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Market Intermediation, Publicness, and Securities Class Actions

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MARKET INTERMEDIATION, PUBLICNESS, AND SECURITIES CLASS ACTIONS

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ABSTRACT

*Securities class actions play a crucial, if contested, role in the policing of securities fraud and the protection of securities markets. The theoretical understanding of these private enforcement claims needs to evolve to encompass the broader set of goals that underlie the securities regulatory impulse and the publicness of those goals. Further, a clear grasp of the modern securities class action also requires an updated understanding of how the role of market intermediation in securities transactions has reshaped the realities of securities litigation in public companies and the evolution of the fraud cause of action in the context of open-market transactions. The Supreme Court's embrace of market efficiency as a mechanism to establish reliance in its 1988 decision, *Basic Inc. v. Levinson*, illustrates the necessary adaptation of common-law fraud to the modern market setting, and congressional enactment of the PSLRA in 1995 exemplifies the efforts to respond to the litigation risks inherent in that adaptation. Together, *Basic* and the PSLRA provide a framework for understanding both a series of recent Supreme Court decisions on securities class actions and a different understanding of the theory undergirding those class actions. To develop this understanding, we expand the conversation about the goals of securities regulation to include the set of goals that are rooted in publicness and focus on market protection, innovation, and growth, as well as stability and systemic considerations. We posit that this broader theoretical understanding explains why the Court rejected a challenge to the fraud-on-the-market*

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doctrine and, instead, permitted the continued use of market efficiency: the Court chose to preserve the deterrence and enforcement role of these cases in promoting market growth and innovation. We then apply this understanding of publicness and market intermediation to the interpretation of the Court's limited, but ambiguous, use of "price impact" in securities-fraud cases. Our analysis reveals that the practical balance established by Basic and the PSLRA has prevailed over pure doctrinal approaches to issues like reliance or other, more incomplete, theoretical explanations focused solely on compensation, deterrence, and investor protection, but neglects the role of publicness in the securities markets.

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INTRODUCTION

The legitimacy and efficacy of Rule 10b-5¹ and the use of class actions to enforce it have been debated at great length. The initial judicial focus on the implication of a private right of action gave way to contests over the meaning of the elements of common-law fraud and other prerequisites necessary to prove the cause of action.² The seesaw pattern of the cases in the first half-century of federal securities laws were enough to give a reader whiplash.³ Later congressional and judicial action, such as the Private Securities Litigation Reform Act of 1995 (“PSLRA”), inserted procedural hurdles to contain litigation agency costs and provided openings to vigorous contests over which elements of fraud are ripe for decision at early points in the litigation cycle.⁴ Over time, the fact of the 10b-5 cause of action has become more clear and permanent, but the

1. 17 C.F.R. § 240.10b-5 (2016) (prohibiting fraud in connection with the purchase or sale of a security).

2. See A.C. Pritchard & Robert B. Thompson, *Securities Law and the New Deal Justices*, 95 VA. L. REV. 841, 894 (2009).

3. An initial long stretch of expansive holdings by the Supreme Court gave way to a seemingly unbroken run of restrictive opinions. See E. Thomas Sullivan & Robert B. Thompson, *The Supreme Court and Private Law: The Vanishing Importance of Securities and Antitrust*, 53 EMORY L.J. 1571 (2004) (showing expansive decisions from the late 1930s through the early 1970s and then twenty-four restrictive decisions and one expansive decision in the 1970s and 1980s after Justices Powell and Rehnquist joined the Court); see also A.C. Pritchard, *Justice Lewis F. Powell, Jr., and the Counterrevolution in the Federal Securities Laws*, 52 DUKE L.J. 841 (2003) (tracing the change from expansive to restrictive decisions to the influence of Justice Lewis Powell, appearing upon his arrival and disappearing with his retirement).

4. See 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.).

interpretation of it has become more opaque and procedurally focused.⁵ A series of post-2010 US Supreme Court cases focused on how much of the 10b-5 cause of action is fair game at the class-certification phase of the litigation.⁶ In doing so, they illustrate the turn to procedure and the complexity and confusion that have come with it, while reaffirming the Court's commitment to the securities class action as an enforcement and deterrence mechanism.

But it was not just the law that changed; there were fundamental changes in the role of markets in securities transactions. The expanding role of market intermediation in securities transactions is important to understanding the evolution of the common-law tort of deceit into today's fraud-on-the-market-based 10b-5 class action, as well as to the specific issue of price impact. First, as the Supreme Court said in *Basic Inc. v. Levinson*, the market is an unpaid agent of the investors in modern securities transactions.⁷ By adopting the fraud-on-the-market presumption, it recognized that the necessary connection between defendants' misrepresentations and plaintiffs' loss can be shown when, in an efficient market, the fraud is incorporated into the market price of a security and thereby impacts the investors' decision to buy or sell stock.⁸ In doing so, the Court acknowledged the role of the market as an impersonal intermediary in the transmission of information in today's securities transactions. Second, modern financial learning, including, for example, diversification and portfolio theory, tells us that most shareholders own only a small percentage in any particular company and, thus, have little reason to be active investors, including, for example, suing when there is fraud.⁹ The class action mechanism brings efficiencies to this setting and, as the Court has recognized, is practically the only way private actions are likely to be brought, providing an enforcement mechanism for securities regulations and, thereby, acting as a deterrent to wrongdoers.

5. John C. Coates IV, *Securities Litigation in the Roberts Court: An Early Assessment*, 57 ARIZ. L. REV. 1 (2015).

6. Those cases pushed two fraud elements—materiality and loss causation—out of the class-certification phase and reaffirmed the Court's pathbreaking *Basic Inc. v. Levinson* decision, published a quarter-century earlier, which embraced theories of market efficiency as the basis for a presumption of the reliance element of fraud. *Basic Inc. v. Levinson*, 485 U.S. 224 (1988).

7. *Basic*, 485 U.S. at 244 (citing one of the early fraud-on-the-market cases, *In re LTV Sec. Litig.*, 88 F.R.D. 134, 143 (N.D. Tex. 1980)). That opinion, written by Patrick Higginbotham, later a judge on the Fifth Circuit, also discussed “the market's role as a transmission belt” for information. *LTV*, 88 F.R.D. at 143.

8. *Basic*, 485 U.S. at 246–47.

9. See *infra* note 37 and accompanying text.

These legal developments and the new market realities have combined to poke holes in traditional theories for private enforcement. Diversified investors, particularly those following more passive investment strategies of relying on the market, may seem just as likely to be hurt by private fraud suits (as their portfolio companies pay the costs of the litigation) as to benefit on the receiving end of those suits. Further, the law of the 10b-5 claim has lost any coherent connection to the traditional tort-based compensation rationale, and more generally, the case law has made a hash of the 10b-5 jurisprudence.¹⁰

This Article develops a better theoretical understanding of these issues. In Part I, we focus on the Rule 10b-5 cause of action and its foundation in common-law fraud. The 10b-5 claim is ripe for confusion. Its fraud base means there are as many as eight elements the plaintiff must separately prove to prevail and an equal number of places where the defendant can mount an attack.¹¹ A judicial tendency to conflate the elements and their proof—for example, materiality with reliance, or reliance with loss causation—exacerbates the mess.¹² Further, the interaction of two key temporal dimensions of the 10b-5 claim adds to the complexity:

(1) The front end and back end of litigation (i.e., matters to be addressed in pretrial motions versus those left to trial). Congress has chosen to move judicial review forward for some, but not all, of the elements that make up a Rule 10b-5 claim so that parties have ample incentive to characterize their claims to fit the procedural setting most favorable to their case.

(2) The front end and back end of a fraud. The nature of fraud is that there seemingly is a temporal division between when defendant's misrepresentation and plaintiff's reliance on it occur and when plaintiff's injury is ordinarily realized and measureable. This line turns out to be less real in a class action context, but has been subject to recurring battles in the class certification setting.¹³

10. See *infra* Part IV.

11. See *infra* Part I for a discussion of the common-law elements of fraud.

12. See, e.g., *Amgen Inc. v. Conn. Ret. Plans & Trust Funds*, 133 S. Ct. 1184, 1212 (2013) (Thomas, J., dissenting) (arguing the *Amgen* majority “conflat[ed] the doctrinally independent (and distinct) elements of materiality and reliance”); *Oscar Private Equity Invs. v. Allegiance Telecom, Inc.*, 487 F.3d 261 (5th Cir. 2007) (conflating loss causation with reliance), *abrogated by* *Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179 (2011).

13. Jill Fisch has very effectively addressed the temporal confusion between ex ante price distortion and ex post price impact. Jill E. Fisch, *The Trouble with Basic: Price Distortion after Halliburton*, 90 WASH. U. L. REV. 895, 899, 921, 924 (2013). Don Langevoort likewise has pointed to

As to the first, defendants' natural inclination is to push issues forward to the earlier stages of litigation, where procedure reigns over substance.¹⁴ In three cases before the Supreme Court since 2010, defendants sought to require the plaintiffs to prove three of the substantive elements of the 10b-5 cause of action—materiality, reliance, and loss causation—as a condition to class certification.¹⁵ The defense bar has pressed the Court to accept that elements that might otherwise be subject to proof only at trial should be proved earlier in the litigation, thereby preventing a trial. The defendants came up short in each case, but those cases shifted the judicial focus to yet another issue: price impact. Defendants are now using the price impact element to contest reliance during the class-certification phase. We explore that debate later in the Article by examining its place in the larger theoretical debate about securities class actions.¹⁶ We also discuss another key element of the class action, reliance, which is very

the conflation of reliance and loss causation. Donald C. Langevoort, *Judgment Day for Fraud-on-the-Market: Reflections on Amgen and the Second Coming of Halliburton*, 57 ARIZ. L. REV. 37 (2015).

14. The PSLRA permits defendants to bring a motion to dismiss as to scienter and misrepresentation prior to any discovery, increasing opportunities for defendants to take advantage of the procedural settings at the front end of litigation. Private Securities Litigation Reform Act of 1995, 15 U.S.C. § 78u-4(b)(3) (2014). One study showed that almost 40 percent of cases are dismissed at the motion-to-dismiss stage. Michael Klausner & Jason Hegland, *When Are Securities Class Actions Dismissed, When Do They Settle, and for How Much?—Part II*, PLUS J. REPRINT, Mar. 2010, at 1, available at [http://plusweb.org/Portals/0/Event%20Material/When%20Are%20Securities%20Class %20Actions%20Dismissed,%20When,%20and%20For%20How%20Much%20-%20Part%202.pdf](http://plusweb.org/Portals/0/Event%20Material/When%20Are%20Securities%20Class%20Actions%20Dismissed,%20When,%20and%20For%20How%20Much%20-%20Part%202.pdf); Michael Klausner et al., *When Are Securities Class Actions Dismissed, When Do They Settle, and for How Much?—An Update* 1, 3 (Stanford Law Sch. John M. Olin Program in Law and Econ., Working Paper No. 445, 2013), available at <http://ssrn.com/abstract=2260831> (studying all securities class actions filed between 2006 and 2010 showing that “38% of cases ended relatively quickly and painlessly for the defendants”). Yet, cases that do survive the motion to dismiss have higher settlement value, thus increasing the pressure on defendants to settle the case, or, alternatively, increasing their incentive to find another way to eliminate the case procedurally prior to discovery or trial. See Klausner et al., *supra*, at 9–10. Additional sources show that between 1996 and 2013, about 41 percent of cases were dismissed at the motion-to-dismiss stage. CORNERSTONE RESEARCH, SECURITIES CLASS ACTION FILINGS: 2014 YEAR IN REVIEW 12 (2014), available at <https://www.cornerstone.com/Get Attachment/52bfaa16-ff84-43b9-b7e7-8b2c7ab6df43/Securities-Class-Action-Filings-2014-Year-in-Review.pdf>.

15. *Halliburton Co. v. Erica P. John Fund, Inc. (Halliburton II)*, 134 S. Ct. 2398 (2014) (reliance); *Amgen Inc. v. Conn. Ret. Plans & Trust Funds*, 133 S. Ct. 1184 (2013) (materiality); *Erica P. John Fund, Inc. v. Halliburton Co. (Halliburton I)*, 131 S. Ct. 2179 (2011) (loss causation).

16. Price impact is not yet well understood, and the confusion is due, at least in part, to the confusion surrounding the second temporal dimension—the difference between the front and back end of fraud. In short, the defendants' misrepresentation and plaintiffs' reliance on it would typically occur at Time 1, or at the beginning of the class period, but the plaintiffs' injury is typically realized and usually measured with regard to facts available later, at, for example, Time 2, after the fraud is revealed. It is, in fact, endemic to fraud that investors do not know about it at the front end. As the Supreme Court pointed out in *Dura Pharmaceuticals, Inc. v. Broudo*, at the time of the purchase or sale, the investor has not yet sustained an economic loss that would give rise to recovery, nor can damages be effectively measured. *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 342–43 (2005).

different in open-market, anonymous transactions than in traditional face-to-face encounters.¹⁷

In Part II, we explore the arguments and tensions surrounding the use of the class action to pursue open-market transaction claims and how the securities version of fraud has necessarily developed differently from its common-law cousin. In Part III, we trace the key recent Supreme Court decisions that have produced the emerging jurisprudence on class actions more generally and on price impact in particular. These cases, when read together, reveal how the focus on the “science” of market efficiency, combined with a ratcheting up in procedural battles, has created layers of litigation that are both muddled and problematic. The result is a diminished and impoverished understanding of the substance of fraud, which harms both investors and corporate decisionmakers, who often have to make reporting decisions in rapid fashion.

