2007); *Erica P. John Fund*, 131 S. Ct. at 2186 ("Loss causation . . . requires a plaintiff to show that a misrepresentation that affected the integrity of the market price *also* caused a subsequent economic loss.").

[150] Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co., 597 F.3d 330, 334 (5th Cir. 2010).

[151] *Erica P. John Fund*, 131 S. Ct. at 2187.

[152] *Id.* at 2186.

[153] *Id.*

[154] An alternative question arising from this reasoning, although it would be a departure from prior judicial practice, is whether plaintiffs should be required to show price distortion in order to gain the FOTM presumption of reliance. This possibility is discussed further in Part VI, *infra*.

[155] *Erica P. John Fund*, 131 S. Ct. at 2187.

[156] Archdiocese Supporting Fund, Inc. v. Halliburton Co., No. 3:02-CV-1152-M, 2012 WL 565997, at *3 (N.D. Tex. Jan. 27, 2012).

[157] Erica P. John Fund, Inc. v. Halliburton Co., 718 F.3d 423, 436 (5th Cir. 2013).

with materiality, a lack of market impact would simply end the case rather than causing individual reliance issues to predominate.[158]

In its petition for certiorari, Halliburton—emboldened by the skepticism of the four dissenting and concurring justices in *Amgen*—decided to launch a full frontal assault on *Basic* and the FOTM presumption,[159] with the market impact argument retained as a mere backup.[160] In its brief on the merits, Halliburton made two arguments. First, Halliburton argued that the FOTM presumption was inconsistent with the Court's usual interpretive practice of modeling implied causes of action on the most closely analogous express cause of action.[161] As the only express private right of action in existence at the time of section 10(b)'s enactment addressing fraud affecting aftermarket prices, the petitioners identify section 18(a) of the 1934 Act as the most closely analogous to 10(b).[162] Sec-

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[158] *Id.* at 434 ("Although the 10b-5 fraud action does not expressly require proof of price impact as an element of the claim, a plaintiff must nevertheless prevail on this fact in order to establish another element on which the plaintiff does bear the burden of proof: loss causation."). As is discussed further, *infra*, this conclusion is debatable. An investor who relies on a misrepresentation can suffer a loss—say, an avoidable tax loss—despite the absence of any market impact. Thus it is only *almost* the case that all plaintiffs' claims will be doomed absent market impact. This stands in contrast to materiality, the lack of which does doom all claims—by definition, an investor cannot have relied on a statement that is immaterial.

[159] Petition for a Writ of Certiorari, *supra* note 145, at 12–25.

[160] *Id.* at 26–32.

[161] Brief for Petitioners, *supra* note 2, at 12.

[162] *Id.*; *see also* Musick, Peeler & Garrett v. Emp'rs Ins., 508 U.S. 286, 294–97 (1993). In *Musick, Peeler & Garrett*, the Court identified sections 9 and 18 as the provisions most analogous to the implied private right of action under 10(b), noting that "both target the precise dangers that are the focus of § 10(b)" and that "the intent motivating all three sections is the same." 508 U.S. at 296 (quoting Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. 350, 360 (1991)) (internal quotation marks omitted); *see also* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 211 n.31 (1976) (examining the legislative history of section 18 as an aid to interpreting the scope of 10b-5 actions).

The principal difference between 10(b) and 18(a) is that 18(a) limits liability to false statements in documents filed with the SEC, while 10(b) does not. Section 18 reads, in part "Any person who shall make or cause to be made any statement in any application, report, or document filed pursuant to this chapter or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 78o of this title [concerning registration and regulation of brokers and dealers], which statement was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, shall be liable to any person (not knowing that such statement was false or misleading) who, in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement, for damages caused by such reliance, unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading. A person seeking to enforce such liability may sue at law or in equity in any court of competent jurisdiction. In any such suit the court may, in its discretion, require an undertaking for the payment of the costs of such suit, and assess reasonable costs, including reasonable attorneys' fees, against either party litigant." 15 U.S.C. § 78r(a) (2012).

tion 18(a), however, allows recovery only for plaintiffs who, "in reliance upon" the alleged misrepresentation, "purchased or sold a security at a price which was affected by such statement."[163] In light of this language and the relevant legislative history,[164] courts have consistently required actual "eyeball or eardrum" reliance—that is, the plaintiff must prove that he actually read and relied on the relevant document filed with the SEC.[165] The FOTM doctrine has never been applied in Section 18(a) litigation.[166] As a result, the petitioners conclude, the Court ought to require actual reliance in 10(b) litigation as well.[167]

Again, however, perhaps taking their cue from the *Amgen* Justices, Halliburton—both in its certiorari petition and in its main brief—placed market efficiency front and center, hyperbolically claiming that "*Basic* is premised on economic theory that is now roundly rejected"[168] and "[e]conomists now largely agree that *Basic*'s efficient-market hypothesis does not reflect reality."[169] Relatedly, the petitioners argued that many in-

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[163] 1934 Act § 18(a) (codified as amended at 15 U.S.C. § 78r(a)).

[164] *See* Grundfest, *supra* note 35, at 4–6, 30.

[165] *See, e.g.*, 4 Thomas Lee Hazen, Treatise on the Law of Securities Regulation § 12.18[2], at 412 (6th ed. 2009) ("The section 18(a) cause of action is available to any investor who, after having read the faulty document filed, *actually relies* upon statements in the document and is therefore injured. . . . [T]he actual reliance requirement in section 18(a) means that constructive reliance will not suffice."); Heit v. Weitzen, 402 F.2d 909, 916 (2d Cir. 1968) ("Reliance on the actual 10K report is an essential prerequisite for a Section 18 action and constructive reliance is not sufficient."); Cohen v. Stevanovich, 722 F. Supp. 2d 416, 433 (S.D.N.Y. 2010) (actual reliance required); Jacobson v. Peat, Marwick, Mitchell & Co., 445 F. Supp. 518, 525 (S.D.N.Y. 1977) ("[C]onstructive reliance will not suffice [in section 18 claims]. Plaintiff may only recover if he is able to establish reliance on the actual 10-K form." (citation omitted)).

[166] Hazen, *supra* note 165, § 12.18[2], at 412 ("Reliance based on a 'fraud on the market' theory may be the foundation for a remedy under Rule 10b-5, but will not satisfy section 18(a)'s requirements." (footnote omitted)).

[167] Brief for Petitioners, *supra* note 2, at 12–13. Professor Joseph Grundfest develops this argument in great detail in a recent working paper, concluding that "because the right of recovery under the implied Section 10(b) private right of action cannot be broader than the equivalent express private right, it follows that plaintiffs in implied private rights of action under Section 10(b) must also demonstrate actual eyeball reliance as a precondition to the recovery of money damages . . . . The current practice . . . is thus inconsistent with the Supreme Court's textual approach to the interpretation of Section 10(b)." Grundfest, *supra* note 35, at 32.

[168] Petition for a Writ of Certiorari, *supra* note 145, at 13.

[169] Brief for Petitioners, *supra* note 2, at 15. Unfortunately, the petitioner's briefs are hardly a model of thoughtful advocacy, repeatedly citing articles for propositions they do not support. To take but a single example, in their discussion of academic skepticism of the ECMH, the petitioners cite William Bratton and Michael Wachter for the proposition that "*Basic*'s efficient-markets theory 'simply did not work in practice.'" *Id.* But Bratton and Wachter's article (and the articles it cites as representing the academic consensus) barely mentions the ECMH at all, but rather condemns the FOTM doctrine almost entirely on the basis that enterprise liability and out-of-pocket damages make it a woefully blunt policy tool for pursuing deterrence or improved corporate governance. *See* Bratton & Wachter, *supra* note 7,

vestors trade not "in reliance on the integrity of the market price," as envisioned in *Basic*, but rather in a belief that the market price is incorrect.[170]

2. *The* Halliburton *Opinion*

Given the heated speculation around the *Halliburton* case, the actual ruling turned out to be a bit anticlimactic. Instead of a radical overhaul of the 10b-5 action, Chief Justice Roberts took a more minimalist approach. In doing so, he was joined by Justices Ginsburg, Kagan, Breyer, Sotomayor, and Kennedy, with Kennedy evidently having reconsidered his seeming enthusiasm for reconsidering *Basic* in *Amgen*. Describing *Basic* as "a long-settled precedent," Roberts found that Halliburton had failed to show a "special justification" for overturning it, as required by *Dickerson v. United States*.[171] He dismissed the argument that implied 10(b) actions should be no broader than express 18(a) actions, simply noting that the "dissenting Justices [had] made the same argument" in *Basic*, and that "[t]he *Basic* majority did not find [it] persuasive then, and Halliburton has given us no new reason to endorse it now."[172]

The majority then dismissed the argument that evolving evidence on market efficiency had fatally undermined *Basic*, holding—correctly, as will be discussed more fully below—that "[t]he academic debates discussed by Halliburton have not refuted the modest premise underlying the presumption of reliance. Even the foremost critics of the efficient-capital-markets hypothesis acknowledge that public information generally affects stock prices."[173] The majority quotes Judge Easterbrook—one of the foremost academic practitioners of law and economics—noting that just because "the . . . price [of a stock] may be inaccurate does not de-

at 72–73. Similarly, the petitioners cite Barbara Black as "repudiat[ing] *Basic's* economic premise," quoting her as saying that "[b]ecause the notion of information efficiency upon which the fraud-on-the-market presumption rests is crumbling under sustained academic scrutiny, the future of securities fraud class action litigation—dependent on this presumption—may be in jeopardy." Brief for Petitioners, *supra* note 2, at 21–22 (quoting Barbara Black, Essay, *Behavioral Economics and Investor Protection: Reasonable Investors, Efficient Markets*, 44 LOY. U. CHI. L.J. 1493, 1502 (2013)) (emphasis and internal quotation marks omitted). The petitioner neglects to mention however, that the entire passage quoted from Black's article is itself a quote of a district court opinion. *See id.* Nor does the petitioner mention that, two sentences later, Black writes in her own voice, "I submit, however, that the persuasive power of *Basic* does not depend on acceptance of the efficient market hypothesis." *Id.*

170 Brief for Petitioners, *supra* note 2, at 16.

171 Halliburton Co. v. Erica P. John Fund, Inc., 134 S. Ct. 2398, 2407 (2014) ("Before overturning a long-settled precedent, however, we require 'special justification,' not just an argument that the precedent was wrongly decided. Halliburton has failed to make that showing." (citing Dickerson v. United States, 530 U.S. 428, 443 (2000))).

172 *Id.* at 2409.

173 *Id.* at 2410.

tract from the fact that false statements affect it, and cause loss, which is all that *Basic* requires."[174] Nor did the majority find relevant the fact that many investors do not believe market prices to be accurate, noting that even a value investor "presumably tries to estimate *how* undervalued or overvalued a particular stock is, and such estimates can be skewed by a market price tainted by fraud."[175]

Instead of wiping out the fraud-on-the-market doctrine altogether, the majority sought to chart a middle course, allowing defendants the opportunity to rebut the presumption of reliance at the class-certification stage by showing that the alleged misrepresentations had no impact on the market price.[176] Noting that the *Basic* Court had allowed for the possibility of defendants rebutting the applicability of the FOTM presumption at class certification, the Court largely adopted the position advocated by the law professors Adam Pritchard and Todd Henderson in an amicus brief that was heavily discussed at oral argument.[177]

The plausibility of this result, particularly in light of *Amgen*, is questionable, and is discussed further below.[178] The concurring justices—Justice Thomas, joined by Justices Scalia and Alito—focus not on criticizing the actual result, but rather on criticizing the failure to go further by overruling *Basic* altogether.[179] Unfortunately, after briefly suggesting that an implied right of action for securities fraud is not in keeping with more recent precedent, and largely ignoring the powerful textual arguments put forward by the petitioners and developed at length by Professor Grundfest,[180] Thomas devotes most of his effort to the argument that recent economic research calling into question the ECMH has undermined the FOTM doctrine. Thomas argues that *Basic*'s "view of market efficiency has since lost its luster."[181] In particular, he maintains that "even 'well-developed' markets (like the New York Stock Exchange) do not uniformly incorporate information into market prices with high speed," and that "'overwhelming empirical evidence' now suggests that even when markets do incorporate public information, they often fail to do so accurately."[182]

The concurrence further maintains that "[m]any investors in fact trade . . . because they think the market has under- or overvalued the

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[174] *Id.* (alterations in original) (quoting Schleicher v. Wendt, 618 F.3d 679, 685 (7th Cir. 2010)) (internal quotation marks omitted).

[175] *Id.* at 2411.

[176] *Id.* at 2414–17.

[177] *See* Brief of Law Professors as Amici Curiae in Support of Petitioners at 27–28, *Halliburton*, 134 S. Ct. 2398 (No. 13-317).

[178] *See infra* Part VI.

[179] *Halliburton*, 134 S. Ct. at 2418 (Thomas, J., concurring).

[180] *See* Grundfest, *supra* note 35, at 32.

[181] *Halliburton*, 134 S. Ct. at 2421 (Thomas, J., concurring).

[182] *Id.* (quoting Baruch Lev & Meiring de Villiers, *Stock Price Crashes and 10b-5 Damages: A Legal, Economic, and Policy Analysis*, 47 STAN. L. REV. 7, 20 (1994)).

stock, and they believe they can profit from that mispricing."[183] In doing so, Thomas argues, they are trading "without regard for price 'integrity,'" thus rendering anomalous a presumption of reliance on the integrity of the market price.[184]

As the majority suggests—and as the next section will demonstrate in greater detail—this argument is misguided as applied to *Basic* and the FOTM doctrine. Moreover, such extreme expressions of skepticism as to market efficiency are likely to do significant mischief if extended to other contemporary legal debates.