Part IV turns to the theoretical understanding of securities class actions more generally, expanding the discussion from investor-based justifications to a view of the class action as part of the larger securities regulatory impulse. To do so, we expand the discussion of the goals of securities regulation to include those that are focused on creating strong, healthy markets that enable capital allocation, growth, and innovation. These goals, along with those focused on systemic risk and stability, are a part of the securities regulatory structure that has its home in publicness, the space outside of the private focus on transactions between sellers and purchasers that takes into account the broader effect on citizens at large. Publicness in the more general sense reflects what society demands of powerful institutions, in terms of transparency, accountability, and openness, in order for that power to be legitimate.¹⁸ The specific

17. Two traditional elements of common-law fraud—reliance and loss causation—correspond to these two time periods (Time 1 and Time 2). Reliance (transaction causation or but-for causation) focuses on the connection between the plaintiff’s harm and the defendant’s wrongful conduct at Time 1. There cannot be a cause of action, even for a misrepresentation that is material and made with the requisite mental state, if there is not a sufficient connection to the plaintiff’s harm. A traditional phrasing would sound something like this, “I heard your misrepresentation and in response changed my conduct.” *List v. Fashion Park, Inc.*, 340 F.2d 457, 463 (2d Cir. 1965) (asking whether the “plaintiff would have been influenced to act differently than he did act if the defendant had disclosed to him the undisclosed fact”). In contrast, loss causation describes the connection at the back end, after the fraud has been revealed. A plaintiff who has relied on the defendant’s wrongful conduct cannot recover unless the loss is properly attributed to the fraud. This loss-causation link addresses the fact that in open-market securities-fraud cases, the question has been how to sort out the change in value properly attributed to the fraud from the changes due to other, often constant, market-price changes.

18. We and others have discussed the term “publicness.” See Donald C. Langevoort & Robert B. Thompson, “Publicness” in *Contemporary Securities Regulation After the JOBS Act*, 101 *Geo. L.J.* 337 (2013); Hillary A. Sale, *J.P. Morgan: An Anatomy of Corporate Publicness*, 79 *BROOK. L. REV.*

application here encompasses the idea that over time, the motivations for securities regulation have expanded well beyond individual investors and their relationship to the financial markets to include the impact of those markets on society and citizens more broadly.¹⁹ Congress and the Supreme Court recognize class actions as an accepted part of American securities regulation, and we argue that publicness and the market- and citizen-focused goals of securities regulation support that recognition. As a result, we argue, securities-fraud class actions are necessarily different from traditional common-law fraud and will have correspondingly different risks of, for example, overcompensation.²⁰

In this Part, we identify a third temporal dimension that is important to our argument—the front end and back end of the regulation of securities. The front end is the familiar disclosure regime that is the recurring focus of American securities regulation, and the back end is the antifraud enforcement that Rule 10b-5 provides. Market efficiency and intermediation play a role in both facilitating securities offerings and enabling the class action that helps support the deterrence and enforcement necessary to create strong and healthy markets. This is the space in which securities regulation and market intermediation meet publicness and where the scope of the traditional theory of class actions necessarily expands. Interestingly, however, the result is that the space for arguing about reliance then contracts. We illustrate this result by applying this publicness-based theory to the price-impact, class-certification context. We conclude that the resulting contraction reflects both the role of market intermediation in securities litigation that is consistent with market intermediation at the front end of securities regulation, as well as the

1629 (2014); Hillary A. Sale, *Public Governance*, 81 GEO. WASH. L. REV. 1012 (2013); Hillary A. Sale, *The New “Public” Corporation*, 74 LAW & CONTEMP. PROBS. 137 (2011); see also Joan MacLeod Heminway & Shelden Ryan Hoffman, *Proceed at Your Peril: Crowdfunding and the Securities Act of 1933*, 78 TENN. L. REV. 879 (2011).

19. We develop publicness in this Article both in the context of market efficiency and the deterrent effect of class actions. What we used to view as a form of “private” regulation is in fact increasingly public in nature. Publicness impacts regulatory decisions as well as those of corporate actors, who, as a result of publicness, are subject to heightened accountability. The impact of corporate decisions on the markets resulting, for example, in the 2009 financial crisis, increases pressure on legislatures, regulators, and others to address, through the regulatory structure, the potential for further market shocks and recessions. In addition, in the context of securities litigation, publicness means that choices by corporate actors about what and how they communicate do not stop at the corporate door.

20. Both Congress and the Court have addressed this risk, for example, by permitting rebuttal to the presumption of reliance in *Basic* and by developing multiple requirements for securities-fraud class actions through the PSLRA. See 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.); *Basic Inc. v. Levinson*, 485 U.S. 224 (1988).

importance of securities-fraud enforcement to the broader, publicness goals of market protection, innovation, growth, *and* stability and systemic risk.

I. THE COMMON-LAW FOUNDATION OF SECTION 10(b) AND RULE 10b-5

Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated by the Securities and Exchange Commission have been the source of considerable academic commentary over the years. Although at one point there was a fight about whether the courts could “disimply” the private cause of action that had been implied by courts, congressional action in 1995 retained it, adding procedural hurdles to cabin its use in contexts seen as worrisome.²¹ Nevertheless, the 10b-5 cause of action and the cost of litigating it remain controversial.²²

Rule 10b-5 claims have multiple elements, almost all with roots in the common law. In the end, if a case goes to trial (and very few do), the Supreme Court has provided the following list of elements that the plaintiffs must prove:

1. a material misrepresentation or omission by the defendant(s);
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.²³

The Supreme Court’s list, not surprisingly, reflects the long-standing elements of common-law fraud; the black-letter elements of the tort of deceit are basically the same. Private recovery for deceit can occur if there is:

21. *See generally* Private Securities Litigation Reform Act of 1995.

22. *See, e.g.*, Fisch, *supra* note 13.

23. This list originates in *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336, 341–42 (2005). It also appears in a somewhat shortened form in *Stoneridge Investment Partners, LLC v. ScientificAtlanta, Inc.*, 552 U.S. 148, 157 (2008), *Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309, 1317–18 (2011), *Halliburton I*, 131 S. Ct. 2179, 2184 (2011), *Amgen Inc. v. Connecticut Retirement Plans and Trust Funds*, 133 S. Ct. 1184, 1191–92 (2013), and *Halliburton II*, 134 S. Ct. 2398, 2418 n.1 (2014).

1. a defendant's misrepresentation of
2. a material
3. fact
4. done with scienter
5. on which plaintiff relies
6. suffering damages as a consequence.²⁴

Indeed, the Supreme Court has said repeatedly that the securities statutes explicitly draw on common law, sometimes phrasing it as expanding on common-law fraud and other times adapting the common-law fraud.²⁵

Rule 10b-5's language, as promulgated by the Securities and Exchange Commission in 1942, included the first three specific elements from common-law fraud—*misrepresentation of a material fact*.²⁶ The elements of scienter, reliance, economic loss, and loss causation were omitted—not surprising for a rule originally adopted in an afternoon to empower the government to go after fraudsters.²⁷ When courts later decided that the same policy and rule would permit private causes of action, it was also not a surprise that they looked to common-law fraud to fill out the requirements of scienter, reliance, and loss causation.²⁸ Plaintiffs must prove all of the elements to recover.

The Court's list of the elements, which comes from a 2005 Supreme Court opinion, *Dura Pharmaceuticals*, has contributed to the confusion around these claims.²⁹ For example, it combines two elements—

24. WILLIAM L. PROSSER, HANDBOOK OF THE LAW OF TORTS § 105 (4th ed. 1971). This source does not break out materiality in a separate heading, but discusses it within misrepresentation. *Id.* § 106.

25. Compare *Dura Pharms.*, 544 U.S. at 341 (noting that a Rule 10b-5 claim “resembles, but is not identical to,” a common-law tort action for deceit), with *Herman & MacLean v. Huddleston*, 459 U.S. 375, 389 (1983) (stating that “an important purpose of the federal securities statutes was to rectify perceived deficiencies in the available common law protections by establishing higher standards of conduct in the securities industry”); see also *Basic*, 485 U.S. at 244 n.22 (stating that Rule 10b-5 actions are “in part designed to add to the protections provided investors by the common law”).

Section 11 of the 1933 Act is framed against this same template of the elements of common-law fraud, but it relaxes the requirements for reliance, changes the burden of proof for loss causation, and does both for scienter. 15 U.S.C. § 77k (2014). Section 12(a)(2) of the 1933 Act adopts a different combination of these same elements, *id.* § 77l(a)(2), and Section 18 of the 1934 Act provides yet a different combination that includes a double reliance requirement, *id.* § 78r.

26. 17 C.F.R. § 240.10b-5 (2016).

27. Milton V. Freeman, *Administrative Procedures*, 22 BUS. LAW. 891, 922 (1967).

28. See, e.g., *Kardon v. Nat'l Gypsum Co.*, 69 F. Supp. 512, 514–15 (E.D. Pa. 1946).

29. *Dura's* addition of economic loss to the list has also been criticized as not following from common-law deceit precedents. John C.P. Goldberg & Benjamin C. Zipursky, *The Fraud-on-the-*

materiality and misrepresentation—that common law and prior Supreme Court opinions have recognized as separate.³⁰ There are many material facts that shareholders would want to know, but unless the corporation or a person associated with it has an obligation to disclose information, the failure to do so is not a misrepresentation (by omission), and, therefore, no 10b-5 claim arises.³¹ The list also omits entirely the requirement that the material misrepresentation be as to a fact (as opposed to an opinion), a context that generated the Court's most recent securities opinion.³² Further, the Court drops into the middle of its list of common-law fraud elements the requirement that the misrepresentation be in connection with the purchase or sale of a security.³³ These words, drawn from similar language in the Securities Act, reflect the New Deal desire to provide a federal claim for common-law fraud cases occurring in securities markets for which state law had proven inadequate.³⁴

As our first step in clarifying the 10b-5 cause of action and aspects of its proof, then, we suggest that the Court's framework in *Dura* causes unnecessary confusion. Rather than continuing to rely on the *Dura* list, we propose a reframing of the elements organized around:

1. the defendants' prohibited conduct;
2. the plaintiffs' harm;
3. the connection between the conduct and the harm; and
4. the link to a securities transaction.

The two elements that make up the requisite "connection" are core to this Article, and both are sometimes denoted as causation. The reliance element provides a front-end link between the plaintiffs' purchase or sale

Market Tort, 66 VAND. L. REV. 1755, 1768, 1773 (2013) (damage understood as a prudential filter by which judges have excluded certain well-founded but trivial deceit claims; this requirement "dissipates (or, perhaps, disappears)" when plaintiff only seeks relief based on rescission or unjust enrichment; because courts have understood damages as a pragmatic filter, they have not insisted on the exacting conception of economic loss invoked by *Dura*).

30. See *Basic Inc. v. Levinson*, 485 U.S. 224, 239 n.17 (distinguishing materiality—addressed in that case—from duty to disclose, an element of misrepresentation).

31. *Gallagher v. Abbott Labs.*, 269 F.3d 806, 808 (7th Cir. 2001) ("We do not have a system of continuous disclosure. Instead firms are entitled to keep silent (about good news as well as bad news) unless positive law creates a duty to disclose.")

32. *Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund*, 135 S. Ct. 1318, 1327–29 (2015) (distinguishing opinion from facts that can be misleading in the context of a Section 11 (not Rule 10b-5) action, but finding that statement of opinion qualifies as misleading statement if opinion expressed was not sincerely believed).

33. *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 341 (2005).

34. See, e.g., Securities Act of 1933, Pub. L. No. 73-22, § 12, 48 Stat. 74 (1933).

and the defendants' prohibited conduct (Time 1). Reliance is sometimes referred to as transaction, or but-for, causation. Loss causation, however, refers to a different connection usually measured at the back end and sorts out losses that can be attributed to the fraud from those that can be allocated to another source (Time 2). This element addresses the concern that market prices can move in response to factors other than the alleged misstatement or omission. For example, the market price of an individual security can fall in response to an overall decline in the market. Loss causation responds to the legal and policy concerns that the plaintiffs should not be insured against market changes.³⁵ This element plays the intervening or proximate cause role that the *Palsgraf* case plays in traditional tort cases.³⁶ Yet, in securities-fraud cases, the change in market price normally shows up after the fraud has been revealed; thus, loss causation seeks to disaggregate the loss, or to separate out the portion due to the fraud. Reliance and loss causation are, therefore, different from each other and, because of market intermediation, different in an open-market securities setting from that of the traditional common-law fraud claim.

Common-Law Elements Relating to Defendant's Conduct	Common-Law Elements Relating to Plaintiff	Common-Law Elements Defining Connection Between Defendants' Wrongful Act & Plaintiffs' Loss	Necessary Connection to Securities
1. Misrepresentation (includes <i>a.</i> affirmative lies; <i>b.</i> half-truths; or <i>c.</i> silence if there is a duty to speak)	5. Plaintiff suffers harm (economic loss)	6. Reliance (by plaintiff on defendant's wrongful act, sometimes discussed as "transaction causation" or "but-for" causation or "causation in fact")	8. In connection with the purchase or sale of a security
2. of a Material		7. Loss causation (sometimes discussed as proximate cause, and distinguishing loss from the fraud from loss from other sources, such as the market)	
3. Fact			
4. done with Scienter (a sufficiently bad mental state)			

35. See Donald C. Langevoort, *Basic at Twenty: Rethinking Fraud on the Market*, 2009 WIS. L. REV. 151, 181–84 (discussing the *Dura* Court's analysis of loss causation); see also Jill E. Fisch, *Cause for Concern: Causation and Federal Securities Fraud*, 94 IOWA L. REV. 811 (2009) (discussing the *Dura* Court's analysis of loss causation).