IV. THE EFFICIENT-CAPITAL-MARKETS HYPOTHESIS IS LARGELY IRRELEVANT TO *BASIC*

The *Halliburton* concurrence's focus on the ECMH is regrettable, but understandable. A steady drumbeat of case law and commentary—culminating in the concurrence and dissents in *Amgen* and *Halliburton*—has claimed an essential connection between the FOTM presumption of reliance and the ECMH. This drumbeat, however, is misleading. The FOTM presumption does assume that market prices reflect and transmit information, including fraudulent information. It also assumes that traders rely on the integrity of market prices—not necessarily on the market prices being *correct*[185]—but simply that they have not been fraudulently distorted. These assumptions are, as the *Halliburton* majority emphasizes, far more modest than those underlying the ECMH. Furthermore, these assumptions have not been meaningfully called into question by research into the shortcomings of the ECMH. Most fundamentally, one may believe in the ECMH and still believe the FOTM doctrine is bad policy. Equally, one may reject the ECMH and still believe that it usually makes little sense to require securities-fraud plaintiffs to demonstrate reliance.

This Part proceeds in three Sections. First, it demonstrates how routine it has become to claim that the FOTM doctrine depends intimately on the ECMH. Second, it discusses attempts to discredit the FOTM doctrine by criticizing the ECMH. Third, it shows how the FOTM doctrine does not live or die with the ECMH, and how recent criticism of the ECMH does little to undercut the FOTM doctrine.

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[183] *Id.* at 2422.

[184] *Id.*

[185] By this, I simply mean that prices need not be an infallible measure of the so-called "fundamental value" of the stock—usually defined as the net present value of the future cash flows to the stockholder. *See* Jill E. Fisch, *The Trouble with* Basic: *Price Distortion After* Halliburton, 90 WASH. U. L. REV. 895, 912 (2013); Robert G. Newkirk, Comment, *Sufficient Efficiency: Fraud on the Market in the Initial Public Offering Context*, 58 U. CHI. L. REV. 1393, 1398–99 (1991) (explaining the concept of fundamental value).

A. Claims That FOTM Doctrine Depends on the ECMH

While the *Halliburton* majority disavows it, conventional judicial wisdom has long been that adherence to *Basic*—and to the FOTM doctrine as a whole—demands adherence to the ECMH, as well. While many early discussion of the FOTM doctrine did not discuss market efficiency, the concepts began to become entangled in the 1980s. As discussed above, Daniel Fischel's 1982 article helped to crystallize the idea that FOTM and the ECMH were inextricably linked.[186]

Even before Fischel's article, however, one district court, in adopting the FOTM presumption, claimed that "economists have now amassed sufficient empirical data to justify a present belief that widely-followed securities of larger corporations are 'efficiently' priced: the market price of stocks reflects all available public information—and hence necessarily, any material misrepresentations as well."[187] Two student notes tying FOTM to ECMH also appeared in 1982.[188] As the 1980s progressed, an increasing number of courts[189] and academic commentators sought to re-

[186] *See* Fischel, *supra* note 48, at 10. Ironically, the main function of the ECMH in Fischel's argument was not to support the idea that fraud can distort market prices—an idea that hardly requires a belief in efficient markets. Rather, Fischel's most forceful use of the ECMH was to argue that, as a policy matter, it is a bad idea to require investors to expend resources and effort reading corporate disclosures, given that the information they contain will already be reflected in the market price. *Id.* at 4 (arguing that, because market prices already reflect the information in corporate disclosures, "investors would be wasting their money" by reading them). This notion provides a policy justification for abandoning the reliance element in securities-fraud actions, and does depend on a relatively robust belief in efficient markets. *But see* Paul G. Mahoney, *Precaution Costs and the Law of Fraud in Impersonal Markets*, 78 VA. L. REV. 623 (1992) (arguing that eliminating the reliance requirement would, in practice, actually *discourage* reliance and lead to waste).

[187] *In re* LTV Sec. Litig., 88 F.R.D. 134, 144 (N.D. Tex. 1980).

[188] *See* Lynn, *supra* note 57, at 648–49 ("Empirical studies of securities prices before and after important financial disclosures confirm the hypothesis that market forces rapidly adjust prices to reflect new information. The studies thus support one presumption embraced by the fraud-on-the-market theory: manipulation of material information distorts market prices." (footnote omitted)); Note, *supra* note 57, at 1155–56 ("The available empirical evidence suggests that the large, impersonal, 'developed' markets to which the courts have applied efficient-market reasoning are indeed efficient. Even beyond its empirical validity, the efficient-market hypothesis argues persuasively for the adoption of the *Blackie* version of the fraud-on-the-market theory." (footnote omitted)). The Harvard Law Review Note goes on to suggest that, "[b]ecause a developed-market investor may be injured simply by trading at a price distorted by the reliance of other traders, causation in that setting should not hinge on 'actual reliance.'" *Id.* at 1156.

[189] *See, e.g.*, Peil v. Speiser, 806 F.2d 1154, 1163 (3d Cir. 1986) (claiming that "a well-developed market can reasonably be presumed to respond to even a single material misrepresentation or omission concerning a stock"); Reingold v. Deloitte Haskins & Sells, 599 F. Supp. 1241, 1264 (S.D.N.Y. 1984) ("In [inefficient] markets, the price of a security does not necessarily reflect all [information, thus] an inference of . . . reliance is inapposite.").

late the idea of efficient markets to the proper handling of securities-fraud claims.

Ultimately, of course, Justice White's dissent in *Basic* cemented the idea that the *Basic* plurality's ruling depended on the validity of the ECMH. Justice White described the ruling as "embrac[ing] novel constructions of a statute based on contemporary microeconomic theory,"[190] citing to an article discussing the ECMH.[191] Following *Basic*, a number of influential scholars agreed with White that the plurality had "adopt[ed] the semi-strong version of the efficient-capital-markets hypothesis, whether it was aware it was doing so or not."[192] This contention has subsequently been repeated by dozens of courts.[193]

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[190] Basic Inc. v. Levinson, 485 U.S. 224, 253 (1988) (White, J., concurring and dissenting).

[191] Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549, 549–50 (1984).

[192] Macey & Miller, *supra* note 59, at 1077; *see also* Adams & Runkle, *supra* note 81, at 1109 ("The Court based its adoption of the fraud-on-the-market theory on its implicit assumption of the validity of the principles underlying the ECMH . . . . Although the Court did not state its acceptance of the ECMH by name, the Court unmistakably stated its acceptance of the ECMH in substance . . . ."); Frederick C. Dunbar & Dana Heller, *Fraud on the Market Meets Behavioral Finance*, 31 DEL. J. CORP. L. 455, 464 (2006) ("The efficient market hypothesis is the basis of the fraud-on-the-market theory that the Supreme Court established as a rebuttable presumption of liability for the majority of securities fraud cases."); Larry E. Ribstein, *Fraud on a Noisy Market*, 10 LEWIS & CLARK L. REV. 137, 168 (2006) (claiming that FOTM theory "was explicitly based on an assumption of market efficiency").

[193] *See, e.g.*, Conn. Ret. Plans & Trust Funds v. Amgen, Inc., 660 F.3d 1170, 1173 (9th Cir. 2011), *aff'd*, 133 S. Ct. 1184 (2013) ("[The FOTM] doctrine, first approved by the Supreme Court in *Basic*, rests on the efficient capital market hypothesis: The price of a stock traded in an efficient market fully reflects all publicly available information about the company and its business." (citation omitted)); *In re* DVI, Inc. Sec. Litig., 639 F.3d 623, 631 (3d Cir. 2011) ("The Supreme Court appears to have endorsed the semi-strong version of the efficient capital market hypothesis."); Schleicher v. Wendt, 618 F.3d 679, 685 (7th Cir. 2010) ("[T]he fraud-on-the-market doctrine rests on the semi-strong form [of the ECMH]."); ATSI Commc'ns, Inc. v. Shaar Fund, Ltd., 493 F.3d 87, 100 n.4 (2d Cir. 2007) ("The efficient capital market hypothesis, as adopted by the Supreme Court, posits that 'the market price of shares traded on well-developed markets reflects all publicly available information.'" (quoting *Basic*, 485 U.S. at 246)); Raab v. Gen. Physics Corp., 4 F.3d 286, 289 (4th Cir. 1993) (claiming that the FOTM presumption assumes "the market price has internalized all publicly available information"); Freeman v. Laventhol & Horwath, 915 F.2d 193, 197 (6th Cir. 1990) ("The fraud on the market theory rests on the assumption that the price of an actively traded security in an open, well-developed, and efficient market reflects all the available information about the value of a company."); *In re* Fed. Home Loan Mortg. Corp. (Freddie Mac) Sec. Litig., 281 F.R.D. 174, 177 (S.D.N.Y. 2012) ("The fraud on the market theory is based on the semi-strong form of market efficiency."); Camden Asset Mgmt., L.P. v. Sunbeam Corp., No. 99-CV-8275, 2001 WL 34556527, at *5 (S.D. Fla. July 3, 2001) ("[The ECMH] has been a staple of the legal canon ever since a divided Supreme Court embraced the soundness of the hypothesis in the course of applying the 'fraud on the market' rationale . . . ."); Ravens v. Iftikar, 174 F.R.D. 651, 663 (N.D. Cal. 1997) ("[T]he efficient capital market hypothesis allows a court to assume that any material

As discussed above, the apparent significance of market efficiency, combined with the need for some gatekeeping requirement to deal with the flood of securities class actions that followed *Basic*, led the lower courts to develop the requirement that plaintiffs seeking class certification show the relevant security traded in an "efficient market."[194] Class certification is the signal event in modern securities litigation, and market efficiency has become the primary battleground at the class-certification stage. As a result, judicial opinions in securities-fraud cases are replete with discussions of the ECMH and the degree of efficiency plaintiffs are required to establish. The current consensus across the courts of appeals is that plaintiffs are required to show that the relevant market is "informational[ly] efficien[t]," which is generally said to be congruent to the semi-strong form of the ECMH.[195]

B. Attacks on FOTM Doctrine via the ECMH

Given the centrality of market efficiency to actual securities-fraud cases, and the consistency with which courts have asserted the importance of the ECMH to the FOTM doctrine, it is unsurprising that opponents of the FOTM doctrine have attempted to undermine it by attacking the ECMH. Indeed, the digging began in *Basic* itself. In his dissent, Justice White repeatedly characterized the ECMH as a new and untested theory that had yet to survive the test of time.[196] As such, he suggested

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misrepresentation made by an issuer of securities will quickly and accurately be reflected in the market price of that issuer's securities . . . .").

[194] *See supra* Part II.B.

[195] Comprehensive citation would strain the storage capacity of SSRN. *See, e.g.*, *In re* Polymedica Corp. Sec. Litig., 432 F.3d 1, 19 (1st Cir. 2005) ("For purposes of establishing the fraud-on-the-market presumption of reliance, we adopt the prevailing definition of market efficiency, which provides that an efficient market is one in which the market price of the stock fully reflects all publicly available information. . . . This is known as 'information efficiency.'"); Gariety v. Grant Thornton, LLP, 368 F.3d 356, 367 (4th Cir. 2004) ("[I]n an efficient market, 'the market price . . . adjusts rapidly to reflect all new information.'" (quoting Macey & Miller, *supra* note 59, at 1060)); Greenberg v. Crossroads Sys., Inc., 364 F.3d 657, 661 n.6 (5th Cir. 2004) ("[W]here securities are traded in an efficient market, it is assumed that all public information concerning a company is known to the market and reflected in the market price of the company's stock."); No. 84 Emp'r-Teamster Joint Council Pension Trust Fund v. Am. W. Holding Corp., 320 F.3d 920, 947 (9th Cir. 2003) ("[I]n a modern and efficient securities market, the market price of a stock incorporates all available public information."); GFL Advantage Fund, Ltd. v. Colkitt, 272 F.3d 189, 208 (3d Cir. 2001) (defining an "efficient marketplace" as one "in which stock prices reflect all available relevant information about the stock's economic value"); Kowal v. MCI Commc'ns Corp., 16 F.3d 1271, 1276 n.1 (D.C. Cir. 1994) ("[I]n an efficient securities market all publicly available information regarding a company's prospects has been reflected in its shares' price.").

[196] *See Basic*, 485 U.S. at 250 (1988) (White, J., concurring and dissenting) (describing the ECMH as "a mere babe"), 253 (referring to it as a "contemporary microeconomic theory"), 253 n.4 (quoting Gilson & Kraakman, *supra* note 191, at

that it "may or may not prove accurate upon further consideration."[197] Anticipating later criticism from behavioral economics, White suggested that many market participants do not trade in reliance on the "integrity of the market price," but instead buy or sell a stock because they believe the market price is inaccurate.[198]

While lower courts have been understandably reserved in their criticism of the FOTM doctrine, a handful of recent opinions have claimed that new research on efficient markets undermines the doctrine's logic. For example, one Massachusetts district court suggested that "[b]ecause the notion of information efficiency upon which the fraud-on-the-market presumption rests is crumbling under sustained academic scrutiny, the future of securities fraud class action litigation—dependent on this presumption—may be in jeopardy."[199]

It is, thus, understandable that the concurring Justices in *Halliburton* jumped on this notion with both feet. The argument that a new "academic consensus" rejects the efficient-market hypothesis renders *Basic*'s presumption of reliance "fictional" took center stage in the petition for writ of certiorari, and was the lead argument in the petitioner's merits brief.[200]

550, describing the ECMH as "an economic concept that did not exist twenty years ago"), 255 (characterizing the ECMH as a "recent economic theor[y]").

[197] *Id.* at 254.

[198] *Id.* at 255–56 ("Indeed, 'many investors purchase or sell stock because they believe the price *inaccurately* reflects the corporation's worth.' If investors really believed that stock prices reflects a stock's 'value,' many sellers would never sell, and many buyers never buy (given the time and cost associated with executing a stock transaction)." (quoting Barbara Black, *Fraud on the Market: A Criticism of Dispensing with Reliance Requirements in Certain Open Market Transactions*, 62 N.C. L. REV. 435, 455 (1984)) (citation omitted)). Soon after *Basic*, Jonathan Macey picked up on this point, as well. *See* Jonathan R. Macey, *The Fraud on the Market Theory: Some Preliminary Issues*, 74 CORNELL L. REV. 923, 925–26 (1989) (noting that investors who seek to "beat the market" are "in essence betting that the market for the securities they are buying is in fact inefficient" and concluding that "[s]ome investors rely on market integrity and others do not"). As discussed *infra*, Macey does not attempt to draw any firm conclusions from these observations regarding the viability of the FOTM doctrine.

[199] *In re* Polymedica Corp. Sec. Litig., 453 F. Supp. 2d 260, 272 n.10 (D. Mass. 2006); *see also In re* Xcelera.com Sec. Litig., 430 F.3d 503, 511 (1st Cir. 2005) (expressing concern that the "rarity of efficient markets . . . would have the likely effect of making it unduly difficult to establish the fraud-on-the-market presumption of reliance"). As is discussed *infra*, to their credit, academic critics of FOTM doctrine—even where they suggest that new economic evidence suggests that aspects of FOTM doctrine as currently practiced are misguided—rarely argue that questions about the ECMH fundamentally challenge the rationale for a presumption of reliance. *But see* Dunbar & Heller, *supra* note 192, at 520–21 (2006) (arguing that behavioral economics suggests that many investors do not rely on the market price, and thus that reliance can rarely be a question common to the class).

[200] Brief for Petitioners, *supra* note 2, at 15–16; *see also* Brief for the United States as Amicus Curiae Supporting Respondent at 23, Halliburton Co. v. Erica P. John Fund, Inc., 134 S. Ct. 2398 (2014) (No. 13-317) ("Petitioners' primary contention is that the Court should abandon the fraud-on-the-market presumption because of academic debate regarding the efficient-market hypothesis." (citation omitted)).

A number of the briefs filed by amici also made versions of the argument that the FOTM doctrine is rendered incoherent by new economic understanding of the operation of markets.[201]

While hardly models of clarity, the arguments take several forms, attacking each link in the chain of indirect causation, and showing up in various guises in the concurrence itself. First is the simple assertion that the *Basic* Court's holding relied on the ECMH—supported by language from *Basic* about market prices reflecting "all publicly available information"[202]—and that, *ipso facto*, any evidence that undermines the ECMH therefore undermines the holding of *Basic*.[203] Though neither the concurrence nor the petitioners state it clearly, the essential intuition at work seems to be that if market prices are not semi-strong efficient, it makes little sense to assume that a material misrepresentation will rapidly be reflected in the market price. As a result, we cannot assume that an investor has indirectly relied on the misrepresentation by relying on the market price. Furthermore—though the concurrence does not make this argument—if markets are inefficient, it might be *unreasonable* for investors to rely on the market price.[204] A somewhat more limited version of this argument is that subsequent studies have shown that market efficiency is not a binary, all-or-nothing proposition. A market may be efficient at some times or for some types of information, but not at other times or for other types of information.[205]

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[201] *See* Brief for Amgen Inc. as Amicus Curiae in Support of Petitioners at 5, *Halliburton*, 134 S. Ct. 2398 (No. 13-317); Brief of the Securities Industry & Financial Markets Ass'n as Amicus Curiae in Support of Petitioners at 2, *Halliburton,* 134 S. Ct. 2398 (No. 13-317); Brief for Vivendi S.A. as Amicus Curiae in Support of Petitioners at 3, *Halliburton,* 134 S. Ct. 2398 (No. 13-317). Even the respondents got in on the act, urging the Court to uphold *Basic* in part because "the semi-strong efficient market hypothesis . . . continues to enjoy widespread support among economists." Brief in Opposition at 5–6, *Halliburton*, 134 S. Ct. 2398 (No. 13-317).

[202] *Basic*, 485 U.S. at 246.

[203] *See Halliburton,* 134 S. Ct. at 2421 ("In sum, economists now understand that the price impact *Basic* assumed would happen reflexively is actually far from certain even in 'well-developed' markets. Thus, *Basic*'s claim that 'common sense and probability' support a presumption of reliance rests on shaky footing."); Brief for Petitioners, *supra* note 2, at 15 ("'[F]urther consideration' has devastated *Basic*'s core premises. Economists now largely agree that *Basic*'s efficient-markets hypothesis does not reflect reality." (alteration in original)), 17 ("*Basic*'s presumption of reliance cannot coexist with the reality that . . . markets can prove extraordinarily *in*efficient and *ir*rational."); Brief for Amgen Inc. as Amicus Curiae in Support of Petitioners, *supra* note 201, at 2 ("[E]xperience has shown that the theoretical underpinnings of *Basic* are unsound . . . ."); Brief of the Securities Industry & Financial Markets Ass'n as Amicus Curiae in Support of Petitioners, *supra* note 201, at 2 ("[T]he economic theories underpinning the presumption have been debunked . . . .").

[204] *See* Brief of the Securities Industry & Financial Markets Ass'n as Amicus Curiae in Support of Petitioners, *supra* note 201, at 28.

[205] Brief for Petitioners, *supra* note 2, at 20–22; Brief of the Securities Industry & Financial Markets Ass'n as Amicus Curiae in Support of Petitioners, *supra* note 201, at 27–28 ("Since *Basic,* however, scholarship has demonstrated that market efficiency is not a 'binary, yes or no question.'"). As a general matter, this proposition is

A second line of attack focuses on the second link in the chain of causation by expanding upon Justice White's comment that many market participants trade in a belief that the market price is erroneous. Behavioral-economics researchers have since identified numerous types of trading activity—some rational and some not—where traders may not rely on the accuracy of the market price. These traders may range from value investors seeking stocks they believe are mispriced,[206] to momentum traders[207] to money managers engaging in herding behavior.[208] The natural argument, then, is that it makes little sense to assume that all investors have relied on the market price and thus, indirectly, on any misrepresentation.[209] The *Halliburton* concurrence makes this argument in especially forceful terms, describing the assumption "that investors categorically rely on the integrity of the market price" as "simply wrong,"[210] and claiming that without this assumption "*Basic*'s critical fiction falls apart."[211]

In short, the *Halliburton* concurrence—following the arguments of both parties and several amici[212]—frames challenges to the ECMH as fatal

uncontroversial. *See, e.g.*, Gilson & Kraakman, *supra* note 191, at 612–13; Langevoort, *supra* note 77, at 167; Macey & Miller, *supra* note 59, at 1083–87.

[206] *See* Louis Lowenstein, *Searching for Rational Investors in a Perfect Storm*, 30 J. Corp. L. 539, 543 (2005) (describing "value investors" as those who seek out stocks that have "intrinsic value" well above the market price).

[207] *See* Harrison Hong & Jeremy C. Stein, *A Unified Theory of Underreaction, Momentum Trading, and Overreaction in Asset Markets*, 54 J. Fin. 2143, 2143 (1999); J. Bradford De Long et al., *Positive Feedback Investment Strategies and Destabilizing Rational Speculation*, 45 J. Fin. 379, 381–84 (1990).

[208] *See generally* Abhijit V. Banerjee, *A Simple Model of Herd Behavior*, 107 Q.J. Econ. 797 (1992); Sushil Bikhchandani et al., *A Theory of Fads, Fashion, Custom, and Cultural Change as Informational Cascades*, 100 J. Pol. Econ. 992 (1992).

[209] Brief for Petitioners, *supra* note 2, at 15–16 ("[M]any investors' 'strategies' involve 'attempt[ing] to locate undervalued stocks in an effort to 'beat the market,' meaning that they 'are in essence betting that the market for the securities they are buying *is in fact inefficient*.' At most, therefore, '[s]ome investors rely on market integrity and others do not.'" (alterations in original) (citations omitted) (quoting Macey, *supra* note 198, at 925, 926)), 16 ("*Basic* simplistically presumed that investors generally purchase in reliance on the integrity of the market price. But reality demonstrates otherwise: the commonality of reliance generated by the *Basic* presumption is fictional." (citation omitted)); Brief for Amgen Inc. as Amicus Curiae in Support of Petitioners, *supra* note 201, at 6–7 (arguing that investors in an ERISA stock plan do not necessarily rely on the stock price, and should not be given a presumption of reliance); Brief for Vivendi S.A. as Amicus Curiae in Support of Petitioners, *supra* note 201, at 4–10 (describing various trading strategies that do not rely "on the integrity of the market [price]," and arguing that "plaintiffs of that stripe" cannot be found to have relied on any underlying misrepresentations affecting the market price).

[210] Halliburton Co. v. Erica P. John Fund, Inc., 134 S. Ct. 2398, 2420 (2014) (Thomas, J., concurring).

[211] *Id.* at 2423.

[212] As Bebchuk and Ferrell have recently pointed out, "while the two sides take different overall views in the debate, they both invited the Court to form a judgment on the state of the evidence for the efficient market hypothesis." Bebchuk & Ferrell, *supra* note 18, at 677.

to the FOTM hypothesis. This belief is understandable, given the language of *Basic* and *Amgen*, and given the pervasive judicial focus on market efficiency in securities-fraud cases. It is, however, mistaken.

C. The Attacks on the ECMH Do Little to Undermine the Essential Reasoning of the FOTM Doctrine

The arguments set forth in the concurrence, even where they accurately characterize modern economic research, do little to undermine (or bolster) the essential reasoning behind the FOTM doctrine. In some instances, they are simply founded on misunderstandings. The *Halliburton* majority addresses some of these misunderstandings, but not always satisfactorily. Most fundamentally, one may be a skeptic of market efficiency, and still believe it makes little sense to require investors in developed markets to demonstrate that they directly relied on a misrepresentation in order to bring a securities-fraud claim. Equally fundamentally, one may be an enthusiastic believer in market efficiency and still believe that *Basic* is disastrous as a matter of legal doctrine and public policy, and should be torn from the legal firmament root and branch.

As an initial matter, the Supreme Court itself has never formally claimed that the FOTM presumption hinges on a firm belief in the semi-strong ECMH, in *Basic* or elsewhere. As the *Halliburton* majority emphasized, the Court has frequently used far more modest language in describing the degree of efficiency envisioned.[213] While the Court has rather cavalierly used the language of market efficiency,[214] and often described efficiency in terms that echo the language of academic formulation of the ECMH, their actual handling of FOTM is inconsistent with a firm commitment to the ECMH. Most tellingly, the Court has consistently maintained a distinction between materiality and market impact.[215] For a strong believer in the ECMH, it would be—as Professor Fischel argued in

[213] In *Basic* itself, while the Court pointed to "empirical studies [that] have tended to confirm . . . that the market price of shares traded on well-developed markets reflects all publicly available information," the Court also claimed to be relying only on the proposition that "most publicly available information is reflected in market price." Basic Inc. v. Levinson, 485 U.S. 224, 246–47 (1988).

[214] *See, e.g.*, Amgen Inc. v. Conn. Ret. Plans & Trust Funds, 133 S. Ct. 1184, 1192 (2013) ("The fraud-on-the-market theory rests on the premise that certain well developed markets are efficient processors of public information. In such markets, the 'market price of shares' will 'reflec[t] all publicly available information.'" (alteration in original) (quoting *Basic*, 485 U.S. at 246)), 1195 ("The [FOTM theory] is premised on the understanding that in an efficient market, all publicly available information is rapidly incorporated into, and thus transmitted to investors through, the market price.").

[215] Three years after *Basic*, in fact, the Court held that defendants could not avoid liability by arguing that market professionals had seen through a misrepresentation, thus preventing any impact on the market price. *See* Va. Bankshares, Inc. v. Sandberg, 501 U.S. 1083, 1097 (1991) ("If it would take a financial analyst to spot the [misrepresentation], whatever is misleading will remain materially so, and liability should follow.").

1982—a contradiction to believe that a public misrepresentation could be material yet have no impact on the market price.[216] As one respected scholar noted, the "notion that a statement can be materially misleading even if informed investors are not fooled (and accordingly price remains unchanged) is flatly inconsistent with the premises" of the ECMH, and shows that, for the Court, "belie[f] in the informational content of prices . . . is merely a one-way street."[217] When they have been made, strong statements of the ECMH and the need for market efficiency have tended to come from lower courts.[218]

This focus on market efficiency, however, has been misguided. The logic of the FOTM doctrine rests not on market efficiency, but on the structure of impersonal securities markets. Such markets differ from more familiar markets for consumer goods and services where the common law of fraud developed, in that (1) prices are set by impersonal market mechanisms, rather than by face-to-face bargaining; and (2) securities are typically not being purchased for any form of personal consumption, instead of or in addition to for investment and resale.[219] In a face-to-face market, the reliance element serves to draw a causal connection between the antisocial conduct—the material misrepresentation—and harm to the purchaser.[220] Reliance is simply not necessary to draw such a causal connection between a material misrepresentation and a purchaser (or seller) of a publicly traded security.

Consider, for example, a buyer considering purchasing a used car that is being offered for $10,000. The seller falsely represents that the

[216] *See* Fischel, *supra* note 48, at 11.

[217] Mahoney, *supra* note 117, at 662 n.96.

[218] *See supra* Parts II.B & IV.A.

[219] Judge Easterbrook made this point vividly, if rather caustically, in *West v. Prudential Securities, Inc.*, 282 F.3d 935 (7th Cir. 2002). He noted there is not "an economic market in 'Jefferson Savings Stock' as there is in dill pickles or fluffy towels. . . . [I]nvestors do not want Jefferson Savings *stock* (as if they sought to paper their walls with beautiful certificates); they want monetary returns (at given risk levels), returns that are available from many financial instruments." *Id.* at 939.

[220] *See, e.g.*, PROSSER AND KEETON ON THE LAW OF TORTS, *supra* note 38, § 110, at 767; RESTATEMENT (SECOND) OF TORTS, *supra* note 34, § 546; Barbara Black, *The Strange Case of Fraud on the Market: A Label in Search of a Theory*, 52 ALB. L. REV. 923, 924 (1988) ("The function of the reliance element is to establish causation in fact."). Professors Goldberg, Sebok, and Zipurksy have argued that, rather than simply serving to show a connection between the defendant's fraud and the plaintiff's harm, reliance serves to show that the defendant "wrong[ed]" the plaintiff by "interfer[ing] with her interest in being able to make certain kinds of decisions in certain settings free of misinformation generated by others." John C.P. Goldberg, Anthony J. Sebok & Benjamin C. Zipursky, *The Place of Reliance in Fraud*, 48 ARIZ. L. REV. 1001, 1002 (2006). This explanation serves to make sense of decisions denying recovery to common-law-fraud plaintiffs even where it is evident the defendant's misrepresentation caused the plaintiff harm. *See, e.g.*, Summit Props., Inc. v. Hoechst Celanese Corp., 214 F.3d 556, 561–62 (5th Cir. 2000); Rosen v. Spanierman, 894 F.2d 28, 33–34 (2d Cir. 1990); Pegram v. Hebding, 667 So. 2d 696, 702–04 (Ala. 1995); Cummings v. Kaminski, 290 N.Y.S.2d 408, 410–11 (N.Y. Sup. Ct. 1968).

car's tires are brand new, when they are actually old and in need of replacing, which will cost $500. The buyer would be willing to pay up to $11,000 for the car if it had new tires, but would value it at $10,500 if he knew the truth about the tires. The buyer pays $10,000 for the car. The buyer cannot be said to have been harmed by the misrepresentation, because the buyer is in the same position he would have been in had he known the truth, or had the misrepresentation never been made. Either way, the buyer would have paid $10,000 for a car with old tires. The misrepresentation did not change the state of the world.[221] Common-law fraud doctrine blocks liability in this circumstance by concluding that the buyer did not "rely" on the misrepresentation because he would have bought the car at the same price even had he known the truth.