36. *Palsgraf v. Long Island R.R. Co.*, 162 N.E. 99 (N.Y. 1928).

II. SECURITIES-FRAUD CLASS ACTIONS

Securities-fraud cases are different from the traditional common-law fraud case. Modern securities transactions often occur in public markets, not in face-to-face transactions. The common characteristics of markets and transactions mean that individual suits for fraud arising in this setting make little economic sense. Thus, securities-fraud cases usually occur as class actions, creating a different litigation context and the need for a different understanding of some of the elements, including, for example, reliance and damages.³⁷

A. *Class Actions as a Response to the Economics of Individual Shareholders*

Securities-fraud litigation occurs largely in the class-action context, and the cases support an industry for both plaintiff- and defense-side lawyers.³⁸ The class action mechanism addresses two key issues for open-market securities-fraud claims arising in modern public corporations. The first is that the costs of litigating an individual securities-fraud claim exceed the holdings of most individual investors.³⁹ Portfolio theory and investment patterns reveal that shares are dispersed among numerous shareholders, each owning a small percentage of a company's stock. Indeed, most investors do not hold a significant number of shares in any given company.⁴⁰ As a result, the cost of hiring a lawyer to pursue a fraud claim will likely quickly surpass the value of the typical individual stake in a public company, so that it is not worth an individual's while to pay the costs of litigating a claim. In economic terms, these small investors have a collective-action problem. Their losses are too small to support litigation unless they join as a group or class.

B. *Class Actions and Litigation Agency Costs*

In addition to low incentives to sue due to the size of their claims, investors also have low incentives to monitor the class-action litigation

37. See, e.g., *Halliburton II*, 134 S. Ct. 2398 (2014).

38. See Lynn A. Baker et al., *Setting Attorneys' Fees in Securities Class Actions: An Empirical Assessment*, 66 VAND. L. REV. 1677, 1678–80 (2013).

39. See *id.* at 1679.

40. Jill E. Fisch, *Class Action Reform: Lessons from Securities Litigation*, 39 ARIZ. L. REV. 533, 536 n.21 (1997).

that may be brought on their behalf.⁴¹ As a result, the plaintiffs' lawyers play a very significant role in these cases. They take the cases on contingency and manage the litigation in consultation with representative plaintiffs. Because of the contingency aspect, the lawyers also assume the risk of any loss, including the cost of cases that do not result in settlement.⁴² When these cases do settle, there are often substantial fees to the lawyers and, when spread across the class, relatively small recoveries for individual plaintiffs. Opponents argue that many of these cases amount to little more than strike suits.⁴³ The litigation is frequently described as vexatious.⁴⁴ Others have argued that the plaintiffs' bar brings cases simply to extract unwarranted settlements, and that the cases can harm the reputation of the defendants. This, opponents argue, results in high opportunity and transaction costs from the litigation.⁴⁵ Some claims are difficult to sort out,⁴⁶ and, whether or not the fraud occurred, litigation takes time away from executives running the business.

Proponents of private class actions, however, argue that the cases are key to deterrence and, therefore, enforcement of the securities regulations, and that they support the scarce resources of the Securities and Exchange Commission.⁴⁷ In this view, plaintiffs' lawyers act as private attorneys general, enforcing the fraud prohibitions and, thereby, promoting the goals of fair and efficient markets that, as we explore in Part IV, are tied to publicness, innovation, growth, and stability. This private-attorneys-general view is particularly important when considered in light of the relatively small holdings of the average plaintiff and the resulting lack of incentive for a small investor to bring the cases on his or her own.⁴⁸

C. *The Role of Insurance*

The power of the litigation is increased by the fact that, for the defendants, the consequences of litigating and losing are very high.

41. Robert B. Thompson & Randall S. Thomas, *The Public and Private Faces of Derivative Lawsuits*, 57 VAND. L. REV. 1747, 1758 (2004) (discussing litigation agency costs).

42. See, e.g., Fisch, *supra* note 40, at 554.

43. See Brief for Petitioners at 42–43, *Halliburton II*, 134 S. Ct. 2398 (2014) (No. 13-317).

44. See, e.g., *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 739 (1975).

45. Eric Helland, *Reputational Penalties and the Merits of Class-Action Securities Litigation*, 49 J.L. & ECON. 365, 375–78 (2006).

46. *Blue Chip Stamps*, 421 U.S. at 742 (noting that oral claims in securities cases can be hard to sort out).

47. William B. Rubenstein, *On What a "Private Attorney General" Is—And Why It Matters*, 57 VAND. L. REV. 2129, 2148–54 (2004).

48. For a summary of the debates on these issues and a discussion of research on the topic, see generally Fisch, *supra* note 40.

Defendants found liable for fraud lose their directors' and officers' insurance coverage and their indemnification.⁴⁹ Further, the damages, which would be personal at that point, are potentially very large.⁵⁰ This looming shadow of liability (at the back end) arguably adds to the (front-end) value of the claim and increases its strike and settlement value. For those reasons and many others, including the mixed incentives of both the defense- and plaintiff-side lawyers, these cases rarely go to trial. Instead, they are resolved by settlement, after litigation focused on motions and procedural arguments, and with little attention to actual facts or evidence.⁵¹ Insurance policies cover the settlement costs, including fees for plaintiffs' counsel, as well as paying the defense-lawyer fees along the way. Thus, insurance policies, with their exclusions for fraud and bad faith, play a role in the incentive to settle and the amount of money available for settlement.

D. Causation and Impersonal Market Transactions

The common law of fraud requires each injured person to have relied on the misstatement or omission in order to prove her claim.⁵² Yet, in publicly-held corporations, the interactions supporting these fraud claims are trades in impersonal markets and thus are unlike the traditional relationship-based fraud of the common-law fraud setting. The market acts as an intermediary. Further, the class-action rules that cover typical securities litigation require that class member claims be sufficiently similar, addressed with a standard that focuses on whether “questions of law or fact common to class members predominate over any questions affecting only individual members.”⁵³ Combining the impersonal nature of

49. They also suffer reputational harm, though that harm may well be more perceived than actual. See Helland, *supra* note 45, at 365.

50. See Urska Velikonja, *Public Compensation for Private Harm: Evidence from the SEC's Fair Fund Distributions*, 67 STAN. L. REV. 331, 372 (2015) (discussing the average recovery and aggregate damages in securities class actions); see also Frank H. Easterbrook & Daniel R. Fischel, *Optimal Damages in Securities Cases*, 52 U. CHI. L. REV. 611 (1985).

51. See Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497 (1991); Donald C. Langevoort, *Theories, Assumptions, and Securities Regulation: Market Efficiency Revisited*, 140 U. PA. L. REV. 851, 896 (1992) (noting that the potential for “substantial overcompensation” influences the parties’ “bargaining dynamics associated with pre-trial settlement”).

52. *Halliburton II*, 134 S. Ct. 2398, 2407 (2014) (quoting *Amgen Inc. v. Conn. Ret. Plans & Trust Funds*, 133 S. Ct. 1184, 1192 (2013)) (“To recover damages for violations of section 10(b) and Rule 10b-5, a plaintiff must prove . . . ‘reliance upon the misrepresentation or omission . . .’”).

53. FED. R. CIV. P. 23(b)(3).

the transaction with the class action, then, results in the need to adjust the common law, and in particular, the reliance element.

Consider the following example. If all investors were Warren Buffett, they would be able to prove their reliance on a defendant's misstatement or omission, because they would read the company's offering documents, quarterly reports, or annual reports. Those investors would be well informed and up to date on the company's changes in management, product lines, and strategies—at least those that were made public.⁵⁴

Investors, however, trade for multiple reasons and with varying degrees of information. Indeed, unlike Warren Buffett, small investors are less likely to read all or any of a company's filings.⁵⁵ Their reliance is not directly on company documents or statements, but is, instead, indirectly on those filings as interpreted by analysts or brokers and others who translate the information to the market.⁵⁶ As a result, an insistence on maintaining reliance as developed at common law would defeat the use of the class action and eliminate the enforcement it brings. It is for this reason that, in 1988, the Supreme Court recognized the fraud-on-the-market doctrine in the now famous case of *Basic Inc. v. Levinson*.⁵⁷ In *Basic*, the Court defined the requisite connection between a defendant's wrongful act and plaintiffs' harm, noted that there is more than one way to demonstrate that connection, and decided that the 10b-5 version of fraud must account for the difference between modern securities-markets transactions and their common-law, face-to-face counterparts.⁵⁸ Applying these principles, the Court held that as long as the securities trade in an efficient market, all investors—both Warren Buffett and the small investor—can be presumed to have relied on the market price as a reflection of the value of a share.⁵⁹ This is where market intermediation comes into play. In short, the theory is that if the market is efficient—a term about which there is considerable debate—public information about the company will be impounded into the

54. Of course, if all investors were like Warren Buffet, they would have relatively large holdings in companies, making it worth their while to sue.

55. Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549, 569 (1984).

56. *Id.*

57. *Basic Inc. v. Levinson*, 485 U.S. 224, 243–45 (1988) (stating that “our understanding of Rule 10b-5’s reliance requirement must encompass” the differences between “modern securities markets, literally involving millions of shares changing hands daily” and “face-to-face transactions contemplated by early fraud cases,” and “[r]equiring a plaintiff to show a speculative state of facts . . . would place an unnecessarily unrealistic evidentiary burden on the Rule 10b-5 plaintiff who has traded on an impersonal market”).

58. *Id.* at 241–50.

59. *Id.* at 246–50.

stock price. Thus, when an investor or that investor's retirement fund buys the securities at the market price, the price reflects the information—true or false. The presumption is that public, material misrepresentations can distort the price of stock traded in an efficient market, and, as a result, purchasers in that market may be considered to have done so in reliance on the misrepresentation. To be sure, this form of reliance is only a presumption and is subject to rebuttal.⁶⁰

This theory of market efficiency, or market intermediation, acts as a proxy, so to speak, for reliance as traditionally required for face-to-face transactions. It was controversial when adopted in *Basic*, and it has been debated ever since—both in the legal⁶¹ and the economic literature.⁶² Nevertheless, it provided the commonality necessary for class actions and, as we will explore in Part III, prompted a trio of recent Supreme Court cases, one of which affirmed both the presumption and its importance.

A second element affected by the open-market setting is the calculation of damages. The usual method has been to use an event study that measures the change in the price at the time of correction of the fraud, or Time 2, as a proxy for how much inflation occurred at the time of the misstatement, or Time 1.⁶³ This delta is generally referred to as the price impact of the fraud, and much of what we know about its measure has occurred in the context of damage and loss-causation measurement.

In theory, the value of the fraud could be measureable at the front end—at the time defendant makes the misrepresentation and plaintiffs enter into the securities transaction. The goal would be to measure the out-of-pocket harm to the security holder, or the difference between the value the stock was represented to have and its actual value at the time of the transaction. But that turns out to be somewhat difficult to measure. The price at the time of transactions is available, but if it incorporates the

60. *Id.* at 248–49 (giving three examples of when the presumption might be rebutted: (1) where “market makers” are already privy to the information conveyed by the defendant; (2) where credible countervailing information enters the market and dissipates the effect of the fraud; and (3) where plaintiffs would have sold without relying on the integrity of the market (i.e., if motivated by concerns unrelated to the fraud). This combination of rationales applicable to all investors and only to one investor creates some conceptual problems that have plagued later efforts to coherently describe the theoretical basis for the presumption and its rebuttal. See *infra* text accompanying notes 169–90.

61. See generally Roberta S. Karmel, *When Should Investor Reliance Be Presumed in Securities Class Actions?*, 63 BUS. LAW. 25 (2007); Fisch, *supra* note 13.

62. See Frederick C. Dunbar & Dana Heller, *Fraud on the Market Meets Behavioral Finance*, 31 DEL. J. CORP. L. 455, 457–58 (2006); Donald C. Langevoort, *Taming the Animal Spirits of the Stock Markets: A Behavioral Approach to Securities Regulation*, 97 NW. U. L. REV. 135 (2002).

63. See Merritt B. Fox, *Halliburton II: It All Depends on What Defendants Need to Show to Establish No Impact on Price*, 70 BUS. LAW. 437 (2015) (discussing event studies in securities litigation generally and in price-impact contexts more specifically).

fraud, it does not reflect the security's true value. Economists, therefore, have focused on data that is more cacheable as a proxy for that value, using information from the back end.⁶⁴ They look at how much the price changed (i.e., dropped) when the fraud was revealed and use that as a measure for the value of the misrepresentation.⁶⁵ The event study methodology aids in separating the price change attributable to the fraud from any other source, including particularly from the usual changes that occur in public markets.⁶⁶ This work is that of the loss-causation element, which necessarily operates off data at the Time 2 point to make a conclusion about damages for the Time 1 fraud. Here is where the conflation between the two elements has occurred.⁶⁷ As discussed below, it is hard to reconcile price impact in the context of reliance, or Time 1, with this Time 2 approach.