The same is not true for a publicly traded security. Assume an analogous set of facts. The issuer of a security that is trading at $9,500 makes a misrepresentation that causes the market price to rise to $10,000. The buyer believes the security is mispriced, and is really worth $11,000. Even if the buyer knew the truth, she would be willing to pay up to $10,500 for it. She therefore buys the security for $10,000. Just like in the previous example, the buyer would have still been willing to pay $10,000 even if she had known the truth. But this time, the buyer is *not* in the same position she would have been in absent the misrepresentation. If the misrepresentation had not been made, she may still have been *willing* to pay $10,000, but she would not, in fact, have paid $10,000—she would have paid $9,500. Thus, even if she knew the truth, and even if she did not rely on the market price as reflecting the "true value" of the security, the buyer has still been harmed by the misrepresentation.

In the example of a publicly traded security, the concept of reliance simply does not play a useful role. All that matters is that the defendant's misrepresentation affected the market price.[222] A trader cannot *not* rely on the market price, because the market price determines the price the trader pays whether the trader believes that price is "right" or not. Even if the trader would still have traded if the misrepresentation had not been made, she would have paid a different price.[223] As such, appeals to behavioral economics to support the proposition that many traders do not "rely" on the market price being accurate[224] simply miss the point. A trader is equally harmed by a distorted market price whether she believes market prices to be an accurate reflection of value or not. So long as the harm

[221] Arguably, the buyer is still worse off because of the misrepresentation, in that he may have been able to negotiate a lower price absent the lie. A functionalist might therefore question whether reliance should ever be required in cases involving deliberate misrepresentation.

[222] Of course, this assumes—as securities law long has—that misrepresentations constitute misconduct and that trading losses stemming from such misconduct constitute compensable harms.

[223] Depending on her risk tolerances and portfolio composition, a trader might also trade more or fewer shares.

[224] *See supra* notes 198, 206–08 and accompanying text.

alleged stems from a distortion in the market price from a misrepresentation, the relevant question is simply whether the market price was distorted by the misrepresentation at issue[225]—a question that is common to the class.[226]

The answer to this market-impact question does not depend on the validity of the ECMH—that is, whether all public information is rapidly and accurately reflected in the market price of securities.[227] It has long been recognized that a market need not be "efficient" in this sense in order to be distorted by a given misrepresentation.[228] Even a market that is highly "inefficient" with respect to many kinds of information may be powerfully and rapidly distorted by a highly salient misrepresentation, such as a false announcement that the relevant company will be ac-

[225] *See, e.g.*, Donald C. Langevoort, *Theories, Assumptions, and Securities Regulation: Market Efficiency Revisited*, 140 U. PA. L. REV. 851, 898–99 (1992) ("The only important question is whether the price was distorted."); *see also* Fisch, *supra* note 185, at 927–28 ("As this Article has argued, *Basic* is premised on the notion of price distortion."); Daniel R. Fischel, *Efficient Capital Markets, the Crash, and the Fraud on the Market Theory*, 74 CORNELL L. REV. 907, 908 (1989) (The crucial question for application of FOTM is "whether the challenged disclosure artificially inflated ([or] deflated) the market price of the particular security. Inquiry into whether the market price was inflated ([or] deflated) replaces individualized inquiry into the extent to which particular investors were aware of a challenged disclosure.").

[226] Such harms are typically the only ones alleged in a securities-fraud claim. The possibility of individual plaintiffs with unusual harms is discussed *infra* at note 303.

[227] *See* Fama, *supra* note 59, at 383 ("A market in which prices always 'fully reflect' available information is called 'efficient.'"). In the academic literature, this condition is often expressed in terms of a lack of arbitrage opportunities—that is, an inability to make abnormal returns—from possession of publicly available information. *See, e.g.*, *id.*; Robert A. Jarrow & Martin Larsson, *The Meaning of Market Efficiency*, 22 MATHEMATICAL FIN. 1, 2 (2012) ("[T]o test for an efficient market, one only needs to show that there are [no arbitrage] opportunities nor dominated securities with respect to an information set."); Michael C. Jensen, *Some Anomalous Evidence Regarding Market Efficiency*, 6 J. FIN. ECON. 95, 97–98; Burton G. Malkiel, *The Efficient Market Hypothesis and Its Critics*, J. ECON. PERSP., Winter 2003, at 59, 60 (defining an efficient market as one that does "not allow investors to earn above-average returns without accepting above-average risks"). Even Robert Shiller, one of the most vocal critics of the ECMH, and awarded the 2013 Nobel Prize for his work questioning it, acknowledges that "[o]f course, prices reflect available information." Robert J. Shiller, *We'll Share the Honors, and Agree to Disagree*, N.Y. TIMES, Oct. 27, 2013, at BU6.

[228] *See, e.g.*, Fisch, *supra* note 185, at 913 ("Prices need not respond accurately, instantaneously, or rapidly to information to justify the claim that, if the market contains misinformation, securities trades are likely to occur at different prices than in a market free from fraud. Price distortion, not market efficiency, is, in reality, the core concept on which *Basic*'s reasoning depends." (footnote omitted)); Fischel, *supra* note 225, at 911–12; Langevoort, *supra* note 77, at 161 (noting that efficiency may be "a sufficient reason why an investor relying on market-price integrity would be harmed" by a material misrepresentation, but that it is not a necessary condition "because fraud can and does distort prevailing prices" even in inefficient markets); Langevoort, *supra* note 225, at 899; Jonathan R. Macey, et al., *Lessons from Financial Economics: Materiality, Reliance, and Extending the Reach of* Basic v. Levinson, 77 VA. L. REV. 1017, 1021 (1991); Newkirk, *supra* note 185, at 1394; Oldham, *supra* note 32, at 999.

quired.[229] Thus, the petitioner's contention that "[a] stock might trade efficiently some of the time, for some information types, but then trade inefficiently at other times, for other information types,"[230] suggests not that FOTM doctrine is incoherent, but rather that the focus on market efficiency is misguided.

Because the focus on market efficiency is misguided, the focus on criticisms of the ECMH is also misguided.[231] The academic debate over market efficiency does nothing to call into question the ability of market prices to be distorted by misrepresentations. Bebchuk and Ferrell have recently posted an extended essay arguing this point.[232] They evaluate three of the most important critiques of efficient markets:[233] (1) that markets sometimes overvalue stocks, leading to long-term predictability of returns;[234] (2) that market prices are more volatile than the fundamentals of the underlying firms;[235] and (3) that market prices over- or

[229] Consider, as a simple example, Acme, Inc., a hypothetical company with extremely low market capitalization and low trading volume on an over-the-counter market. The company would surely fail the *Cammer* test or any other sensible test of market efficiency. Yet, if the board were to issue a credible news release that the company had agreed to be acquired for a hefty premium to the market price, the company's stock would undoubtedly rise sharply to near the merger price. As long as the news release is credible, it would have the same large and rapid effect whether it was true or simply a credible misrepresentation, despite the "inefficiency" of the market for Acme's stock.

[230] Brief for Petitioners, *supra* note 2, at 20–21 (quoting Geoffrey Rapp, Essay, *Rewiring the DNA of Securities Fraud Litigation:* Amgen*'s Missed Opportunity*, 44 LOY. U. CHI. L.J. 1475, 1484 (2013)).

[231] A number of influential scholars have come to this conclusion. *See, e.g.*, Black, *supra* note 169, at 1502–03 ("I submit, however, that the persuasive power of *Basic* does not depend on acceptance of the efficient market hypothesis . . . . I believe . . . that this debate over competing economic theories, while important and interesting, has nothing to do with the continuing viability of the fraud-on-the-market presumption."); Fisch, *supra* note 185, at 913 ("A strong version of market efficiency should not, however, be a predicate for application of the *Basic* presumption . . . . Price distortion, not market efficiency, is, in reality, the core concept on which *Basic*'s reasoning depends.").

[232] Bebchuk & Ferrell, *supra* note 18, at 674 ("We review the key types of evidence that have been put forward to question market efficiency and show that, even fully accepting the views and evidence of efficiency critics such as Professor Shiller, it is possible for market prices to be distorted by fraudulent disclosures. Conversely, we demonstrate that, even fully accepting the views and evidence of market efficiency supporters such as Professor Fama, it is possible for market prices not to be distorted by a given fraudulent disclosure.").

[233] *See id.* at 679–82.

[234] *See, e.g.*, John Y. Campbell & Robert J. Shiller, *The Dividend-Price Ratio and Expectations of Future Dividends and Discount Factors*, 1 REV. FIN. STUD. 195, 195–97 (1988); John Y. Campbell & Robert J. Shiller, *Stock Prices, Earnings, and Expected Dividends*, 43 J. FIN. 661, 662–63 (1988); Robert J. Shiller, *Stock Prices and Social Dynamics*, 2 BROOKINGS PAPERS ON ECON. ACTIVITY 457, 458–60 (1984).

[235] *See, e.g.*, Robert J. Shiller, *Do Stock Prices Move Too Much to Be Justified by Subsequent Changes in Dividends?*, 71 AM. ECON. REV. 421, 421–23 (1981); Robert J. Shiller, *The Use of Volatility Measures in Assessing Market Efficiency*, 36 J. FIN. 291, 291–92

underreact to certain types of information, giving prices "momentum."[236] Bebchuk and Ferrell consider each of these critiques and show that even if they are accepted as true, market prices can still be distorted by fraudulent information.[237] Conversely, Bebchuk and Ferrell argue that even if markets are efficient, seemingly material misrepresentations can have no effect on the market price if, for example, market participants do not believe the misrepresentation,[238] or if the misrepresentation is sufficiently "buried" or "opaque."[239]

The ultimate conclusion drawn by Bebchuk and Ferrell is that the state of play in the academic debates over the ECMH is ultimately irrelevant to the question of whether common issues will predominate in a securities-fraud claim.[240] In this conclusion, they join other prominent law

(1981); John H. Cochrane, *Volatility Tests and Efficient Markets: A Review Essay*, 27 J. MONETARY ECON. 463, 464 (1991).

[236] *See, e.g.*, Saeyoung Chang & David Y. Suk, *Stock Prices and the Secondary Dissemination of Information: The Wall Street Journal's "Insider Trading Spotlight" Column*, 33 FIN. REV. 115, 125 (1998) (presenting evidence that the Wall Street Journal's publication of reports on insider trading affect stock prices despite the fact that the information in the reports is already public); Kent Daniel et al., *Investor Psychology and Security Market Under- and Overreactions*, 53 J. FIN. 1839, 1839–40 (1998); Rebecca Files et al., *Stealth Disclosure of Accounting Restatements*, 84 ACCT. REV. 1495, 1495–97 (2009) (showing evidence that the size and speed of market reactions to accounting restatements depends on the prominence of the announcement); Hong & Stein, *supra* note 207, at 2143.

[237] *See* Bebchuk & Ferrell, *supra* note 18, at 680–81 ("It is quite difficult to see why classwide reliance should turn on the fact that the market's current [price-to-earnings] ratio represents overvaluation or the fact that future returns for the market, and for this particular firm, might be lower (or perhaps even negative) as a result of the [price-to-earnings] ratio drifting back toward the historical average over time."), 681 ("[I]t is very difficult to see why excessive volatility should determine classwide reliance . . . . Throughout the [relevant] period, the security's price was subject to a fraudulent distortion that would have a classwide impact on the purchasers of the stock."), 682 (Even if the market price adjusted to the misrepresentation slowly, "it is still the case that any investor who purchased the stock after the false representation (but before the corrective disclosure) paid an additional [amount] as a result of the fraudulent distortion.").

[238] *See id.* at 683 (canvassing reasons market prices might not react to a given misrepresentation and concluding that "[a]t the end of the day, however, the reason for the lack of a price reaction is not central to the classwide reliance question," and "[w]hat should be determinative of that question is the absence of fraudulent distortion").

[239] *See id.* at 683–84 ("[A]gain, while the reasons might be helpful in understanding why there was no price reaction, it is the fact that there was no price reaction that is determinative.").

[240] *See id.* at 685 (Whether one reads the evidence as generally supportive of the efficient-market hypothesis or as undermining it "should not affect the judgment as to the existence of classwide reliance. Rather, we recommend that, going forward in determining classwide reliance, courts focus on whether the alleged misstatement resulted in fraudulent distortion, an inquiry that does not turn on providing a definitive yes/no answer to the market efficiency question.").

professors,[241] several of whom entered an amicus brief in support of the petitioners in *Halliburton* making many of the same points.[242]

I do not wish to overstate the irrelevance of market efficiency to securities-fraud claims. Securities class actions are complex, uncertain, and costly. It is only prudent to limit the universe of cases to those in which the injury and the mechanism by which it was generated are relatively clear and easily comprehended. If market efficiency were truly a binary yes-or-no proposition—either the market price rapidly and accurately reflects all public information or it bears no discernible relation to public information at all—it would serve such a purpose at least to a degree, preserving straightforward claims while screening out cases where the relationship between the misrepresentation and harm to investors is likely to be muddled or attenuated.[243]

Given, however, that neither defenders nor critics of the ECMH would advance such an all-or-nothing picture, market efficiency can only serve as a highly imperfect proxy for the real question—whether the alleged misrepresentation actually affected the price at the time of purchase or sale.[244]

[241] *See, e.g.*, Langevoort, *supra* note 225, at 900 ("The efficient market hypothesis is invoked [by *Basic*], but in ways that on close inspection are neither necessary nor sufficient to the ultimate conclusion.").

[242] *See* Brief of Law Professors as Amici Curiae in Support of Petitioners, *supra* note 177, at 2 ("The efficient capital markets hypothesis is not necessary to the use of the fraud on the market theory—whenever the market incorporates fraudulent information into the price, a 'fraud on the market' has occurred, whether the market is efficient or not."), 3–4 ("These difficulties are encountered unnecessarily because the fraud on the market theory does not require use of the efficient capital markets hypothesis to show reliance. All that is necessary is evidence of a particular misstatement's effect on a security's market price."), 7 ("Proving that a market is generally highly efficient, and thus tends to incorporate all information quickly, is unnecessary to demonstrating that there has been a fraud on the market as to a specific statement, as long as a market functions well enough to incorporate the specific misrepresentation at issue into a security's price.").

[243] Indeed, elsewhere I have admitted that "the market efficiency requirement is, at the very least, not inherently *illogical* as applied" to material misrepresentation claims. Korsmo, *supra* note 81, at 1153.

[244] *See* Oldham, *supra* note 32, at 1011 (noting that the ECMH "effectively became a proxy for showing that the misrepresentation actually affected the stock price"). In addition to serving as an imperfect proxy, the efficient-market requirement has certain perverse consequences discussed *supra* in Part II.B. *See also* Brief of Law Professors as Amici Curiae in Support of Petitioners, *supra* note 177, at 10 ("The fact that total market efficiency is unnecessary to establish fraud on the market is not itself reason to eliminate the requirement for such a showing. But reference to market efficiency has disadvantages that counsel the use of a different mechanism for demonstrating reliance.").

V. REJECTION OF THE EFFICIENT-CAPITAL-MARKETS HYPOTHESIS WOULD UNDERMINE NUMEROUS IMPORTANT DOCTRINES

The use of skepticism about the ECMH by the concurring justices in *Halliburton* as a harpoon against *Basic* was not only unnecessary, but also unwise. It was unwise not only for the reason usually given—that the Supreme Court is ill-suited to referee academic disputes over economic theories[245]—but for the more substantively important reason that broad judicial rejection of the idea of efficient markets would destabilize a number of legal doctrines. Some of these doctrines are of far greater fundamental importance than the FOTM doctrine.

It could be argued—and argued correctly, in my view—that many of the doctrines discussed in this Part do not depend on the technical accuracy of academic formulations of the ECMH. But if the discussion so far has demonstrated anything, it has demonstrated the ease with which claims about the ECMH can ineluctably mutate into claims about market efficiency more generally, and vice versa. At the very least, the concurring justices' repudiation of the ECMH hands a potent rhetorical weapon to proponents of regulatory paternalism, whose ends those justices presumably would not wish to advance.

A. *Important Securities-Law Doctrines Explicitly Rely on the ECMH*

Perhaps the most oft-cited example of legal doctrine built around the ECMH is the SEC's integrated disclosure system.[246] The integrated disclosure system sits at the center of the SEC's disclosure-oriented regulation of public companies.[247] The promulgation of the integrated system "marked the culmination of the SEC's efforts to effect a major policy reversal: to deemphasize the Securities Act's disclosure system which mandates delivery of a prospectus to the investor upon the distribution of

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[245] *See* Basic Inc. v. Levinson, 485 U.S. 224, 254–55 (1988) (White, J., dissenting) ("The Congress, with its superior resources and expertise, is far better equipped than the federal courts for the task of determining how modern economic theory and global financial markets require that established legal notions of fraud be modified. . . . I doubt that we are in much of a position to assess which theories aptly describe the functioning of the securities industry.").

[246] *See* Black, *supra* note 198, at 468 ("The SEC explicitly recognized the efficient market thesis in 1982 by its adoption of an integrated disclosure system.").

[247] Very early on, former SEC Commissioner and Supreme Court Justice William O. Douglas emphasized the centrality of disclosure to the Securities Act in terms that anticipate later discussion of informationally efficient markets. He described the chief purposes of the Act as "(1) prevention of excesses and fraudulent transactions, which will be hampered and deterred merely by the requirement that their details be revealed; and (2) placing in the market during the early stages of the life of a security a body of facts which, operating indirectly through investment services and expert investors, will tend to produce more accurate appraisal of the worth of the security if it commands a broad enough market." William O. Douglas & George E. Bates, *The Federal Securities Act of 1933*, 43 YALE L.J. 171, 172 (1933) (footnote omitted).

securities, and to emphasize the Exchange Act's disclosure system which mandates periodic filing of disclosure documents" with the SEC.[248]

The integrated disclosure system established three tiers of registrants. Small or new issuers are required to provide detailed disclosure when they issue securities and are required to disseminate the information to investors in prospectuses. Small issuers that had been subject to SEC disclosure requirements for at least three years could provide a somewhat more abbreviated prospectus to investors. Meanwhile, large issuers who had been subject to SEC disclosure requirements for at least three years could supply investors with only a bare-bones prospectus—known as Form S-3—bringing up to date any stale information from prior filings with the SEC. The three-tier system has since been reduced to a two-tier system, and Form S-3 is now available to issuers of any size as long as they have been subject to SEC filing requirements for at least one year and meet certain other requirements.[249]

The logic of such "short-form" equity offerings is relatively straightforward. Any information about a security that has previously been included in a filing with the SEC is already publicly available and should be reflected in the market price. Only new information is potentially material to investors. As a result, forcing issuers to provide investors a lengthy re-hash of stale information would be a waste of time and money. This conclusion is evident if one accepts the semi-strong form of the ECMH.[250] Indeed, the SEC stated in the proposal to adopt Form S-3 that it was the "Commission's belief that the market operates efficiently for [S-3] companies, *i.e.*, that the disclosure in Exchange Act reports and other communications by the registrant, such as press releases, has already been disseminated and accounted for by the market place."[251] The final adopting release is even more explicit that the SEC created Form S-3 "in reliance on the efficient market theory."[252]

[248] Black, *supra* note 198, at 468–69. For general background on the integrated disclosure system, see generally Adoption of Integrated Disclosure System, 47 Fed. Reg. 11,380 (Mar. 16, 1982) (codified at scattered pts. in 17 C.F.R.), Reproposal of Comprehensive Revision to System for Registration of Securities Offerings, 46 Fed. Reg. 41,902 (proposed Aug. 18, 1981) (to be codified in 17 C.F.R. pt. 239), and Proposed Comprehensive Revision to System for Registration of Securities Offerings, 45 Fed. Reg. 63,693, 63,693–95 (proposed Sept. 25, 1980) (to be codified in 17 C.F.R. pts. 230 & 239).

[249] *See* 17 C.F.R. § 239.13 (2014).

[250] *See* Langevoort, *supra* note 225, at 879 ("If the efficient market hypothesis holds, this is obviously correct: the information [filed with the SEC] is already correctly impounded in price and disclosure adds no value.").

[251] Reproposal of Comprehensive Revision to System for Registration of Securities Offerings, 46 Fed. Reg. at 41,904.

[252] Adoption of Integrated Disclosure System, 47 Fed. Reg. at 11,382; *see also* Wielgos v. Commonwealth Edison Co., 892 F.2d 509, 510 (7th Cir. 1989) (discussing Form S-3 and noting that "[t]he Securities and Exchange Commission believes that markets correctly value the securities of well-followed firms, so that new sales may rely on information that has been digested and expressed in the security's price"); Black,

Another part of the SEC's early-1980s reforms that relies on the ECMH is so-called "shelf registration" under Rule 415.[253] Rule 415 allows issuers eligible to use Form S-3 to register securities offerings for issuance at a later date and leave them "on the shelf" until the issuer's management believes market conditions are propitious.[254] Again, the theory is that, as long as the issuer is complying with its standard disclosure requirements, the market price will already reflect all material information and provide an accurate—or at least unbiased—price for the new issuance, whenever it occurs. The SEC's release accompanying adoption of the rule again invoked the ECMH, at least obliquely.[255] Indeed, Rule 415 relies on a relatively robust view of market efficiency. If market prices are "noisy," or tend to overreact to good news, issuers could take advantage of Rule 415 to issue more shares when they believe prices have drifted irrationally high.[256]

There are policy arguments not involving market efficiency to support both the integrated disclosure system and Rule 415, so one may reasonably question the extent to which they must live or die by the ECMH.[257] More broadly, though—and as is discussed more fully below in

supra note 198, at 468 ("The SEC explicitly recognized the efficient market thesis in 1982 by its adoption of an integrated disclosure system."); Langevoort, *supra* note 225, at 876 ("Form S-3 is significant because it is the primary example of regulatory reform cited for the proposition that the SEC accepts the teachings of the efficient market hypothesis.").

[253] *See* 17 C.F.R. § 230.415 (2014). For a discussion of shelf registrations generally, see 1 THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION § 3.11, at 424–26 (6th ed. 2009). The shelf-registration rules were liberalized further in 2005. *Id.* § 3.11, at 427.

[254] HAZEN, *supra* note 253, § 3.11, at 425; *see also* Langevoort, *supra* note 225, at 881–82 ("[Rule 415] allows issuers eligible to use Form S-3 to register offerings on a delayed basis (that is, to have securities eligible for sale, waiting for some future point to begin the distribution). The regulatory intent was to provide issuers with greater flexibility in timing their offerings, looking for windows of opportunity in market conditions, and then proceeding quickly with the distribution." (footnote omitted)).

[255] *See* Shelf Registration, 48 Fed. Reg. 52,889, 52,892 (Nov. 23, 1983) (codified at 17 C.F.R. pt. 230) (referring to the efficient market hypothesis in noting that "at the time S-3/F-3 registrants determine to make an offering of securities, a large amount of information already has been disseminated to and digested by the marketplace").

[256] Langevoort, *supra* note 225, at 883 ("A noisy view of the securities markets—especially one characterized by high levels of feedback trading—suggests that there will be times when the prevailing price is excessively high as a result of investor overreaction to positive signals. That is the ideal market window, and without some assumption about efficiency, Rule 415 would simply be inviting the issuer with a shelf registration to take advantage of it.").

[257] Donald Langevoort, for his part, concludes that the adoption of Form S-3 is only weakly dependent upon the ECMH, while Rule 415 is somewhat more strongly reliant upon it, though still not definitively so. *See id.* at 876 (claiming that "on close inspection, it is clear that the adoption of Form S-3 rests very weakly—if at all—on the efficient market hypothesis."), 886 ("In the end, then, we are left with ambiguity in assessing whether there is any strong efficiency claim implicit in Rule 415."). Indeed, the ECMH is generally taken as claiming that market prices not only incorporate public information, but do so extremely quickly. Short-form registration merely

the context of corporate law[258]—the general emphasis of the securities-law regime on disclosure as a mode of regulation, rather than on affirmative rules of conduct, depends on a baseline notion of market efficiency. In an efficient market, where prices reflect all public information, the disciplining effect of those prices will largely constrain issuer misbehavior. Public regulation can thus focus on ensuring that disclosure is honest and complete. If the relationship of market prices to all public information is weakened, however, so too is the disciplining effect of the market—and so too is the case against conduct-regulating securities law. Proponents of a more interventionist system of securities regulation will therefore find much to like in the Supreme Court's expressions of skepticism regarding market efficiency, particularly with these statements issuing from the Court's "conservative" wing.

While the FOTM presumption of reliance is the most prominent example, several other judicially created doctrines also reference market efficiency and may be called into question if the Court appears to reject the ECMH. To take just a single example: the duties of ERISA fiduciaries when they learn inside information pose a thorny question.[259] On the one hand, section 404 of ERISA imposes upon ERISA fiduciaries a duty to inform beneficiaries, including "an affirmative duty to inform when the trustee knows that silence might be harmful."[260] When, however, the fiduciary possesses inside information, "such a fiduciary may neither act on (i.e., sell) nor share confidential corporate information before it has been publicly released by the corporation."[261] The Third Circuit has squared this circle by noting that:

> [H]ad the [fiduciaries] publicly released any adverse information they had prior to the [corporate] announcement, under the "efficient capital market hypothesis," such a disclosure would have resulted in a swift market adjustment. Therefore . . . the Plans would not have been able to sell their . . . stock holdings at the higher, pre-announcement price, and the Plans would have sustained the same losses they incurred when the Company publicly announced the [information].[262]

counts on the markets incorporating existing public information, even if they do so relatively slowly.

[258] *See infra* Part V.B.

[259] For other examples of judicially created doctrines arguably dependent on the ECMH, see Langevoort, *supra* note 225, at 903–11.

[260] Bixler v. Cent. Pa. Teamsters Health & Welfare Fund, 12 F.3d 1292, 1300–01 (3d Cir. 1993); Employee Retirement Investment Security Act of 1974 (ERISA) § 404, 29 U.S.C. § 1104 (2012); *see* Edgar v. Avaya, Inc., 503 F.3d 340, 350 (3d Cir. 2007) ("It is well-established that an ERISA fiduciary 'may not materially mislead those to whom section 1104(a)'s duties of loyalty and prudence are owed.'" (quoting *In re* Unisys Sav. Plan Litig., 74 F.3d 420, 440 (3d Cir. 1996))).

[261] *In re* Wilmington Trust Corp. ERISA Litig., 943 F. Supp. 2d 478, 491 (D. Del. 2013).

[262] *Edgar*, 503 F.3d at 350 (citation and internal quotation marks omitted) (quoting Edgar v. Avaya, Inc., No. Civ.A. 05-3598, 2006 WL 1084087, at *9 (D.N.J.

The ECMH thus underlies the conclusion that ERISA beneficiaries are not harmed by the failure of plan fiduciaries to disclose negative inside information.

B. The Structure of American Corporate Law Implicitly Relies on Notions of Market Efficiency

Two of the most striking structural features of American corporate law are its federalism—that is, the primacy of state law[263]—and the large extent to which corporate law consists of default rules—that is, rules that can be altered by contract.[264] Both of these features are subjects of long-running normative debates over their desirability. Furthermore, as explained below, the extent to which one views these features as desirable turns in large part on the extent to which one believes in the ECMH. As a result, the concurring *Halliburton* justices' unnecessary attacks on the ECMH potentially provide powerful ammunition to opponents of these bedrock features of corporate law.