E. PSLRA Provisions to Regulate Class Actions

The arguments surrounding the costs and benefits of securities class actions formed the basis of a strong push for reform of the litigation of these claims, culminating in the PSLRA.⁶⁸ The PSLRA contained a myriad of reforms to securities claims and litigation, most of which have played out procedurally and two of which provide the foundation for the most recent series of 10b-5 cases before the Supreme Court.⁶⁹

As noted above, scienter, or the defendants' state of mind, is an element of a securities-fraud claim. Prior to the PSLRA, several courts had

64. Dunbar & Heller, *supra* note 62, at 508.

65. See Green v. Occidental Petroleum Corp., 541 F.2d 1335, 1344 (9th Cir. 1976) (Sneed, J., concurring) (reasoning that out-of-pocket measure, but not rescission, could be the basis for class certification, and describing how data between the date of misrepresentation and date of corrective disclosure can be arranged on a "price line" and "value line" to measure the effect of defendant's wrong conduct at the time of the misrepresentation and the times afterwards).

66. See Esther Bruegger & Frederick C. Dunbar, *Estimating Financial Fraud Damages with Response Coefficients*, 35 J. CORP. L. 11, 12–13 (2009) ("The iconic status of the event study is due to what it replaced: expert opinion based on unsupported assertions about materiality and loss causation, and as inflation-per-share estimates drawn from little more than junk science."); Fisch, *supra* note 13, at 918–22; Langevoort, *supra* note 35, at 180 n.127 ("To some extent at least, doubts about efficiency also call into question the precision of the event study itself, which often makes efficiency-driven assumptions in drawing the baseline against which observed returns are measured.").

67. See Michael J. Kaufman, *At a Loss: Congress, the Supreme Court and Causation Under the Federal Securities Laws*, 2 N.Y.U. J.L. & BUS. 1, 37–38 (2005).

68. See H.R. REP. NO. 104–369, at 31–32 (1995) (Conf. Rep.) (discussing the benefits and potential for abuse in securities class actions); Hillary A. Sale, *Judging Heuristics*, 35 U.C. DAVIS L. REV. 903, 915 n.57 (2002).

69. See *Halliburton II*, 134 S. Ct. 2398, 2426 (2014); *Amgen Inc. v. Conn. Ret. Plans & Trust Funds*, 133 S. Ct. 1184 (2013).

used Rule 9(b) of the Federal Rules of Civil Procedure to require that 10b-5 claims be subjected to heightened pleading requirements.⁷⁰ As to scienter, the PSLRA requires that plaintiffs plead with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.⁷¹ This inquiry, of course, is very fact-based. As a result, although the standard is “uniform,” the outcomes will never be. Fights about this standard, and how courts should implement it, were the first wave of procedural litigation under the PSLRA.⁷²

The PSLRA also added a provision that stays discovery pending the outcome of a motion to dismiss.⁷³ This provision works in tandem with the heightened pleading standard for scienter (and also for the misrepresentation element) to push plaintiffs to develop facts prior to filing their complaints in order to survive the motion to dismiss and pursue their claims.⁷⁴ With respect to the strike suit/vexatious litigation argument summarized above in Part II.B, these provisions have also worked to decrease the settlement value of a complaint early in the litigation and have given defendants the opportunity to end potentially frivolous cases without having to sustain the costs of discovery.⁷⁵ At the same time, a complaint that survives the motion to dismiss is one that has met a very

70. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 (2007).

71. 15 U.S.C. § 78u-4(b)(2) (2014). While providing a heightened pleading standard, the statute does not identify the required state of mind, leaving that to be determined by the courts. *See id.*

72. *See generally* A.C. Pritchard & Hillary A. Sale, *What Counts as Fraud? An Empirical Study of Motions to Dismiss Under the Private Securities Litigation Reform Act*, 2 J. EMPIRICAL LEGAL STUD. 125, 130 (2005).

73. 15 U.S.C. § 78u-4(b)(3)(B).

74. *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 81 (2006) (stating that in order “to curb . . . perceived abuses” in class actions, Congress “authorize[d] a stay of discovery pending resolution of any motion to dismiss”); *see also* *SG Cowen Sec. Corp. v. U.S. Dist. Court for N. Dist. of Cal.*, 189 F.3d 909, 912–13 (9th Cir. 1999) (emphasis omitted) (internal quotation marks omitted) (“The ‘Stay of Discovery’ provision of the Act clearly contemplates that discovery should be permitted in securities class actions only after the court has sustained the legal sufficiency of the complaint.”); *Avenue Capital Mgmt. II, LP v. Schaden*, Civil Action No. 14-cv-02031-PAB-KLM, 2015 WL 758521, at *2 (D. Colo. Feb. 20, 2015) (quoting *In re LaBranche Sec. Litig.*, 333 F. Supp. 2d 178, 181 (S.D.N.Y. 2004)) (“The legislative history of the PSLRA indicates that Congress enacted the discovery stay to prevent plaintiffs from filing securities class actions with the intent of using the discovery process to force a coercive settlement.”); *Pension Trust Fund for Operating Eng’rs v. Assisted Living Concepts, Inc.*, 943 F. Supp. 2d 913, 914 (E.D. Wis. 2013) (“The purpose of this stay is to allow the Court to evaluate plaintiffs’ claims in security actions before the defendant is required to engage in extensive and expensive discovery.”); *In re Diamond Foods, Inc., Sec. Litig.*, No. C 11-05386 WHA, 2012 WL 6000923, at *17 (N.D. Cal. Nov. 30, 2012) (“[T]he consolidated complaint has sufficiently pled scienter and loss causation under the PSLRA The discovery stay is now lifted”).

75. Hillary A. Sale, *Heightened Pleading and Discovery Stays: An Analysis of the Effect of the PSLRA’s Internal-Information Standard on ‘33 and ‘34 Act Claims*, 76 WASH. U. L.Q. 537, 576–78 (1998).

stringent pleading standard and has done so without access to documents or other discovery. For these cases, the settlement price tag likely has increased. Defendants could choose to settle those cases and move on, and in the early days, some did just that.⁷⁶ Increasingly, however, defendants have been deploying additional procedural litigation tactics at other pretrial stages of the case.⁷⁷ The goal here, like in employment and consumer-fraud cases, is to prevent the case from going to trial through the use of the class-certification process.

F. Class-Certification Procedures in Securities Class Actions

To understand the growth in the procedural issues raised by the defense bar, it is necessary to review the typical litigation path for these cases. After the initial step of filing a complaint, the litigation of one of these cases begins with a motion to dismiss, subject to the heightened pleading standard. The plaintiffs' lawyers must meet the defendants' motion to dismiss with very strong facts to support their case. Additionally, as mentioned above, they must do so without the aid of discovery.

After the motion to dismiss, the parties can settle, or they can move on to discovery and trial. Increasingly, these cases face a second stage of procedural battles focused on class certification. Defendants have sought to bring a larger number of issues into the class-certification stage in an attempt to defeat certification, and, thereby, the case. In addition, during the class-certification battle, the defendants have argued that discovery should be limited solely to issues related to class certification.⁷⁸

At this stage, the focus, given Federal Rule of Civil Procedure 23(b)(3), is whether common or individual issues predominate. The challenge has been to determine whether a particular fraud element of the claim is one that is key to predominance or, if not proved at trial, would result in the case's failing for all plaintiffs alike. The defendants have fought aggressively at this stage, arguing that the plaintiffs need to prove, not plead, materiality, reliance, and loss causation at class certification and

76. Stephen J. Choi & Robert B. Thompson, *Securities Litigation and Its Lawyers: Changes During the First Decade After the PSLRA*, 106 COLUM. L. REV. 1489, 1498–99 (2006).

77. See generally JONATHAN C. DICKEY, *SECURITIES LITIGATION: A PRACTITIONER'S GUIDE* (2013) (providing a practical guide, including many procedural tactics, for defending securities class-action suits).

78. Before *Halliburton I*, discovery began after the motion to dismiss, limited to class certification. While *Halliburton II* was pending, cases began to move into general discovery.

before trial.⁷⁹ In addition, defendants have argued that reliance as presumed by *Basic* should be proved, and not presumed, at class certification.⁸⁰

The Court has rejected almost all of these claims by defendants, but it has done so in ways that have prompted additional fights. Both *Halliburton* opinions are examples of the procedural nature of much of current litigation. The *Halliburton* defendants have now made two trips to the Supreme Court to argue about the various levels of proof required on two different elements of these claims.⁸¹ Both arguments involve the class-certification stage, and the second round of litigation was prompted by the Court's language in the first opinion.⁸² As a result, the case, which was filed in 2001, has not yet been tried or "proved," and presumably, defense counsel have billed thousands of hours in litigation.⁸³

G. Class Actions and Theories About Securities Regulation

Class actions have not only led to significant changes in the elements of the fraud, but also have disrupted the traditional tort-based theories used to support Rule 10b-5 claims. In particular, class actions challenge the compensatory rationale often given for tort claims like securities fraud. In the usual securities-fraud class-action setting, shareholders who were deceived, and therefore paid too much or too little, sue to recover their loss from the deceiver. A compensatory theory easily supports such a claim in a 1933 Securities Act setting, where the wrongdoer (the issuer and those working with it) is on the other side of the transaction from the investor and gains what the investor lost. In the typical setting under the 1934 Securities Exchange Act, however, the wrongdoer is the company or its management, and usually neither buys nor sells shares as a counterparty to the investor. Rather, the company/insiders made the misleading statement,

79. *Halliburton II*, 134 S. Ct. at 2412; Brief for Petitioners at 3-4, 17-18, 21, *Halliburton II*, 134 S. Ct. 2398 (2014) (No. 13-317).

80. *See, e.g., id.* at 35-37.

81. *See Halliburton II*, 134 S. Ct. at 2405-17 (considering whether defendants could rebut the *Basic* presumption with evidence of a lack of price impact at the class-certification stage); *Halliburton I*, 131 S. Ct. 2179 (2011) (considering whether plaintiffs relying on the fraud-on-the-market theory to establish reliance were separately required to establish loss causation in order to obtain class certification).

82. *See Halliburton I*, 131 S. Ct. at 2187 ("Because we conclude the Court of Appeals erred by requiring EPJ Fund to prove loss causation at the certification stage, we need not, and do not, address any other question about *Basic*, its presumption, or how and when it may be rebutted.")

83. The District Court granted class certification for one corrective disclosure and denied class status for five others in July 2015, referring to the "long and winding history of [the] matter." *See Erica P. John Fund, Inc. v. Halliburton Co.*, 309 F.R.D. 251, 255 (N.D. Tex. 2015).

and the investor thereafter traded with a third party, who is not a defendant and gets to keep any gain.

Tort law, of course, is amenable to making those who deceive pay for the harm even if they did not directly benefit. In the corporate setting, the result is that the corporate treasury will pay directly or indirectly by indemnifying directors and officers or paying the insurance that funds the settlement. Thus, circularity arises as funds go from one shareholder pocket (or one set of shareholders) to another shareholder pocket (or a somewhat different set of shareholders) after a substantial amount has been subtracted for attorneys' fees and other transaction costs. Consequently, the compensation justification for recovery loses much of its force.

The other traditional justification for fraud recovery, deterrence, fares better than compensation but triggers additional complications in the class-action context. Although the individuals who make misleading corporate statements can be held personally liable, such that damages would likely be expected to deter their conduct, the reality is that payments from the company or its insurer diminish this direct form of deterrence/enforcement. Instead, the deterrence/enforcement justification is much more indirect: if companies pay, it will make their officers and boards change their behavior, increase investor trust in the markets, and support the publicness goals of securities regulation. We return to these issues when we engage in the theoretical discussion of securities class actions, market intermediation, and publicness in Part IV.

III. TWENTY-FIRST CENTURY SUPREME COURT SECURITIES JURISPRUDENCE: MATERIALITY, RELIANCE, LOSS CAUSATION, AND PRICE IMPACT

Four twenty-first century Supreme Court opinions are responsible for the current confusion over the use of price impact in proof of reliance and loss causation, and those cases share several common features.⁸⁴ First, they illustrate narrow holdings that, like common-law cases generally, decide only the immediate case, putting off the larger issue for another day. Each issue and case unfolds from, and is connected to, the prior case, such that one needs to read them together to understand the Court's current approach to 10b-5 and price impact. Further, the narrow holdings—and the Court's loose language as to questions such as price impact—have

84. *See generally* Fisch, *supra* note 13.

given defendants (who lost the cases) room to continue to litigate, including bringing the same case, *Halliburton*, back to the Court.

Second, these cases illustrate the current focus of 10b-5 litigation on the class-certification context. The Court has trimmed the scope of class-certification arguments, holding that materiality and loss-causation questions are not appropriate, and that the presumption of reliance does apply. In the wake of those holdings, attention has shifted to another dimension arising at class certification: the narrowly-defined space for price impact left open by *Halliburton II*.

Third, the cases reaffirm *Basic*'s foundation that class actions are a core part of securities regulation and, importantly, *Basic*'s conclusion that adaptations to the common law of reliance through market intermediation and the fraud-on-the-market presumption are necessary if class actions are to have the effective deterrence role the Court supports.