To speak of American corporate law is to speak almost entirely of state law. Virtually all corporations are chartered by the states, and firms have enormous freedom to be chartered in whichever state they choose. States can thus compete to provide corporate-law statutes firms will find attractive and benefit from the franchise taxes and associated economic activity that results.[265] Delaware has long been particularly successful in this competition and currently hosts the lion's share of economically significant firms, including virtually all firms not incorporated in their home states.[266] Critics of this result have argued that state competition constitutes a "race to the bottom," whereby states compete to offer corporate-law provisions that allow corporate managers—who control the decision regarding where to incorporate—maximum scope for exploiting

Apr. 25, 2006)); *see also In re* Schering-Plough ERISA Litig., No. 08-CV-1432 (DMC), 2010 WL 2667414, at *6 (D.N.J. June 29, 2010).

[263] *See generally* ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW (1993).

[264] *See, e.g.*, Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 577 (2003) ("As a positive matter, contractarians contend that corporate law is comprised mainly of default rules, from which shareholders are free to depart, rather than mandatory rules."); Bernard S. Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 84 NW. U. L. REV. 542, 544 (1990) (arguing that "appearances notwithstanding, state corporate law is trivial: it does not prevent companies—managers and investors together—from establishing any set of governance rules they want"); Henry N. Butler & Larry E. Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians*, 65 WASH. L. REV. 1, 11 (1990) ("In sum, truly 'mandatory' provisions are the exception rather than the rule in the law of business associations.").

[265] *See generally* ROMANO, *supra* note 263; Roberta Romano, *The State Competition Debate in Corporate Law*, 8 CARDOZO L. REV. 709 (1987).

[266] Romano, *supra* note 265, at 710–11.

shareholders.[267] As an obvious corollary, proponents of the race-to-the-bottom view of federalism generally argue for a more robust body of federal corporate law that cannot be evaded simply by chartering in another state.[268]

Defenders of state competition argue that it in fact leads to a "race to the top" because corporations must compete for scarce capital in markets that efficiently price corporate-law provisions.[269] Managers choosing to incorporate in states with corporate-law provisions that are disadvantageous to shareholders will face a higher cost of capital and will subsequently be at a competitive disadvantage in products and labor markets. As a result, competition for capital will force managers to incorporate in states whose corporate codes balance the interests of managers, shareholders, and other corporate constituents. States competing for corporate charters will accordingly be driven to provide such codes.[270] One influential commentator has referred to corporate-law federalism as "the genius of American corporate law" and argued that the dynamic it creates has led to American corporate law being the best and most influential in the world.[271]

The position one takes in this fundamental debate depends largely on whether one believes that state-law terms are efficiently priced.[272] If the ECMH is accurate, the "race to the top" argument is immensely strengthened. Corporate-law provisions are public information. Thus, if market prices reflect all public information, provisions that are disadvantageous to shareholders will result in lower market prices and corre-

[267] The leading "race to the bottom" article is William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663 (1974). *See also* Lucian Ayre Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435 (1992); Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588 (2003).

[268] Roe, *supra* note 267, at 603–04.

[269] The leading "race to the top" article is Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251 (1977). *See also* Daniel R. Fischel, *The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law*, 76 NW. U. L. REV. 913 (1982); Romano, *supra* note 265, at 711–13.

[270] *See* Larry E. Ribstein, Review Essay, *Writing About and Teaching Corporate Law: Reflections on* Corporate Law and Economic Analysis, 40 EMORY L.J. 509, 519–20 (1991) ("Some commentators argue that corporations should be governed by federal rather than state law because states 'race to the bottom' by offering provisions that are favorable to corporate managers. Other commentators argue that state competition for corporate chartering business is really a 'race to the top' because corporations must compete for capital in efficient securities markets by offering terms that balance the interests of managers and other contracting parties." (footnote omitted)).

[271] *See* ROMANO, *supra* note 263, at 1, 4–5, 12–13.

[272] *See, e.g.*, Ribstein, *supra* note 270, at 529 ("Whether state law should be replaced by a more regulatory regime turns partly on whether state law terms are adequately priced.").

spondingly higher costs of capital.[273] Conversely, if the ECMH is inaccurate and market prices fail to fully reflect differences in corporate statutes—due to information asymmetries, investor irrationality, or any other reason—it becomes possible that market discipline will not prevent corporate managers from choosing a jurisdiction with exploitative corporate laws, and a race to the bottom may ensue, justifying federal intervention. Supreme Court expressions of skepticism regarding the ECMH are thus likely to prove rhetorically useful to opponents of corporate-law federalism and proponents of a federal corporate-law regime.

Equally fundamentally, corporate law is made up largely of default—as opposed to mandatory—rules.[274] Even to the limited extent that state law imposes superficially "mandatory" rules on corporations, these rules can often be avoided by choice of organizational form, capital structure, or by reincorporating in another state.[275] As with corporate-law federalism, the dominance of default rules is hardly uncontested, both as a descriptive matter[276] and—to a far greater extent—as a matter of normative desirability. Indeed, the question of when, if ever, it is appropriate to impose non-waivable "regulatory" rules of corporate governance is perhaps the most fundamental debate in modern corporate law, with prominent and influential scholars on both sides generating vast literatures.[277]

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[273] In order for charter competition to work, of course, charter provisions need not be priced nearly instantaneously. It is only essential that charter provisions be priced over a reasonably short period of time. As before, the semi-strong version of the ECMH is somewhat stronger than is necessary to support charter competition.

[274] Mandatory and default rules are often called "regulator[y]" and "contractual" rules, respectively, to emphasize the extent to which they seek to directly regulate conduct rather than simply facilitate private bargaining. *See* Lucian Ayre Bebchuk, Foreward, *The Debate on Contractual Freedom in Corporate Law*, 89 COLUM. L. REV. 1395, 1395–99 (1989).

[275] *See* Butler & Ribstein, *supra* note 264, at 10–11 (explaining how most "mandatory" corporate-law rules are either manipulable or avoidable). Indeed, given the relative ease of avoiding mandatory corporate-law rules by reincorporating in another state, the debate over corporate-law federalism can be seen as a subset of the debate over default versus mandatory rules. *See* Ribstein, *supra* note 270, at 529 ("The appropriate extent of regulation of corporate terms depends largely on whether state law should be trumped by federal regulation. From a positive-law standpoint, as long as state statutes and judicial decisions provide corporate terms, corporate law is basically contractual rather than regulatory. In view of the basically enabling and manipulable nature of state law and the ease with which it can be changed or avoided by reincorporation, one commentator has characterized much of state corporation law as 'trivial.'" (citing Black, *supra* note 264, at 555–60)).

[276] *See, e.g.*, Victor Brudney, *Corporate Governance, Agency Costs, and the Rhetoric of Contract*, 85 COLUM. L. REV. 1403, 1408–09 (1985); John C. Coffee, Jr., Lecture, *No Exit?: Opting Out, the Contractual Theory of the Corporation, and the Special Case of Remedies*, 53 BROOK. L. REV. 919, 939–40 (1988) ("Historically, American corporate law has never regarded the corporation as simply a private contract.").

[277] Prominent proponents of the "freedom-to-opt-out" position include Frank Easterbrook, Daniel Fischel, Richard Posner, Ralph Winter, Roberta Romano, Jonathan Macey, Larry Ribstein, and Stephen Bainbridge. Prominent scholars who have, to varying degrees, been supportive of mandatory rules include Lucian

The arguments on both sides of the debate parallel those surrounding the corporate-law federalism debate. Proponents of mandatory rules—"regulators," as Bebchuk has called them[278]—argue that managers can use informational and bargaining advantages to impose exploitative contractual terms on shareholders, in particular terms that insufficiently deter shirking and self-dealing by corporate managers.[279] Opponents of mandatory rules—"deregulators," as Bebchuk has dubbed them—argue that terms in the corporate contract are priced in the market, imposing effective constraints on managers who would adopt exploitative terms.[280] If markets price the terms of the corporate contract accurately, firms will face competitive pressure to develop optimal terms achieving an efficient trade-off between agency costs and monitoring costs.[281]

The centrality of efficient markets to this debate is apparent. Again, one's beliefs on market efficiency will strongly influence their position in the debate over mandatory rules. If market prices do not fully reflect contract terms, capital markets can serve as—at best—only a partial con-

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Bebchuk, Jeffrey Gordon, John Coffee, Robert Clark, Victor Brudney, James Cox, Randall Thomas, and Deborah DeMott.

[278] Bebchuk, *supra* note 274, at 1399.

[279] *See, e.g.*, William W. Bratton & Joseph A. McCahery, *Regulatory Competition, Regulatory Capture, and Corporate Self-Regulation*, 73 N.C. L. REV. 1861, 1865–69 (1995); Brudney, *supra* note 276, at 1406–10; Coffee, *supra* note 276, at 920–25; Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879, 921–23; *see also* John C. Coffee, Jr., *Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance*, 84 COLUM. L. REV. 1145, 1154–61 (1984).

[280] *See, e.g.*, Butler & Ribstein, *supra* note 264, at 35 ("The information efficiently reflected in market prices includes the terms of contracts constraining managerial discretion and the prospects that this discretion will be exercised consistently with investor interests."); Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1416–17 (1989).

[281] *See, e.g.*, Butler & Ribstein, *supra* note 264, at 38–39 ("The presence or absence of [monitoring and bonding] devices would be reflected in the market price of the firm's securities. If shareholders are willing to pay (in the form of a lower return) for these assurances, there is no reason why the managers should not be able to share in this payment in the form of, for example, higher salary."), 47 ("[E]ven if there are only a few informed participants, the efficient securities markets provide pressure toward competitive terms."); Robert H. Sitkoff, *Trust Law, Corporate Law, and Capital Market Efficiency*, 28 J. CORP. L. 565, 570 (2003) ("[B]ecause publicly[ ]traded corporations are on the buy-side of capital markets, there is the potential for capital markets, through their pricing of securities, to discipline corporate managers. Thus, if managers install a weak system of internal governance and in so doing expand their opportunities for mal-, mis-, or nonfeasance, then the price that investors will be willing to pay for the firm's securities will fall accordingly." (footnote omitted)); *see also* Eugene F. Fama, *Agency Problems and the Theory of the Firm*, 88 J. POL. ECON. 288, 292 (1980); Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 313 (1976) ("Prospective minority shareholders will realize that the owner–manager's interests will diverge somewhat from theirs, hence the price which they will pay for shares will reflect the monitoring costs and the effect of the divergence between the manager's interest and theirs.").

straint on adopting suboptimal terms. As such, the possibility exists that public regulation would achieve superior results.[282] Conversely, efficient markets would accurately price contract terms and allocate capital to firms that adopt efficient terms.[283] A strong belief in market efficiency would suggest that even traditional mandatory fiduciary duties like the duty of loyalty are unnecessary—if they would be desirable under particular circumstances, the parties would choose to adopt them voluntarily.[284] Even opportunistic charter amendments disadvantaging existing investors, typically thought to be especially problematic,[285] become less troubling if constraints on such amendments—or the lack of such constraints—are efficiently priced *ex ante*.[286]

An insightful article by Robert Sitkoff has illuminated the importance of market efficiency to the corporate-law debate by comparing the features of corporate law to those of trust law.[287] The beneficiaries of a trust "are awarded their stake in the trust by the donative fiat of the settlor, and there is no well-developed aftermarket for the beneficiaries' interests."[288] As such, there are only limited "opportunities for market-based checks on trust managerial agency costs. Hence, judicial oversight and the fiduciary obligation remain the beneficiaries' principal recourse."[289] A skeptic of market efficiency would likewise believe that the "beneficiaries" in the corporate context—shareholders—are only weakly protected by market checks on managerial agency costs. As Sitkoff points out, this

[282] *See, e.g.*, Butler & Ribstein, *supra* note 264, at 33 ("The important implication of the market's failure to accurately price contract terms is that such terms are suboptimal, and resources are not allocated to their highest value uses."); Coffee, *supra* note 276, at 941–48 (arguing that if the market does not efficiently price alterations of directors' duties, the terms of the corporate contract itself may be inefficient).

[283] Butler & Ribstein, *supra* note 264, at 35 ("[B]ecause information about contract terms and managers is accurately reflected in market price, investors get what they pay for, and capital is allocated to the most efficient firms.").

[284] *See* Charles R. Korsmo, *Venture Capital and Preferred Stock*, 78 BROOK. L. REV. 1163, 1206–16 (2013) (discussing the difficulties mandatory fiduciary duties can engender in the venture capital context).

[285] *See, e.g.*, Lucian Ayre Bebchuk, *Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments*, 102 HARV. L. REV. 1820, 1839–40 (1989); Brudney, *supra* note 276, at 1412–13 & n.25; Melvin Eisenberg, *The Structure of Corporation Law*, 89 COLUM. L. REV. 1461, 1477 (1989); Jeffrey N. Gordon, *The Mandatory Structure of Corporate Law*, 89 COLUM. L. REV. 1549, 1577–81 (1989); Korsmo, *supra* note 284, at 1215–16.

[286] *See* Butler & Ribstein, *supra* note 264, at 52 ("The presence or absence of charter provisions limiting amendment is disciplined by the same markets that constrain other charter provisions. As a result, if liberal amendment provisions open the way to opportunistic amendments, the cost of capital of firms offering such provisions will increase." (footnote omitted)); Easterbrook & Fischel, *supra* note 280, at 1444.

[287] Sitkoff, *supra* note 281.

[288] *Id.* at 570.

[289] *Id.* at 571.

"implies that if one has doubts about the ECMH, then there is likely to be correlation between traditional Anglo-American trust law and the kinds of corporate governance reforms to which one is attracted—stronger fiduciary obligations, freer derivative litigation, mandatory disclosure, and so on."[290] And, indeed, such reforms are frequently proposed by market skeptics.[291]

C. *Weakening the ECMH Strengthens the Case for Paternalistic Interventions Generally*

Opponents of the FOTM doctrine seek to use skepticism about market efficiency to eliminate the 10b-5 class action, which they view as an intrusive and inefficient form of regulation. More often, however, market skepticism—and the behavioral-economics literature that stands behind it[292]—is used to justify regulatory intervention.[293] After all, if capital markets are efficient, capital will be allocated efficiently to the most productive uses, and regulatory intervention must be justified on non-efficiency grounds. If market prices are not efficient, then the case for market allo-

[290] *Id.* (footnotes omitted).

[291] *See, e.g.*, William W. Bratton, *Game Theory and the Restoration of Honor to Corporate Law's Duty of Loyalty*, *in* PROGRESSIVE CORPORATE LAW 139 (Lawrence E. Mitchell ed., 1995) [hereinafter Bratton, *Game Theory*] (advocating stronger mandatory fiduciary duties); Lawrence E. Mitchell, *Fairness and Trust in Corporate Law*, 43 DUKE L.J. 425, 425–26, 428–29, 475–91 (1993) (same); John C. Coffee, Jr., *Market Failure and the Economic Case for a Mandatory Disclosure System*, 70 VA. L. REV. 717, 720–23 (1984) (advocating expanded mandatory disclosure); Lawrence A. Cunningham, *Capital Market Theory, Mandatory Disclosure, and Price Discovery*, 51 WASH. & LEE L. REV. 843, 843–59 (1994); DeMott, *supra* note 279, at 921–24 (arguing corporate charters do not represent "bargained-for" terms between shareholders and officers). *See generally* William W. Bratton, Jr., *The New Economic Theory of the Firm: Critical Perspectives from History*, 41 STAN. L. REV. 1471 (1989) [hereinafter Bratton, *Critical Perspectives*]; Robert B. Thompson & Randall S. Thomas, *Shareholder Litigation: Reexamining the Balance Between Litigation Agency Costs and Management Agency Costs* (Vanderbilt U. Law Sch. Law & Econ., Working Paper No. 02-10, 2002), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=336162 (discussing shareholder litigation).

[292] *See, e.g.*, Bratton, *Game Theory*, *supra* note 291 (advocating stronger mandatory fiduciary duties); Mitchell, *supra* note 291, at 475–91 (same); James D. Cox, Remedies, *Compensation, Deterrence, and the Market as Boundaries for Derivative Suit Procedures*, 52 GEO. WASH. L. REV. 745, 746–49 (1984) (arguing for expanded derivative litigation); Coffee, *supra* note 291, at 720–23 (arguing for mandatory disclosure); Merritt B. Fox, *Retaining Mandatory Securities Disclosure: Why Issuer Choice Is Not Investor Empowerment*, 85 VA. L. REV. 1335, 1338–41 (1999) (same); DeMott, *supra* note 279, at 921–24. *See generally* Bratton, *Critical Perspectives*, *supra* note 291.

[293] *See* Ribstein, *supra* note 192, at 168 (noting that the "judgment errors and biases" identified by behavioral economists "have been used to justify paternalistic laws"). In the same article, however, Ribstein argues that behavioral economics poses problems to would-be regulators. In particular, if markets are not efficient, it may not be possible to predict "how markets will react to the information they are given," making it difficult or impossible to assess the costs and benefits of proposed interventions. *Id.*

cation of capital is weakened and the case for regulatory intervention is strengthened. If capital markets are inefficient—due to investor irrationality or otherwise—the possibility exists that judicious and rational regulators will be able to achieve more efficient outcomes.[294]

As a result, the teachings of behavioral economics—and the market inefficiency claimed to follow from these teachings—feature heavily in arguments for new forms of regulatory intervention.[295] As an article by several of the most prominent proponents of what they call "libertarian paternalism"[296] argued, while "conventional law and economics"—with its emphasis on market efficiency—is "strongly antipaternalistic," "bounded rationality pushes toward a sort of anti-antipaternalism—a skepticism about antipaternalism."[297] Such arguments are not merely the province of obscure academic scribblers. Richard Thaler and Cass Sunstein (who also served as head of the Office of Information and Regulatory Affairs under President Obama) have penned a bestseller on the general topic.[298] Supreme Court claims of market inefficiency—particularly claims penned by "conservative" justices generally perceived to be skeptical of interventionist regulation—are likely to be featured prominently in this debate going forward.

VI. THE PATH FORWARD ON 10B-5

The primary purpose of this Article has been to illustrate that courts and legislators need not and should not attempt to pass judgment on the ECMH in order to pass judgment on the FOTM doctrine. In light of this mainly negative project, the Article has presented the judgment of the *Halliburton* Court in relatively neutral terms, and focused primarily on the dangerous and self-defeating character of the concurrence. Thus far, I

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[294] Plainly, if one concludes that the capital markets are not so efficient that their performance could not be improved by regulatory intervention, the conclusion is that much stronger with regard to labor, products, housing, and other kinds of markets.

[295] *See* Jonathan Klick & Gregory Mitchell, *Government Regulation of Irrationality: Moral and Cognitive Hazards*, 90 MINN. L. REV. 1620, 1620 (2006) ("[L]egal elites increasingly claim that 'persons of normal intelligence' exhibit numerous irrational tendencies that justify restrictions on market and nonmarket transactions."). For examples, see Jon D. Hanson & Douglas A. Kysar, *Taking Behavioralism Seriously: The Problem of Market Manipulation*, 74 N.Y.U. L. REV. 630, 721–43 (1999) (exploring the implications of behavioral economics for regulation of market manipulation), Russell Korobkin, *Bounded Rationality, Standard Form Contracts, and Unconscionability*, 70 U. CHI. L. REV. 1203, 1207 (2003), and Russell B. Korobkin & Thomas S. Ulen, *Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics*, 88 CALIF. L. REV. 1051, 1053–58 (2000).

[296] *See* Richard H. Thaler & Cass R. Sunstein, *Libertarian Paternalism*, 93 AM. ECON. REV. 175, 175 (2003).

[297] Christine Jolls et al., *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471, 1541 (1998).

[298] RICHARD H. THALER & CASS R. SUNSTEIN, NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS (2008).

have not provided much discussion of how the Court *ought* to have ruled, or how courts and legislators might react going forward. Before concluding, it is worth offering a few thoughts on the outcome in *Halliburton*, and how to respond to it.

The Court's halfway measure of allowing defendants to rebut market impact at the class-certification stage has some superficial appeal, both as a matter of doctrine and a matter of policy. Bebchuk and Ferrell have endorsed a similar approach.[299] *Basic* itself stated that defendants may "rebut . . . the presumption" of reliance by "show[ing] that the misrepresentation in fact did not lead to a distortion of price," though it did not specify the stage of the proceeding where such a rebuttal would be appropriate.[300] Moreover, the approach seems to have the benefit of focusing the inquiry directly on the central question as to whether a presumption of reliance is warranted.[301] Upon closer inspection, however, the approach is both incoherent as a matter of doctrine and a near nullity as a matter of practical policy.

As a doctrinal matter, *Halliburton* came only a year after the Court had, in *Amgen*, held that defendants could not rebut the FOTM presumption at the class-certification stage by showing that the alleged misrepresentations were not material. The Court reasoned that a showing of lack of materiality would simply doom the case for all plaintiffs. Thus the inquiry could wait until the merits stage, with no danger that individual issues would predominate. The same reasoning would certainly seem to

[299] Bebchuk & Ferrell, *supra* note 18, at 685–88, 693–97.

[300] Basic Inc. v. Levinson, 485 U.S. 224, 248 (1988).

[301] *See, e.g.*, Brief of Law Professors as Amici Curiae in Support of Petitioners, *supra* note 177, at 28 ("Amici submit that a direct analysis of the market impact of a specific alleged misstatement, rather than examination of general market efficiency, is a more straightforward and reliable test for whether the fraud on the market theory should be invoked."); Bebchuk & Ferrell, *supra* note 18, at 686 ("The issue of whether there is a class of investors similarly situated in terms of reliance should turn on whether there is fraudulent distortion: where such distortion does not exist, classwide reliance does not arise."), 690 ("In contrast to the market efficiency approach, our fraudulent distortion approach focuses on the actual issues presented by the litigation. Thus, if a company is trading in a market in which there are significant deviations from efficiency but the evidence shows fraudulent distortion in the situation actually at issue in the litigation, our approach would result in classwide reliance. Conversely, if a company is trading in a market that is generally efficient but the evidence shows no fraudulent distortion resulting from the alleged misstatement, our approach would lead to a denial of class certification."); Fischel, *supra* note 225, at 908 (The central question in a FOTM case is "whether the challenged disclosure artificially inflated ([or] deflated) the market price of the particular security. Inquiry into whether the market price was inflated ([or] deflated) replaces individualized inquiry into the extent to which particular investors were aware of a challenged disclosure."); *see also* Langevoort, *supra* note 77, at 196 (arguing that the inquiry into whether the market was fooled needed "to be an early[ ]stage determination" made before class certification); Langevoort, *supra* note 225, at 904 (urging courts to focus on "whether the market as a whole was fooled"); Oldham, *supra* note 32, at 1039 (arguing in favor of requiring a showing of market impact at class certification).

apply to price impact.[302] In the absence of an impact on the market price, there can be no damages. It would only be the most unusual plaintiff who could potentially show loss causation in the absence of market impact.[303] The rare exceptions—those who bought publicly traded shares in a negotiated sale, for example—would raise individual issues even if market impact were established, and would be best handled by simply excluding them from the class. One would think, then, that the very fresh *Amgen* precedent would prevent consideration of price impact at class certification. Bizarrely, *Halliburton* dubs this argument "[f]air enough" before dismissing it with a confusing assertion that price impact is "*Basic*'s fundamental premise."[304] Of course, if a misrepresentation is immaterial, it would be unlikely to have a price impact, which would seem to make materiality rather fundamental itself.

Nor do the apparent policy advantages of this approach survive closer inspection. In the vast majority of securities-fraud cases, there *is* a "price impact."[305] Indeed, the classic "strike suit" scenario is when a company's stock takes a sharp dive when negative information comes out, and plaintiffs' attorneys stumble over each other to file claims alleging securities fraud. The dispute is almost never over whether there actually was a stock drop; it is over whether the company fraudulently concealed the negative information. As such, the opportunity to rebut the fraud-on-the-market presumption by showing lack of price impact is likely to be of little avail in most cases.

Given the ineffectiveness of half-measures, one might search for better solutions at the extremes. At one extreme, the tensions in securities class actions could be resolved by fully embracing the logic of the FOTM doctrine and eliminating the reliance requirement altogether without requiring any showing of market efficiency. As Fischel argued in 1982, "[t]he logic of the fraud on the market theory dictates that the reliance requirement as conventionally interpreted be discarded altogether" as an inapt analogy to common-law fraud.[306] Whether markets are generally ef-

[302] Indeed, the Fifth Circuit found that the Court's reasoning in *Amgen*, regarding materiality, applied equally to market impact and foreclosed its consideration at class certification. Erica P. John Fund, Inc. v. Halliburton Co., 718 F.3d 423, 434 n.10 (5th Cir. 2013).

[303] Two possible examples of situations where a plaintiff could be injured by a misrepresentation about a publicly traded security *other* than via a market impact are (1) if the plaintiff purchased their shares in a negotiated block, rather than on the market; or (2) if the misrepresentation caused the plaintiff to sell (or hold) their shares, causing an avoidable tax loss.

[304] Halliburton Co. v. Erica P. John Fund, Inc., 134 S. Ct. 2398, 2416 (2014).

[305] *See* John F. Savarese & George T. Conway III, Recent Developments, *Observations on the* Halliburton *Argument: Are Some Justices Searching for a "Midway Position" That Isn't There?* (Bank & Corp. Governance Law Rep., Mar. 28, 2014) (on file with Lewis & Clark Law Review) (claiming the ability to rebut market impact "would have no effect on the vast majority of cases, because in the vast majority of cases, there *is* price impact").

[306] Fischel, *supra* note 48, at 11.

ficient or not, if the theory of private-securities class actions is that investors should be compensated for out-of-pocket losses as a result of trading at fraudulently distorted prices, the only real question is whether the market was fraudulently distorted.[307] Because the market price of a stock can be distorted even when the market is not "efficient," requiring the plaintiffs to show an efficient market is a non-sequitur—a non-sequitur created and developed by the lower courts, incidentally.[308]

The starting point for a normative discussion, however, must be the fact that—as even proponents of interventionist regulation now tend to concede—the securities class action as currently constituted "fails both as a means of compensation and deterrence."[309] The out-of-pocket damages rule, coupled with the fact that it is the firm rather than the wrongdoers who actually pays, means that even if the system were otherwise functioning optimally, compensation and deterrence would not be achieved.[310] These features also mean that the potential damages in the vast majority of suits will be so catastrophic that a defendant can almost never afford to take the risk of an erroneous jury verdict. As a result, out of the nearly 4,000 securities class actions filed since passage of the PSLRA, only 20 have gone to trial.[311] As such, any reference to issues being decided "at the merits stage" is almost entirely fanciful. While a shift to a disgorgement remedy would be a step in the right direction,[312] the question was not before the Court in *Halliburton*, and is unlikely to come before the Court given the extreme scarcity of damage awards.

Indeed, this points up the problem with any attempt by the Court to "fix" securities-fraud litigation—in the dozens of section 10(b) cases to come before it, the Court is generally faced with a narrow question, almost always pertaining to class certification. The Court has little opportunity to address the more fundamental damages issues and little prospect of getting such an opportunity, given the paucity of cases proceeding past class certification. As such, the section 10(b) private right of action serves as a vivid illustration of the dangers and difficulties of implied rights of action. It is "a judicial oak which has grown from lit-

[307] *See, e.g.*, *id.* at 13 (concluding that "there is no need in a securities fraud case for separate inquiries into materiality, reliance, causation, and damages" and that the only inquiry "in open-market transaction should be whether the market price was in fact artificially affected by false information"). *See generally supra* Part II.

[308] *See supra* note 102 and accompanying text.

[309] John C. Coffee, *After the Fraud on the Market Doctrine: What Should Replace It?*, CLS BLUE SKY BLOG (Jan. 21, 2014), http://www.clsbluesky.law.columbia.edu/2014/01/21/after-the-fraud-on-the-market-doctrine-what-should-replace-it.