A. *The Four Cases*

Before delving into the four 10b-5 cases, a reminder about the front and back end of the claims is useful. As we noted earlier, common-law fraud requires a sufficient connection between a defendant's wrongful act and a plaintiff's loss. The defendant's misrepresentation occurs at Time 1, and the plaintiff's injury typically is realized at Time 2, when the fraud is revealed. The focus of reliance is at Time 1, the time of the transaction: did the plaintiff change his or her position in response to the misrepresentation? In contrast, the focus of loss causation, given the reality of how proof of damages occurs in modern securities markets, is usually later, at Time 2, when the truth is revealed. Demonstrating loss causation requires parsing the loss into the portion that can be attributed to the fraud and the portion allocated to other causes. In securities markets, where prices change regularly, that question is constant and complicated. The recent Supreme Court cases illustrate different aspects of the relationship between these two factors.

1. *Dura Pharmaceuticals: Pleading Front-End (Time 1) Facts Does Not Meet the Standard for Pleading Loss at the Back End (Time 2)*

We begin with *Dura Pharmaceuticals*,⁸⁵ a case decided a few years before the three class-certification cases, and one that turned on the two distinct temporal dimensions inherent in fraud cases: Time 1, when the

85. *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336 (2005).

misrepresentation and reliance occur, and Time 2, when the truth is revealed and the effect of the fraud is actually felt. In *Dura*, the Supreme Court addressed the economic-loss and loss-causation elements in the context of a motion to dismiss.⁸⁶ Put succinctly, the issue in the case was loss at Time 2, and plaintiff's complaint addressed facts only for Time 1. The plaintiff pleaded price inflation due to the fraud.⁸⁷ Necessarily, in any successful fraud case, price distortion occurs.⁸⁸ That is what fraud does. There is not, however, always an injury, and a plaintiff must also show harm (loss) that can be attributed to the fraud as opposed to another cause. Harm and loss, however, are visible only later, at Time 2.

For contextual purposes, the allegations in *Dura* were that the defendants had made misstatements about earnings and about expected FDA approval of an asthmatic spray device that was ultimately not approved.⁸⁹ There was evidence of loss causation for the earnings claim, but that claim failed the scienter pleading standard at the motion-to-dismiss stage, leaving only the FDA claim.⁹⁰ Without getting into the facts of *Dura* in detail, the price movement of the stock was less than ideal for the plaintiffs' purposes.⁹¹ With respect to the loss causation element, the plaintiffs alleged the following: "[i]n reliance on the integrity of the market, [the plaintiffs] . . . paid artificially inflated prices for Dura securities and the plaintiffs suffered damage[s] thereby."⁹²

The defendants argued that this allegation was insufficient for the loss-causation element, which requires a causal connection between the defendants' alleged misrepresentations and the plaintiffs' economic losses.⁹³ After noting that the standard to be applied to the pleading of this

86. *Id.* at 339–46.

87. Fourth Consolidated Amended Complaint for Violation of the Securities Exchange Act of 1934 at 73, *In re Dura Pharms., Inc. Sec. Litig.*, No. 99-CV-0151-L(WMC) (S.D. Cal. July 21, 2006), 2006 WL 3267513.

88. Usually this would be inflation of value, but sometimes, as in *Basic*, the effect can be to lower the value of the stock, harming investors who sell at a deflated price. *Basic Inc. v. Levinson*, 485 U.S. 224, 227–29 (1988).

89. Fourth Consolidated Amended Complaint for Violation of the Securities Exchange Act of 1934, *supra* note 87, at 10, 17–18.

90. *Dura Pharms.*, 544 U.S. at 340 (describing the trial court's dismissal of the drug-profitability claim because plaintiff had not adequately pleaded scienter).

91. There was a noticeable drop after disclosure of new earnings and ambiguous results after disclosures about the FDA action—but the lower court had disposed of the earnings claims on scienter grounds. *In re Dura Pharms, Inc. Sec. Litig.*, 2001 WL 35925887, at *14–15 (S.D. Cal. 2001).

92. *Dura Pharms.*, 544 U.S. at 339–40 (emphasis omitted) (internal quotation marks omitted) (alterations in original).

93. Memorandum of Points & Authorities in Support of Defendants' Motion to Dismiss Plaintiffs' Consolidated & Amended Complaint at 20–21, *In re Dura Pharms., Inc. Sec. Litig.*, No. 99 CV 0151 JL JFS (S.D. Cal. Nov. 22, 1999), 1999 WL 33998677.

element was that of Federal Rule of Civil Procedure 8(a)(2), a “short and plain statement” of the facts, the Court held that the complaint did not meet the test.⁹⁴ Instead, the Court held that the plaintiffs needed to claim a connection between the misstatement or omission and their injury.⁹⁵ In doing so, the Court pointed out that by definition, if the defendants are committing fraud, the harm does not occur at the point at which the plaintiffs buy the stock.⁹⁶ At that point, Time 1, although the market price is presumably inflated or sustained by the fraud, the harm has not yet occurred. It occurs later, at Time 2, when the fraud is revealed, and the shares lose value. Thus, the plaintiffs needed to provide information about where the loss and harm occurred, subject to the Rule 8(a)(2) “short and plain statement” pleading standard.

In reaching the holding, the Court set out the two bookend concerns characteristic of its current approach to Rule 10b-5: the importance of the cause of action in “maintain[ing] public confidence in the marketplace . . . by deterring fraud, in part, through the availability of private securities fraud actions”⁹⁷ and the potential for vexatious litigation in the modern class-action setting.⁹⁸ The Court focused on two settings in which plaintiffs would be able to show inflation at Time 1 but should not be entitled to a recovery.⁹⁹ The first is if there is a misrepresentation about the securities, which, for example, inflates their price above their true worth, but plaintiff sells while the misrepresentation remains alive in the market and is not harmed.¹⁰⁰ Here, there would be misrepresentation, but no loss (yet). Second, the Court identified the context in which there is misrepresentation and loss to the plaintiff, but the loss can be said to arise from a source other than the fraud.¹⁰¹

The first is a familiar problem addressed, for example, in the language of Section 11 of the 1933 Act.¹⁰² The second is the traditional space for

94. *Dura Pharms.*, 544 U.S. at 346.

95. *Id.* at 346–47.

96. *Id.* at 342.

97. *Id.* at 345 (citing *United States v. O’Hagan*, 521 U.S. 642, 658 (1997); *Randall v. Loftsgaarden*, 478 U.S. 647, 664 (1986)).

98. See *Dura Pharms.*, 544 U.S. at 347–48. Here, the Court echoes *Blue Chip Stamps* and the dissenters in *Basic*. *Basic Inc. v. Levinson*, 485 U.S. 224, 262 (1988) (White, J., dissenting); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 747–48 (1975); see also Sale, *supra* note 75, at 552–68 (discussing Congress’s reform movement to curb vexatious litigation); Choi & Thompson, *supra* note 76 (same).

99. *Dura Pharms.*, 544 U.S. at 336, 342.

100. *Id.* at 342.

101. *Id.* at 342–43.

102. See 15 U.S.C. § 77k(a), (e) (2014) (permitting recovery by any person acquiring a security for which a registration statement contains an untrue statement of material fact, but limiting recovery

loss causation both in common-law fraud and in securities-market cases.¹⁰³ The Court's holding is straightforward and noncontroversial, illustrating the difference between the front and back end of 10b-5 cases and the procedural context that frames current litigation.¹⁰⁴ In the end, the Court's holding had a limited effect. On remand, with the pleading on the loss-causation element adjusted from Time 1 to Time 2, the complaint survived a motion to dismiss.¹⁰⁵

2. *Halliburton I: Proof of Loss Causation Is Not Required to Show Reliance at Time 1 or for Class Certification*

Next in the line of evolution is *Halliburton I*,¹⁰⁶ a case that also revolved around loss causation. Here, the focus shifted from pleading loss causation, which turned out to be quite easy in light of *Dura*, to whether the plaintiffs had to prove loss causation at the class-certification stage.¹⁰⁷ Defeating a case at class certification is a win for defendants, because the matter will presumably disappear. Moreover, at that point, the insurance policy is still paying the defense lawyers' fees, and a trial on the merits, with the concomitant discovery and spectacle of officers and directors on the stand, goes away.

This case came to the Supreme Court from the Fifth Circuit, which had earlier held that in order to invoke the fraud-on-the-market presumption of reliance at class certification, the plaintiff had to prove (not just plead) loss causation.¹⁰⁸ The Supreme Court rejected this argument.¹⁰⁹ Reflecting the learning of *Dura* about the role of the loss-causation element as distinct from transaction causation/reliance, the Court held that loss causation's focus on Time 2 has "no logical connection to the facts necessary to

to the difference between the amount paid and the price received in the market before suit if that price remains inflated at the time of the sale, such that purchaser will have suffered no economic loss); see also generally Hillary A. Sale, *Disappearing Without a Trace: Sections 11 and 12(a)(2) of the 1933 Securities Act*, 75 WASH. L. REV. 429 (2000).

103. *Dura Pharms.*, 544 U.S. at 343.

104. But see the Court's inclusion of a quotation from Justice White's dissent in *Basic*, which uses a "Cf." signal to suggest an analogous example of investor insurance when allowing recovery in the face of affirmative evidence of *nonreliance*, thus blurring the lines between reliance and loss causation. *Dura Pharms.*, 544 U.S. at 345.

105. *In re Dura Pharms., Inc. Sec. Litig.*, 452 F. Supp. 2d 1005 (S.D. Cal. 2006); see also *In re Dura Pharms., Inc. Sec. Litig.*, 548 F. Supp. 2d 1126 (S.D. Cal. 2008) (subsequent litigation).

106. *Halliburton I*, 131 S. Ct. 2179 (2011).

107. *Id.*

108. *Oscar Private Equity Invs. v. Allegiance Telecom, Inc.*, 487 F.3d 261 (5th Cir. 2007) (holding that plaintiffs must prove loss causation to qualify for certification), *abrogated by Halliburton I*, 131 S. Ct. 2179 (2011).

109. *Halliburton I*, 131 S. Ct. at 2184–87.

establish” the *Basic* presumption of reliance at Time 1, when an investor decides to buy securities.¹¹⁰ Reliance and loss causation are separate elements and together mean, for example, that even if investors relied on a defendant’s misrepresentation at Time 1 to buy securities when the price was distorted by fraud, they cannot recover absent loss causation at Time 2.¹¹¹ The Court was also clear that only the first question is relevant at class certification.¹¹²

Halliburton I also reaffirmed the core learnings of *Basic*. First, reliance connects misrepresentations to injury.¹¹³ Second, requiring plaintiffs to demonstrate reliance in the same manner as in a traditional face-to-face fraud action would be impossible and would create an unnecessary and unrealistic evidentiary burden for open-market claims.¹¹⁴ Indeed, the requirement would block class actions. And, third, fraud on the market resolves the reliance concern and, in doing so, provides a path for recovery for fraud that helps to ensure public trust in the markets.¹¹⁵ The Court also reaffirmed *Basic*’s holding as to what the plaintiffs must show to gain the presumption of reliance. Here, the Court noted that plaintiffs have to demonstrate that the alleged misrepresentations were publicly known, that the market was efficient, and that the purchase or sale of stock occurred between the misrepresentations and the truth.¹¹⁶

The Court refused, however, to take up the defendants’ efforts to characterize the opinion below as not about loss causation, but really about the conditions for gaining the presumption of reliance.¹¹⁷ *Halliburton* argued that the Court should require the plaintiffs to establish whether the alleged misrepresentations affected the market price in the first place, or whether the misrepresentations had a “price impact” on *Halliburton*’s stock.¹¹⁸ The Court rejected this characterization of the lower court’s opinion, as well as the conflation of the elements, and refused to reach for

110. *Id.* at 2186.

111. *See id.*

112. *Id.* This part of the opinion is simple enough and may reflect why the opinion was a unanimous, five-page opinion with only one unnumbered footnote.

113. *Id.* at 2184–85.

114. *Id.* at 2185.

115. *Id.*

116. *Id.* Note that this listing of the preconditions leaves out materiality, an omission the Court in *Angen* later reinserts without discussion. The list itself comes from footnote 27 of *Basic*, where that Court seemed to be simply citing from the Court of Appeals opinion below. It is a very humble beginning for what turns out to be the determining issue of *Halliburton II*. *See* discussion *infra* Part III.B.

117. *Halliburton I*, 131 S. Ct. at 2186–87.

118. *See* Fisch, *supra* note 13, at 897 n.8.

this issue, leaving the difficulty of proving reliance, or the lack thereof, in the open-market setting for what turned out to be *Halliburton II*.¹¹⁹

3. *Amgen: Materiality Need Not Be Proved at Class Certification Before Basic Is Invoked*

In between *Halliburton I* and *Halliburton II*, defendants argued that plaintiffs must prove materiality at the class-certification stage in order to invoke the fraud-on-the-market presumption.¹²⁰ The Court was no more open to this argument than the loss-causation one.¹²¹ This opinion, however, was substantially longer and more complex. It also generated three dissents and left space for additional litigation of the issues the Court did not decide.

Materiality, like loss causation, is one of the elements of Rule 10b-5 fraud imported from the common law. Notably, neither of these elements is among the ones that Congress, in the PSLRA, decided to subject to the motion to dismiss and discovery stay.¹²² In addition, materiality, unlike loss causation, is specifically mentioned in *Basic* as one of the prerequisites the plaintiff must show to invoke the fraud-on-the-market presumption of reliance (discussed in more detail in the next Part).¹²³ Defendants argued that because materiality was a predicate for the presumption of reliance, and without that presumption individual claims would dominate over common ones, plaintiffs should have to prove materiality at class certification.¹²⁴

The Supreme Court held that although proof of materiality is required to prevail on the merits, it is not a prerequisite to class certification.¹²⁵ The Court's opinion is strongly rooted in procedure, and more particularly in Rule 23(b)(3), which requires that common issues predominate to gain class certification.¹²⁶ The Court first pointed out that Rule 23(b)(3) requires only a showing that the questions common to the class predominate, not that they are answered on the merits for the class.¹²⁷ Then, the Court noted that materiality is an objective standard: it is a

119. *Halliburton II*, 134 S. Ct. 2398 (2014).

120. *Amgen Inc. v. Conn. Ret. Plans & Trust Funds*, 133 S. Ct. 1184, 1191 (2013).

121. *Id.*

122. *See id.* at 1200–01.

123. *Id.* at 1195.

124. *Id.*

125. *Id.* at 1194–1204.

126. FED. R. CIV. P. 23(b)(3).

127. *Amgen*, 133 S. Ct. at 1194–95.

question common to all class members.¹²⁸ Thus, if the plaintiffs were unable to prove materiality, they would fail to do so for all class members, not for individuals, and therefore individual issues would not predominate on the question of materiality.¹²⁹ Specifically, the Court reasoned, “[a]s to materiality, therefore, the class is entirely cohesive: It will prevail or fail in unison.”¹³⁰ As a result, the Court concluded that Rule 23(b)(3) did not stand in the way of certification.¹³¹ Indeed, the role of 23(b)(3) is to determine only which method of adjudication is best and not to adjudicate the case in its entirety.¹³²

Three other aspects of the Court’s opinion are worth noting. First, the Court responded to Amgen’s policy argument that the failure to adopt its view would result in unwarranted settlement pressure.¹³³ The Court emphasized that Congress dealt with this issue through the PSLRA and did not choose to require early proof of materiality (or loss causation).¹³⁴ Instead, the Court stated that it had “no warrant to encumber securities-fraud litigation by adopting an atextual requirement of precertification proof of materiality that Congress, despite its extensive involvement in the securities field, has not sanctioned.”¹³⁵

Second, the Court rejected Amgen’s argument that proof of materiality at class certification would conserve judicial resources, stating that, in fact, “Amgen’s position . . . would waste judicial resources.”¹³⁶ The Court’s point here is that increasing the focus on procedural resolutions of these claims complicates the litigation. Specifically, the Court noted that elevating proof of materiality (or loss causation) to the class-certification stage would create more, not less, litigation, resulting in “a mini-trial . . . at the class-certification stage” that “would entail considerable expenditures of judicial time and resources, costs scarcely anticipated by Federal Rule of Civil Procedure 23(c)(1)(A), which instructs that the decision whether to certify a class action be made ‘[a]t an early practicable time.’”¹³⁷

128. *Id.* at 1195–96.

129. *Id.* at 1191. This is the classic test for Rule 23(b)(3).

130. *Id.*

131. *Id.* at 1194–1204.

132. *Id.* at 1191; *see also* Langevoort, *supra* note 13, at 42.

133. *Amgen*, 133 S. Ct. at 1199–1202.

134. *Id.* at 1200–01.

135. *Id.* at 1202.

136. *Id.* at 1201.

137. *Id.* (alteration in original) (quoting FED. R. CIV. P. 23(c)(1)(A)). The series of cases discussed here are proof of that issue. *Dura* was filed in 1999, went before the Supreme Court in 2005, and was resolved through settlement in 2009. Jocelyn Allison, *\$14M Settlement Reached in Dura Securities*

Finally, four justices dissented or concurred in *Amgen*, raising a broader question that set the stage for *Halliburton II*. Justice Alito's concurrence pointed out that the majority did not "revisit" *Basic* or the fraud-on-the-market presumption.¹³⁸ He then noted that recent evidence "suggest[ed]" that the market-efficiency presumption might rest on a faulty economic premise,¹³⁹ referring to Justice Thomas's dissent, which Justices Kennedy and Scalia, in part, joined. The four justices appeared to be calling for an opportunity to overturn *Basic*,¹⁴⁰ and within months, the Court granted certiorari in *Halliburton II*. A holding in line with the four justices would effectively eliminate securities class actions, and, thus, raised heightened interest in the Court's *Halliburton II* deliberations.

4. *Halliburton II: Affirming the Basic Presumption and Rejecting Proof, but Allowing Rebuttal, of Presumption at Class Certification*

Halliburton I and *Amgen* paved the way for a full-on assault on *Basic* and the fraud-on-the-market presumption. They created the space for a robust challenge to the existence of 10b-5 securities-fraud class actions. *Halliburton II* posed the question about proving market efficiency at the class-certification stage, but that was not the issue on most minds at the time the case was argued. Instead, the focus was on whether the Court would eliminate the fraud-on-the-market presumption altogether.¹⁴¹

The blockbuster possibility of *Halliburton II* failed to materialize. Chief Justice Roberts's majority opinion reaffirmed the core holdings of *Basic*:¹⁴² the element of reliance provides a connection between a misstatement and a purchase or sale, the traditional common-law form of

Suit, LAW 360 (Mar. 24, 2009, 12:00 AM), <http://www.law360.com/articles/93418/14m-settlement-reached-in-dura-securities-suit>. *Amgen* was filed in 2007, went before the Supreme Court in 2013, and remains unresolved as of 2015. See *Amgen*, 133 S. Ct. at 1204; Complaint for Violation of Federal Securities Laws, *Kairalla v. Amgen Inc.*, No. CV 07 2536 PSG (PLAx) (C.D. Cal. Apr. 17, 2007), 2007 WL 4966000. *Halliburton* was filed in 2002, went before the Supreme Court in 2011 and 2014, and remains unresolved as of 2015. *Halliburton II*, 134 S. Ct. 2398 (2014); *Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*, Civil Action No. 3:02-CV-1152-M, 2012 WL 565997 (N.D. Tex. Jan. 27, 2012).

138. *Amgen*, 133 S. Ct. at 1204. Note, however, that Justice Ginsburg's majority opinion did state that Congress had rejected the opportunity to revisit market efficiency. *Id.* at 1201.

139. *Id.* at 1204.

140. See *id.* at 1204–16 (2013). This is an argument that the majority addressed and rebuffed, pointing out that Congress implicitly approved of the fraud-on-the-market presumption when it adopted the PSLRA. *Id.* at 1200.

141. See Stephanie Russell-Kraft, *Cases to Watch: Where Halliburton Might Make Its Mark*, LAW 360 (June 22, 2015, 8:26 PM), <http://www.law360.com/articles/670778/cases-to-watch-where-halliburton-might-make-its-mark>.

142. *Halliburton II*, 134 S. Ct. at 2407–17.

reliance poses an unnecessarily unreasonable burden, and the rebuttable presumption of market reliance resolves the issue in an appropriate fashion for these anonymous transactions.¹⁴³ The Court also rejected the defendants' effort to require the plaintiff to prove price impact at class certification in order to invoke the presumption, noting that requirement would "effectively jettison half of [the presumption]."¹⁴⁴ Nevertheless, and in contravention of its expressed concern in *Amgen* about mini-trials, the Court held that the defendants were entitled to the opportunity at class certification to disprove market efficiency, referring to it as price impact, and creating confusion about the possible conflation of reliance, materiality, and loss causation.¹⁴⁵ As a result, the term "price impact," defined but unused in *Halliburton I*, and not used in *Amgen*, became the point of contest left open in *Halliburton II*.¹⁴⁶

Recall that before we detoured to *Amgen*, the Court had remanded *Halliburton I*, noting that any arguments properly preserved remained available to Halliburton.¹⁴⁷ Thus, on remand, the defendants argued that class certification remained inappropriate.¹⁴⁸ The core of their argument was that the evidence that they used to attempt to disprove loss causation revealed that the alleged misstatements did not impact the price of the stock.¹⁴⁹ The lack of a price impact at Time 2, they argued, rebutted the Time 1, *Basic* presumption, created a situation in which individual issues predominated over common ones, and defeated the use of the class-action mechanism.¹⁵⁰

The District Court rejected that argument and held that the defendants could not defeat class certification by forcing the plaintiffs to prove (or allowing defendants to disprove) the reliance element before the merits stage.¹⁵¹ The Fifth Circuit, relying on *Amgen*, affirmed.¹⁵² According to

143. *Id.* at 2407–08, 2417.

144. *Id.* at 2414.

145. *Id.* at 2417.

146. *See, e.g.*, Fisch, *supra* note 13, at 898–99; Langevoort, *supra* note 13, at 38–39.

147. *Halliburton I*, 131 S. Ct. 2179, 2187 (2011).

148. Defendants' Brief Opposing Class Certification and, in the Alternative, Request to Supplement the Record at 1, *Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*, No. 3:02-CV-1152-M (N.D. Tex. Aug. 31, 2011), 2011 WL 7562399.

149. *Id.* at 1–2.

150. *Id.* at 2–3.

151. *Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*, No. 3:02-CV-1152-M, 2012 WL 565997, at *1–3 (N.D. Tex. Jan. 27, 2012), *vacated and remanded by* Erica P. John Fund, Inc. v. Halliburton Co., 765 F.3d 550 (5th Cir. 2014).

152. *Erica P. John Fund, Inc. v. Halliburton Co.*, 718 F.3d 423 (5th Cir. 2013), *vacated and remanded by Halliburton II*, 134 S. Ct. 2398 (2014).

both courts, the defendants could use the price-impact evidence at trial, where actual proof is required, but not at class certification.¹⁵³

The defendants again petitioned for and gained a grant of *certiorari* from the Supreme Court.¹⁵⁴ And, unlike in *Amgen*, when the Court pushed the defendants back to trial for materiality, the Court opened a window for yet another fight at class certification.¹⁵⁵ To do so, the Court distinguished materiality from reliance, stating that materiality is “an objective issue susceptible to common, classwide proof.”¹⁵⁶ All plaintiffs rise and fall together with a material or immaterial misstatement, defeating the claim on the merits. In contrast, the Court opined, price impact differs from materiality, because price impact is fundamental to *Basic*’s premise: “It thus has everything to do with the issue of predominance at the class certification stage. . . . [Price impact] must be proved before class certification.”¹⁵⁷ Although the first part of the Court’s opinion affirmed the *Basic* reliance presumption and, thus, the class-action mechanism, the last part left space for the defendants to rebut the presumption—at the class-certification stage and, thus, before there is a trial or a jury.¹⁵⁸ In reaching its holding, the Court focused on price impact,¹⁵⁹ or more properly, the absence of price impact, as a term that it defined to provide the common link from *Basic* that would enable the reliance presumption.¹⁶⁰

This review of the cases reveals that defendants’ dragnet for issues that can be decided at an early stage of litigation has reached almost every element of the traditional fraud claim, with materiality, reliance, and loss causation scrutinized for requirements about what the plaintiff must prove to invoke the presumption of *Basic* at class certification. We know from *Halliburton I* that loss causation is not on the list,¹⁶¹ and from *Amgen* that materiality is not either.¹⁶² *Halliburton II* tells us that plaintiffs continue to be entitled to the presumption of reliance, but at the same time, the Court

153. *Id.* at 433.

154. *See Halliburton II*, 134 S. Ct. 2398 (2014).

155. *See generally* Langevoort, *supra* note 13.

156. *Halliburton II*, 134 S. Ct. at 2416.

157. *Id.*

158. *Id.* at 2407–17.

159. The term is used twenty-two times in three pages. *See id.* at 2415–17. For example, the Court states that “[t]he first three prerequisites [of what must be shown to get the *Basic* presumption] are directed at price impact—whether the alleged misrepresentations affected the market price in the first place.” *Id.* at 2414 (internal quotation marks omitted). This statement, of course, is aimed at Time 1. *See id.*

160. *Id.* at 2417.

161. *See supra* notes 106–19 and accompanying text.

162. *See supra* notes 120–40 and accompanying text.

gives prominence to the term “price impact” and permits defendants to deploy it to rebut the presumption at class certification.¹⁶³

As a group, these three cases, along with *Dura*, all contain narrow holdings. Until *Halliburton II*, the Court avoided the big issue left open in *Basic*: rebuttal of the presumption. Although the Court recognized space for rebuttal in *Halliburton II*, we still do not know what proof of the requisite connection between an open-market purchase and a misrepresentation will look like. As a result, although *Halliburton II* narrowed the field of play, price impact, a largely undeveloped term, now has the potential to create confusion, complexity, and mini-trials focused on econometric studies.¹⁶⁴ Before turning to those concerns in Part IV, however, we first develop the growth of the term “price impact” and its meaning in relation to Time 1.

B. The Growth of Price Impact

As *Halliburton II* makes clear, the term “price impact” is now on steroids, and, as a result, a more detailed understanding of its role and growth is necessary. The story has a humble beginning in the prerequisites for the presumption of reliance that first appeared in a footnote in *Basic*.¹⁶⁵ Price impact is not among the prerequisites listed.¹⁶⁶ Instead, it merits only an indirect reference in the discussion of how the presumption might be rebutted.¹⁶⁷ More than twenty years later, *Halliburton I* and *Amgen* treat the presumption prerequisites cavalierly and their relationship to price impact even more so. In short, the Court ducks the hard question as to the requirements for the causal relationship between the defendants’ fraud and the plaintiffs’ trading loss in an open-market transaction. This section of the Article follows the Court’s stunted development of price impact in these cases. Then, in Part IV, we engage in the theoretical discussions about the securities class action, developing the goals of securities regulation in the context of publicness as well as the role of market efficiency/market intermediation in securities transactions and litigation. We then apply those constructs to the price-impact element.