[310] *See* Alexander, *supra* note 89, at 1490–93.

[311] Renzo, *supra* note 129, at 38.

[312] Brief of Law Professors as Amici Curiae in Support of Petitioners, *supra* note 177, at 32–34; Grundfest, *supra* note 35, at 3.

tle more than a legislative acorn,"[313] and has grown beyond the Court's capacity to prune.

From a policy perspective, then, the most desirable result in *Halliburton* would have been for the Court to repent its original sin and eliminate the private right of action under section 10(b) altogether. It is beyond peradventure that the Court would not imply a private right of action from 10(b) were it faced with the question today.[314] The Court first explicitly recognized the private cause of action in 1971,[315] after 25 years of lower-court development, at a time when implied private rights of action were routinely recognized.[316] In 1975, the Supreme Court dramatically

[313] Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 737 (1975). Elsewhere, the Court has noted that this comment should not be "mistake[n] for praise rather than condemnation." Morrison v. Nat'l Austl. Bank Ltd., 130 S. Ct. 2869, 2880 n.4 (2010); *see also* Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. 350, 365 (1991) (Scalia, J., concurring) (denigrating the section 10(b) private right of action as "one of those so-called 'implied' causes of action that, for several decades, this Court was prone to discover in—or, more accurately, create in reliance upon—federal legislation").

[314] *See infra* notes 316–322.

[315] Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 13 n.9 (1971) (stating, without analysis, that "[i]t is now established that a private right of action is implied under [section] 10(b)"); *see also*, Joseph A. Grundfest, *Disimplying Private Rights of Action Under the Federal Securities Laws: The Commission's Authority*, 107 HARV. L. REV. 961, 991 (1994) ("For twenty-five years following *Kardon*[*v. National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946)], the lower courts, acting without Supreme Court guidance, built a virtually unanimous body of largely unreasoned precedent supporting the implied private right of action under Rule 10b-5. . . . [W]hen the Supreme Court directly confronted the question for the first time in *Superintendent*[, 404 U.S. at 13 n.9]," it simply acknowledged a private right of action in a footnote.).

[316] *See, e.g.*, Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S. 148, 176–78 (2008) (Stevens, J., dissenting) (noting that "[f]ashioning appropriate remedies for the violation of rules of law designed to protect a class of citizens was the routine business of judges," and that prior to 1975 "the Supreme Court recognized implied causes of action on numerous occasions" (quoting Leist v. Simplot, 638 F.2d 283, 298 (2d Cir. 1980))); Cannon v. Univ. of Chicago, 441 U.S. 677, 698 (1979) (noting that "during the period between the enactment of Title VI in 1964 and the enactment of Title IX in 1972, this Court had consistently found implied remedies"); Tex. & Pac. Ry. v. Rigsby, 241 U.S. 33, 39 (1916) ("A disregard of the command of [a] statute is a wrongful act, and where it results in damage to one of the class for whose especial benefit the statute was enacted, the right to recover the damages from the party in default is implied . . . ."); Baird v. Franklin, 141 F.2d 238, 245 (2d Cir. 1944) ("The fact that the statute provides no machinery or procedure by which the individual right of action can proceed is immaterial. It is well established that members of a class for whose protection a statutory duty is created may sue for injuries resulting from its breach and that the common law will supply a remedy if the statute gives none."); *Kardon*, 69 F. Supp. at 514 ("[T]he right to recover damages arising by reason of violation of a statute . . . is so fundamental and so deeply ingrained in the law that where it is not expressly denied the intention to withhold it should appear very clearly and plainly."); *see also* Grundfest, *supra* note 35, at 13 ("[P]rior to 1975, the federal courts accepted the view that 'every wrong shall have a remedy,' and that the available remedy should include a private right of action for money damages . . . ." (footnote omitted)).

altered its approach to implied private rights of action, adopting a strict four-factor test calling for a textual analysis of congressional intent to create a private right.[317] Since that time, the Court has repeatedly resisted invitations to stray from this strict approach on implied private causes of action in favor of the earlier understanding that individuals harmed by a statutory violation must be entitled to a remedy even where Congress did not provide one.[318]

Current doctrine would require congressional "intent to create not just a private right but also a private remedy. . . . Without it, a cause of action does not exist and courts may not create one, no matter how desirable that might be as a policy matter, or how compatible with the statute."[319] Under modern doctrine "no private right of action would be implied under Section 10(b) because there [is] no support for the proposition that the enacting Congress ever intended to create a private right."[320] Repudiating the private cause of action under 10b-5 would thus bring securities law into accordance with the past 40 years of Supreme Court doctrine on implied rights of action.[321] Further, as the Court has suggested in a related context, it would be preferable to eliminate an im-

[317] Cort v. Ash, 422 U.S. 66, 78 (1975) (describing a four-factor test for determining whether Congress intended to create a private cause of action); *see also* Grundfest, *supra* note 35, at 14 ("In 1975 . . . the Supreme Court changed its approach to the implication of private rights of action and adopted a stricter, more textualist doctrine that called for clear evidence that Congress intended to create a private right prior to the judicial implication of any such right."); Grundfest, *supra* note 315, at 992 (analyzing the *Cort* test).

[318] *See, e.g.*, Alexander v. Sandoval, 532 U.S. 275, 276 (2001) (declining to "revert to the understanding of private causes of action . . . that . . . was abandoned in *Cort*"); *Cannon*, 441 U.S. at 698–99 (describing and following the "strict approach" required by *Cort*).

[319] *Alexander*, 532 U.S. at 286–87.

[320] Grundfest, *supra* note 35, at 14; *see also* Cent. Bank v. First Interstate Bank, 511 U.S. 164, 173 (1994) ("Congress did not create a private § 10(b) cause of action and had no occasion to provide guidance about the elements of a private liability scheme."); Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. 350, 358–59 (1991) ("Although this Court repeatedly has recognized the validity of such claims, we have made no pretense that it was Congress'[s] design to provide the remedy afforded." (citations omitted)); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 196 (1976) ("[T]here is no indication that Congress . . . contemplated [a private] remedy" in adopting section 10(b) (footnote omitted)); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 737 (1975) ("[I]t would be disingenuous to suggest that either Congress in 1934 or the Securities and Exchange Commission in 1942 foreordained the present state of the law with respect to Rule 10b-5.").

[321] For reasons discussed below, while I believe such a clean sweep approach has much to recommend it, I believe it is highly unlikely the Court would pursue it. *See infra* note 323 and accompanying text. In short, nobody has asked for such a result, and it would require repudiation of decades of precedent declaring—albeit ruefully, on occasion—the private right of action to be well established.

plied private right of action altogether than to cripple it, but leave it in place out of misguided adherence to precedent.[322]

Such an outcome would at the very least have the virtue of clarity, and would provide the strongest possible impetus to Congress to act, on a clean slate, to establish once and for all how—if at all—private 10b-5 litigation should function. Congress would then have the option of creating an explicit private right of action or focusing on public enforcement of 10b-5 via the SEC. If Congress were to create an explicit private right of action, it would have the flexibility to design a workable system from the ground up, rather than trying to graft some form of gatekeeping requirement onto an incoherent body of case law, while remaining within the strictures of Rule 23—the difficulty of which is illustrated by the Court's gyrations in *Amgen* and *Halliburton*.

Unfortunately, the Supreme Court is unlikely to perform such a decisive act of jurisprudential hygiene, particularly after *Halliburton*. It is unlikely the Court will address the question of damages under 10(b), and whether they should be limited to disgorgement in the absence of actual reliance, as Grundfest and others have suggested.[323] Such drastic action, no matter how desirable, would have to come from Congress, or potentially via SEC rulemaking.

An alternative, no less drastic, measure would be to leave damages untouched, but legislatively overrule *Basic* by requiring a showing of actual reliance. This would formally leave the private right of action in place, but would effectively rule out class actions, thus limiting 10b-5 claims to large institutional investors who can establish that they actually read the alleged misrepresentation, and who own enough shares to make a non-class claim economically viable.[324] While Professor Grundfest has made a compelling textual argument for mirroring section 18's actual reliance requirement, the result is not conceptually coherent.

An open-market investor who has actually read a false statement has not suffered any tangible injury that is different from another investor

[322] Va. Bankshares, Inc. v. Sandberg, 501 U.S. 1083, 1114 (1991) (arguing, in the context of the implied private right of action under § 14(a) of the Securities Exchange Act, that "[w]here an implied cause of action is well accepted by our own cases and has become an established part of the securities laws . . . we should enforce it as a meaningful remedy unless we are to eliminate it altogether").

[323] *See* Brief of Law Professors as Amici Curiae in Support of Petitioners, *supra* note 177, at 32; Grundfest, *supra* note 35, at 3, 65; *supra* note 312 and accompanying text.

[324] *See* Grundfest, *supra* note 35, at 8–9 (suggesting that requiring actual reliance would not eliminate 10b-5 actions, but "[i]nstead, they are likely to be pursued by larger investors, suing . . . in individual actions that raise potentially significant damage awards. . . . Aftermarket Section 10(b) securities fraud litigation will therefore likely morph into a scrum of individual actions pursued by sophisticated investors in large cases that promise significant recovery."). *See generally* Korsmo & Myers, *supra* note 96.

conducting the same trades without having read the false statement.[325] Reliance simply does not have a useful role to play in securities fraud cases involving open-market transactions. As such, requiring actual reliance would be an "improvement" insofar as it curtails a wasteful practice (10b-5 class actions). But what would remain of private 10b-5 actions would still be conceptually incoherent, particularly if the "out-of-pocket" damages rule is left in place.

Whether or not these drastic measures are desirable, it seems unlikely a law essentially eliminating the securities class action would be passed in the foreseeable future. In a search for superior alternatives to incoherent and ineffective judicially created half-measures, we must therefore attempt to identify a coherent and perhaps somewhat less-ineffective legislative half-measure.

While it may not be a panacea, an early inquiry into market impact might nevertheless be desirable, both to screen out completely meritless claims and to narrow down the range of potential damages. Unlike market efficiency, market impact is at least a logical gatekeeper, in that it would eliminate claims where the plaintiffs are unable to show loss while allowing potentially meritorious claims to proceed.[326] The costs of such an inquiry would not be trivial, but need not be any more expensive than the existing process of wrangling over market efficiency.[327] Most importantly, wide-ranging discovery into issues like scienter and materiality—which generates the kind of large and asymmetric costs that can fuel nuisance settlements[328]—would not take place until after the crucial issue of market impact had been explored, providing at least some indication the suit has merit.[329]

[325] *See supra* Part IV.C. At least two counterarguments are possible. First, it could be argued that interference with one's decision making constitutes a separate (rather metaphysical) injury. *See* Goldberg, Sebok & Zipursky, *supra* note 220, at 1011–14. Second, it could be argued that investors who actually seek out information to inform their trading decisions help drive market prices to efficiency in the first place. *See* Gilson & Kraakman, *supra* note 191, at 612 n.170. As such, these "producers" of market efficiency should be entitled to the reward of a cause of action that is denied to passive "consumers" of market efficiency. Neither argument is particularly compelling, particularly in that out-of-pocket damages do not appear particularly apt as either compensation for such injury or reward for such activity.

[326] *See* Bebchuk & Ferrell, *supra* note 18, at 697 (arguing that a market-impact inquiry would "screen out at the class certification stage frivolous cases in which market prices were not distorted by the alleged disclosure deficiency").

[327] *See* BROMBERG, *supra* note 48, § 7:484 ("Whether a market is open, developed and efficient for [FOTM] can be a fertile area of dispute with the possibility for many kinds of costly and complex expert testimony.").

[328] *See supra* Part II.

[329] Like the law professor amici, I am not overly troubled by the argument that event studies to establish market impact will be unworkable. *See* Brief of Law Professors as Amici Curiae in Support of Petitioners, *supra* note 177, at 24–28. Event studies are employed routinely in securities litigation, and Professors Bebchuk and Ferrell argue persuasively that suitable tools exist to address likely issues in showing market impact. *See* Bebchuk & Ferrell, *supra* note 18, at 691–93. To the extent that

One partial solution, then, would be to allow plaintiffs a relatively free pass to class certification—perhaps subject to some minimal showing that the relevant market was "open and developed"[330]—and then bifurcate the proceedings, with the first step a mini-trial focused exclusively on market impact. For better or for worse, no court is likely to undertake so substantial an act of judicial engineering. This is precisely the kind of solution even a timorous Congress could easily impose, however, unconstrained by the need to work within the confines of Rule 23 and the issues presented in an individual case.

CONCLUSION

The modern securities-fraud class action deserves to be slain. Market inefficiency, however, is a weapon particularly unsuited to the slaying. Supreme Court pronouncements on market efficiency—or lack thereof—tell us little about how 10b-5 class actions should be structured. Such pronouncements, however, will inevitably resurface as weapons in ongoing controversies in other areas of the law—controversies of a far more fundamental nature than the debate over the presumption of reliance in securities-fraud claims.

A belief in the superiority of markets as a mechanism for allocating resources lies, in many ways, at the very heart of skepticism towards interventionist regulation of economic activity. Ill-considered and unnecessary denigration of market efficiency can only undermine arguments against such regulation. The modern securities-fraud class action is broken and cries out for reform. Upending or limiting the application of *Basic* may be a necessary first step. But the Court—and particularly its more market-oriented justices—should in the future avoid the kinds of reckless proclamations on market efficiency they made in *Halliburton*, lest their words come back to haunt them in other contexts.

plaintiffs will have difficulty demonstrating market impact for volatile or inefficient stocks, or where the effect of the misrepresentation is unclear, this strikes me as a feature, not a bug. *See* Korsmo, *supra* note 81, at 1154 n.196 ("[E]vent studies—identifying the impact, if any, of alleged misstatements—can be done even for thinly traded stocks, but the threshold for statistical significance will likely be far higher to reflect increased volatility." (citing Macey et al., *supra* note 228, at 1018)). Where event studies and related statistical tools are unable to convincingly establish market impact, it is because the underlying causal relations are not clear, which is precisely the type of claim we should want to let fail.

[330] *See, e.g.*, Langevoort, *supra* note 77, at 196–97; Newkirk, *supra* note 185, at 1394; Oldham, *supra* note 32, at 995–99.