The starting point for the role of price impact is the discussion about the requirements necessary to establish *Basic*’s presumption of reliance,

163. See *supra* notes 141–159 and accompanying text.

164. See, e.g., Fisch, *supra* note 13, at 920–21; Langevoort, *supra* note 13, at 56–57; see also Pritchard & Sale, *supra* note 72.

165. *Basic Inc. v. Levinson*, 485 U.S. 224, 248 n.27 (1988).

166. See *id.*

167. See *id.* at 248–49.

which the *Halliburton II* Court collapsed to price impact.¹⁶⁸ *Basic* relegated this key issue to a footnote, and even there, it did little more than restate the view of the Court of Appeals.¹⁶⁹

The elements listed in footnote 27 are:

1. [T]hat the defendant made public misrepresentations;
2. [T]hat the misrepresentations were material;
3. [T]hat the shares were traded on an efficient market;
4. [T]hat the misrepresentations would induce a reasonable, relying investor to misjudge the value of the shares; and
5. [T]hat the plaintiff traded the shares between the time the misrepresentations were made and the time the truth was revealed.¹⁷⁰

The Supreme Court promptly cut that list from five to four, concluding that its holding as to materiality in an earlier part of the *Basic* opinion would collapse elements 2 and 4 into one.¹⁷¹

Price impact was only mentioned later, when the Court addressed rebuttal of the reliance presumption. There, the Court referred to three disjunctive paths listed by the lower court, stating that the defendants could “rebut proof of the elements giving rise to the presumption, *or* show that the misrepresentation in fact did not lead to a distortion of price[,] *or* that an individual plaintiff traded or would have traded despite his knowing the statement was false.”¹⁷² The *Basic* Court then concluded that “[a]ny showing that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff, or his decision to trade at a fair market price, will be sufficient to rebut the presumption of reliance.”¹⁷³

The Court also provided three examples of potential rebuttals. The first is a situation in which “market makers” were privy to the truth about the merger discussions, and as a result, the market would not have been

168. See *Halliburton II*, 134 S. Ct. at 2416 (“Price impact is thus an essential precondition for any Rule 10b-5 class action.”).

169. *Basic*, 485 U.S. at 248 n.27.

170. *Id.*

171. *Id.* Interestingly, the Court of Appeals had said that element 4 was the only one really at issue, but then found that it had been satisfied for pleading purposes. *Levinson v. Basic Inc.*, 786 F.2d 741, 750–51 (6th Cir. 1986), *vacated*, 485 U.S. 224 (1988).

172. *Basic*, 485 U.S. at 248 (emphasis added) (citing *Levinson*, 786 F.2d at 750 n.6).

173. *Id.*

affected when the news became public.¹⁷⁴ The second is when news of the merger credibly entered the market through another source and dissipated the effects of the misstatement.¹⁷⁵ The third is when a plaintiff believed Basic's statements were false, but sold because of unrelated concerns (e.g., potential antitrust problems).¹⁷⁶

We know from their correspondence that Justices Blackmun and Brennan (two of the four in the majority) engaged in a vigorous debate about the strength of the causal link required to show reliance in market transactions and particularly the conditions for this rebuttal. For Brennan, even if there were reasons other than the fraud that the plaintiff traded, the reduced amount that plaintiff received is sufficiently connected to the defendant's wrongful conduct as to permit recovery under 10b-5.¹⁷⁷ For Blackmun, such a trader had been injured (the misrepresentation having led to a lower price than the investor would have received in a market with no fraud) but was not defrauded (i.e., the loss and the wrongful conduct were not sufficiently connected).¹⁷⁸ Both justices agreed that there was little practical difference in their two positions—which related only to the space available to the defendant to rebut the presumption of reliance that both justices agreed was appropriate in an open-market setting, a rebuttal they believed would be very difficult or impractical for defendants.¹⁷⁹ Yet

174. *Id.*

175. *Id.* at 248–49.

176. *Id.* at 249.

177. See Letter from William Brennan to Harry Blackmun at 1 (Jan. 22, 1988) (on file with authors) (stating that the misstatement served as cause-in-fact of injury given the lower market price for the stock; the necessary link between misrepresentation and injury has been shown without the need to show what Brennan called transactional reliance). Professor Langevoort has earlier discussed this correspondence, concluding 10b-5 law would be clearer on this issue if Brennan's views had prevailed. See Langevoort, *supra* note 13, at 49–50. That discussion and this is based on the correspondence at the Library of Congress first identified by Adam Pritchard.

178. See Letter from Harry Blackmun to William Brennan at 2 (Jan. 25, 1988) (on file with authors). Blackmun's letter identified two reasons why the presumption did not apply, both of which are reflected in his opinion in *Basic* addressing rebuttal of the presumption: "If the material misrepresentation did not affect the price, then those who traded at market price were not affected by the misrepresentation. Similarly, if there exists such a person who did not rely on the integrity of the market price to be accurate, that person was not defrauded by the misrepresentation (although he did receive less money for his shares than he would have received absent the misrepresentation)." *Id.* Blackmun had made the same point in his first response to Brennan. See Letter from Harry Blackmun to William Brennan at 2 (Jan. 15, 1988) (on file with authors) ("The presumption of reliance depends on a link between the misrepresentation and the injury. If the defendant can prove that either the price would not have changed or that a particular plaintiff would have traded at the 'incorrect' price nonetheless, he should be entitled to rebut the presumption.")

179. Compare Letter from Harry Blackmun to William Brennan at 2 (Jan. 15, 1988) (stating that rebuttal would "not [be] very useful to defendants . . . because it would be very burdensome to prove") with Letter from William Brennan to Harry Blackmun (Jan. 27, 1988) (suspecting that defendant will find it impractical to use the rebuttal option).

this narrow, even esoteric, rebuttal space remained and gained new attention, as discussed below, when the Court reaffirmed *Basic* in 2014.

Twenty-three years after *Basic*, the Supreme Court elevated the elements necessary to gain the presumption of reliance from the *Basic* footnote to the text of the *Halliburton I* opinion, but inexplicably dropped materiality.¹⁸⁰ Price impact was now expressly identified by the Court, albeit indirectly. Recall from the discussion in Part III.A that the *Halliburton* defendants argued the Fifth Circuit had not really focused on loss causation (which the Supreme Court held was not a requirement to gain the presumption of reliance), but rather price impact (which the defendant argued should be a requirement to gain the presumption).¹⁸¹ The Court rejected that reading of what the Fifth Circuit had done and then proceeded to define price impact, stating, “‘Price impact’ simply refers to the effect of a misrepresentation on a stock price.”¹⁸² Next, the Court drew in reliance (an issue not before it), stating that “if a misrepresentation [did] not affect market price, an investor [could not] be said to have relied on the misrepresentation merely because he purchased stock at that price.”¹⁸³ In short, this means that a price unaffected by fraud does not reflect fraud. Although the Court did not express a view on Halliburton’s argument, this rendition of the argument leaves room for price impact in the form of price support, or propping up a price, to be distinguished from moving the price up or down. Simply put, the fact that a price does not move does not mean that there was no price distortion or impact. Instead, the lack of movement may be price impact in the form of price maintenance.

In *Amgen*, where materiality was at the core of the case, the Court did some backing and filling with respect to its omission of materiality in the *Halliburton I* list of requirements for the presumption of reliance. *Amgen* listed four elements as necessary to gain the presumption of reliance: (1) publicity, (2) materiality, (3) efficient market, and (4) trade timing.¹⁸⁴ The fourth element, trade timing, or a requirement that the plaintiff trade between the time of the misrepresentation and the correction, was now

180. See *Halliburton I*, 131 S. Ct. 2179, 2185 (2011). Materiality was not at issue in that case, but its omission is arguably sloppy for the nation’s most prestigious court.

181. See *supra* notes 147–50 and accompanying text.

182. *Halliburton I*, 131 S. Ct. at 2187.

183. *Id.*

184. *Amgen Inc. v. Conn. Ret. Plans & Trust Funds*, 133 S. Ct. 1184, 1209 (2013). The incomplete listing in *Halliburton I* is passed over as a list that “includ[es]” some of the elements. *Id.* at 1198–99.

described as an inquiry into adequacy of representation and was not tied to the predominance requirement of Rule 23(b)(3).¹⁸⁵

Of the remaining three elements, the Court found one, materiality, cannot be contested at class certification.¹⁸⁶ The Court's rationale was that if materiality failed, it would prevent all plaintiffs from suing, and did not, therefore, "give rise to any prospect of individual questions overwhelming common [questions]."¹⁸⁷ The other two, publicity and market efficiency, remain contestable at class certification.¹⁸⁸ The *Amgen* Court did not specifically discuss materiality's possible overlap with price impact except to say that "immaterial information, by definition, does not affect market price."¹⁸⁹

Finally, *Halliburton II* completed the movement of the predicates of *Basic*'s footnote 27 to center stage. The fourth element, trade timing, was confirmed as within the zone of typicality and adequacy.¹⁹⁰ Importantly, the Court took the first three predicates—publicity, materiality, and market efficiency—and presented them as price impact, previously defined in *Halliburton I*.¹⁹¹ Then, the Court gave them significant new importance when it stated that "[i]n the absence of price impact, *Basic*'s fraud-on-the-market theory and presumption of reliance collapse."¹⁹²

Of course, given the holding in *Amgen*, the Court faced a situation in which it now put publicity, materiality, and market efficiency together as directed toward price impact, but had previously carved off materiality as unsuitable for class certification. The result is that the same substantive inquiry bearing one label was pushed back to the merits, but with another label could be considered at class certification. We return to this issue in Part IV.

Finally, the *Halliburton II* Court also deployed an example of the role of price impact in determining market efficiency, and here is where the contradictions begin to grow. The Court posited a situation in which the defendants submitted event studies that examined the price of the stock in

185. *Id.* at 1198.

186. *Id.* at 1197–1202.

187. *Id.* at 1199. In reaching this holding, the Court rejected both the idea that plaintiffs should have to prove materiality and that defendants can disprove it at class certification. *Id.* at 1194–99.

188. *Id.* at 1198.

189. *Id.* at 1195. The Court noted that when "a market is generally efficient in incorporating publicly available information into a security's market price, it is reasonable to presume that a particular public, material misrepresentation will be reflected in the security's price." *Id.* at 1192.

190. *See Halliburton II*, 134 S. Ct. 2398, 2412 (2014).

191. *Id.* at 2414.

192. *Id.*

relation to six events.¹⁹³ If one of the studies examined the alleged misrepresentation and revealed no price impact at Time 1, and the other five studies showed price impact, then the Court concluded that it would face a situation in which both the market was efficient and the misstatement alleged in the complaint had no price impact.¹⁹⁴ The Court then pointed out that the result in that situation, absent the opportunity for the defendants to rebut the presumption, would be certification, “even though the fraud-on-the-market theory does not apply and common reliance thus cannot be presumed.”¹⁹⁵

The Court’s analysis is problematic unless it is reframed to include price stabilization. The Court’s discussion here and its prior discussion of price impact in *Halliburton I* did not directly address price stabilization. Yet, in the prototypical fraud case where, for example, misstatements continue a trend of positive news, the price impact can be price maintenance with little to no movement. That was the fact pattern in the *Halliburton* cases (and in *Amgen* and *Dura*).¹⁹⁶ Thus, to make sense of the Court’s use of price impact, we have to reconcile it with the Court’s failure to address price stabilization/maintenance and its role in most fraud cases.

In sum, the Court’s development of the predicates for *Basic*’s presumption and its use of price impact as a proxy for those elements reveals a pattern of initial inattention and sloppiness about the elements of the presumption that then left space for litigants to make use of procedural mechanisms to plumb the intricacies of the presumption. Not surprisingly, that is what they are doing. Shortly after *Halliburton II* was decided, courts began to apply it, ruling that defendants could attempt to prove the lack of price impact at class certification. For example, Regions Bank won review of the issue in a case involving its merger with AmSouth Bancorp.¹⁹⁷ *Halliburton* won a similar right, leading to subsequent class

193. *Id.* at 2415.

194. *Id.*

195. *Id.* But see Alon Brav & J.B. Heaton, *Event Studies in Securities Litigation: Low Power, Confounding Effects, and Bias*, 93 WASH. U. L. REV. (forthcoming 2015) (comparing the use of single-firm event studies, and their weaknesses, as used in securities-fraud litigation, with the multi-firm studies that academic research and peer-reviewed journals consider reliable).

196. See *supra* Part III.A.

197. Local 703, I.B. of T. Grocery & Food Emps. Welfare Fund v. Regions Fin. Corp., 762 F.3d 1248, 1252, 1261 (11th Cir. 2014). On remand the trial court found no rebuttal of the presumption. Local 703, I.B. of T. Grocery & Food Emps. Welfare Fund v. Regions Fin. Corp., No. CV-10-J-2847-S, 2014 WL 6661918, at *7–8 (N.D. Ala. Nov. 19, 2014).

certification for one of the claims but not five others.¹⁹⁸ And, in the case of AIG, which had been stayed pending the outcome of *Halliburton II*, the company quickly agreed to a \$960 million settlement in a case involving representations about credit default swaps.¹⁹⁹

The task of courts attempting to resolve these questions has been exacerbated by the Supreme Court's reluctance to explicate the reliance connection that is sufficient for open-market fraud relief in today's public markets. Defendants continue to occupy the space created by this ambiguity by pushing for new issues to be decided at class certification, including, for example, an argument for requiring a showing of an effective measure of damages. Recently, a Texas federal court declined to certify a class, focusing on how an event study would incorporate various theories of liability.²⁰⁰ This opinion, along with the ones described in this Article, are examples of what Professor Don Langevoort has described as litigation taking the form of a repeat "game of whack-a-mole."²⁰¹ To make sense of this game, then, an understanding of the theory of market regulation, as well as the theory of market efficiency and market intermediation and its role in class actions, is necessary. We turn there next.

IV. MARKET INTERMEDIATION AND THE SECURITIES CLASS ACTION

The Court's affirmance of *Basic* in *Halliburton II* made clear that the securities class action as enabled by market efficiency is here to stay. Nevertheless, this area of the law still suffers from gaps and a missing set of guiding principles to unify our understanding of the securities class action. We develop those principles in this Part of the Article. We begin by exploring the goals of securities regulation that are generally deployed in theoretical discussions of the securities class action—investor protection and corporate governance—and then add to those a set of additional goals that focus not only on investors but on the market and its stability more generally. These latter goals are in the publicness space

198. See *Erica P. John Fund, Inc. v. Halliburton Co.*, 309 F.R.D. 251, 254 (N.D. Tex. 2015) (granting class certification for one corrective disclosure and denying class status for five others).

199. Noah Buhayar & Kelly Gilblom, *AIG Agrees to Settle 2008 Securities Litigation for \$960 Million*, BLOOMBERG BUS. (Aug. 4, 2014, 3:24 PM), <http://www.bloomberg.com/news/articles/2014-08-04/aig-agrees-to-settle-2008-securities-litigation-for-960-million>.

200. *In re BP P.L.C. Sec. Litig.*, Civil Action No. 4:10-md-2185, 2013 WL 6388408, at *16–18 (S.D. Tex. Dec. 6, 2013) (finding, pre-*Halliburton II*, that a non-securities Supreme Court case, *Comcast Corp. v. Behrend*, 133 S. Ct. 1426 (2013), "signals a significant shift in the scrutiny required for class certification").

201. Langevoort, *supra* note 13, at 46.

about which each of the Authors has previously written.²⁰² We argue that publicness helps to explain the more robust goals of securities regulation as well as the role of the class action in enforcement and deterrence.

Next, we develop the market's role as an intermediary on both the front and back ends of securities regulation. That role, it turns out, is important to understanding the evolution of the common-law tort of fraud into today's fraud-on-the-market-based 10b-5 class action, as well as the specific issue of price impact. The market-as-intermediary and the correlative efficient-market theories play an enabling role in the front-end, disclosure regulation space. As a result, market efficiency and market intermediation enable and facilitate both offerings *and* enforcement of securities regulation. We conclude, therefore, that because most securities transactions in public corporations now occur in open, anonymous, and increasingly sophisticated public markets, the regulatory and enforcement mechanisms have also evolved, and must continue to do so, to recognize the market as an intermediary in those processes. The result is a market intermediation substitute in both the regulatory and the enforcement/class-action contexts that encompasses publicness in order to support economic growth through strong markets and innovation.

Finally, we turn to a specific discussion of the 10b-5 class action and the reliance element, developing a construct of the doctrine in the securities regulatory world where publicness plays a role. Here, we create an analytic framework for the 10b-5 tort's evolution, again with particular attention to the role of market intermediation. We then deploy the construct of the market as intermediary in the more limited context of price impact, providing an example of how market intermediation and publicness can help to resolve questions in securities class actions.

A. The Publicness of Securities Regulation and Enforcement

We begin by adding to the theoretical work about the role of regulation and enforcement in the securities class-action context. Many of our colleagues in the academy have explored securities regulatory goals and securities class actions, concluding that investor-protection and corporate governance/agency cost arguments provide varying degrees of support (or lack of support) for a theory of these claims.²⁰³ Investor protection, of

202. See *supra* note 18.

203. See William W. Bratton & Michael L. Wachter, *The Political Economy of Fraud on the Market*, 160 U. PA. L. REV. 69 (2011); Jill E. Fisch, *Confronting the Circularity Problem in Private Securities Litigation*, 2009 WIS. L. REV. 333; Merritt B. Fox, *Why Civil Liability for Disclosure*

course, is an important aspect of the class action and is also a core securities regulatory concern more generally. Nevertheless, as the most recent market crash reveals, the system is larger than any one issuer, or set of investors, and the choices of issuers have serious and lasting impacts beyond just investors who invest in any one company. As a result, although we begin with investor protection and corporate governance and their place in the regulatory impulse, we expand the discussion to include goals focused less on investor-specific concerns and more on developing strong and healthy markets and enabling innovation and growth. These goals are less about investors per se, and more about the larger society or publicness. The idea is that issuers both impact and are impacted by the market and forces outside those of the individual entity.²⁰⁴

Publicness, we argue here, has become part of the securities regulatory impulse. As the extremely slow recovery and lagging economic growth after the 2008–2009 financial crisis have revealed, strong markets are key to innovation and growth. In the US system, we have chosen a disclosure-based regulatory system to address the issues that might otherwise hinder the development of strong, healthy capital markets. Those regulations are generally on the front end—the offering side of securities transactions. They are complemented by both government/public and private (e.g., class actions) enforcement. After developing the discussion of the goals and regulatory choices, we will turn to deterrence and the role of the class action in providing back-end securities regulation.²⁰⁵

Investor protection has long been linked to the securities class action. The litigation roots of the 10b-5 claims are in traditional torts based on personal economic injury, and have continued to evolve as the claim has been redefined as a class action, focused on more collective decisions reflecting market intermediation of investor choices. Although we do not recount all of the investor-protection arguments here, the thrust is the class action's effectiveness in protecting investors—despite its shortcomings,

Violations When Issuers Do Not Trade?, 2009 WIS. L. REV. 297; Howell E. Jackson & Mark J. Roe, *Public and Private Enforcement of Securities Laws: Resource-Based Evidence*, 93 J. FIN. ECON. 207 (2009); Steven A. Ramirez, *The Virtues of Private Securities Litigation: An Historic and Macroeconomic Perspective*, 45 LOY. U. CHI. L.J. 669, 724–25 (2014); Robert B. Thompson & Hillary A. Sale, *Securities Fraud as Corporate Governance: Reflections upon Federalism*, 56 VAND. L. REV. 859 (2003).

204. See *supra* notes 18–19 for a discussion of publicness.

205. There are, of course, additional goals beyond disclosure and enforcement. Both the 1933 and 1934 Acts have important provisions directed toward cabinining the selling process. See Robert B. Thompson & Donald C. Langevoort, *Redrawing the Public-Private Boundaries in Entrepreneurial Capital Raising*, 98 CORNELL L. REV. 1573, 1575 (2013) (describing purposes of American securities regulation).

including a lack of significant compensation and potentially excessive costs for a largely diversified investor pool. We acknowledge these issues, though as we explore in Part B of this section, many reforms to the securities class action have worked to reduce these concerns.²⁰⁶

In the core securities setting, when an investor is buying or selling securities, regulation addresses informational asymmetries—issuers and their managers (and sometimes other traders) know more about the intangible interests being traded, and these parties' incentives to disclose are less than perfect.²⁰⁷ Offerors have inadequate incentives to disclose for various reasons, including, for example, worries about revealing valuable information that competitors can use.²⁰⁸ In addition, shares traded in the market are not fungible across companies. The value of one company is different from another, and investors are not all experts or commercial operators.²⁰⁹ Disclosure helps to fill the gaps between offerors and investors, and standardized disclosures allow investors to compare offerors to each other before investing. Regulations that cut across issuers help to create a baseline from which all offerors and investors can operate on an equal basis, without fear of the competitive concerns or the impact of private costs of disclosure on investors, also have aspects of publicness.²¹⁰ A socially optimal level of disclosure, and one that is evenly applied, arguably requires a public mandatory system, rather than private ordering.²¹¹ Good disclosures, with the market as an intermediary, will in turn attract capital and facilitate growth and innovation.

Securities regulations directed toward corporate governance (think proxy regulations, for example) extend investor protection beyond the buying or selling context. Investors who buy shares become shareholders with governance concerns about the entity. For example, when there is a specialization of function in these entities, and managers have control over large amounts of the investors' money, there is a gap between the interests

206. See *Halliburton II*, 134 S. Ct. 2398, 2413 (2014); *Amgen Inc. v. Conn. Ret. Plans & Trust Funds*, 133 S. Ct. 1184, 1200–01 (2013); see also *infra* Part IV.B.

207. JOHN C. COFFEE, JR. & HILLARY A. SALE, *SECURITIES REGULATION: CASES AND MATERIALS* 2, 5 (12th ed. 2012); see also John C. Coffee, Jr., *Re-Engineering Corporate Disclosure: The Coming Debate over Company Registration*, 52 WASH. & LEE L. REV. 1143 (1995) (discussing informational asymmetries in IPOs and secondary offerings); Sale, *supra* note 75, at 590–92 (arguing that informational asymmetries are at the heart of securities regulation).

208. COFFEE & SALE, *supra* note 207, at 5.

209. Marcel Kahan, *Securities Laws and the Social Costs of "Inaccurate" Stock Prices*, 41 DUKE L.J. 977 (1992).

210. Sale, *The New "Public" Corporation*, *supra* note 18, at 138–41.

211. Merritt B. Fox, *Retaining Mandatory Securities Disclosure: Why Issuer Choice Is Not Investor Empowerment*, 85 VA. L. REV. 1335, 1338–39 (1999).

of these two sets of participants. Thus, one of the goals of securities regulation is tied to corporate governance, with the idea that a strong securities disclosure system can help monitor corporate managers and mitigate agency costs.²¹² Securities regulation through mandatory and equal disclosure will decrease the monitoring costs that investors face,²¹³ and that, in turn, will help the market to attract capital and improve capital allocation.²¹⁴ Here again private class-action litigation aids in enforcement, helping to police disclosures and create pressure on the officers and directors to be forthright in information provision. Disclosure and enforcement that mediate the space between investors and issuers are also, in the publicness space, creating a market that attracts issuers, as well as the capital of investors more broadly.

The securities regulatory impulse also supports goals beyond investor protection and corporate governance, including market development and innovation, as well as economic growth. These goals reflect how investors/shareholders share the benefits of regulation along with other groups in society. Securities regulations and disclosure, for example, aid in price setting and, thus, allocative efficiency.²¹⁵ Capital is scarce, and pricing is important to achieving an efficient allocation of it.²¹⁶ The idea is that if we calibrate disclosure properly and ensure its evenness, the result will be to improve the accuracy of the pricing of securities, where accuracy is about pricing that corresponds with the value of the companies.²¹⁷ Of course, in economic terms, an efficient allocation of capital will allow the issuers to access capital and to grow and, thereby, promote economic growth overall, and will redound to the benefit of individual investors as well.²¹⁸ Securities regulation can also decrease the cost of capital by increasing transparency and diminishing informational asymmetries.²¹⁹ As a result, potential shareholders get easier and equal access to information, and that, in turn, facilitates investment, again,

212. See Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 357 (1976); Paul G. Mahoney, *Mandatory Disclosure as a Solution to Agency Problems*, 62 U. CHI. L. REV. 1047, 1048–1050 (1995); Fox, *supra* note 203, at 311; see also COFFEE & SALE, *supra* note 207, at 2.

213. Mahoney, *supra* note 212, at 1048; see also COFFEE & SALE, *supra* note 207, at 5.

214. Merritt B. Fox et al., *Law, Share Price Accuracy, and Economic Performance: The New Evidence*, 102 MICH. L. REV. 331, 340 (2003); Mahoney, *supra* note 212, at 1079.

215. Merritt B. Fox et al., *supra* note 214, at 339–340; Fox, *supra* note 203, at 312.

216. Fox et al., *supra* note 214, at 339.

217. *Id.*

218. See Urska Velikonja, *The Cost of Securities Fraud*, 54 WM. & MARY L. REV. 1887 (2013) (arguing that fraudulent financial reporting distorts economic decisions of all firms and misdirects labor and capital to subpar projects, thus affecting both the misreporting firm and its rivals).

219. COFFEE & SALE, *supra* note 207, at 6.

across companies and the market.²²⁰ Thus, the benefit of the regulation is a public as well as a private one, a form of publicness, and an outcome that is a public benefit exceeding the private cost of disclosure.²²¹

Disclosure and allocative efficiency are also important to the development and maintenance of a competitive and active capital market, and a competitive market, in turn, improves access to capital and promotes innovation.²²² Evidence supports the idea that countries with active securities markets have higher levels of economic growth, which, in turn, favor innovation and new entrants into the market.²²³ Thus, to the extent that disclosure allocates capital and facilitates an active market, it also helps to promote growth and innovation—the point of the regulation in the first place and another way in which publicness undergirds the goals of the regulatory system.²²⁴

Even the more specific investor-protection goals with which we started have a publicness component. Securities regulation and enforcement both facilitate investor confidence more generally, which is vital to belief in the market and, thereby, to growth and innovation.²²⁵ Consider the roots of the federal securities laws. The initial set of securities laws arose after the 1929 stock-market crash and the Great Depression that followed.²²⁶ There was a perception that the Depression may have been prolonged by a lack of confidence in the markets.²²⁷ No one, issuer or shareholder, wants to participate in a rigged market.²²⁸ Thus, regulation to preserve and maintain investor confidence helps to build strong and fluid markets.²²⁹ This need for investor protection beyond individual transactions grows as the number of market participants grows. With approximately half of the households in the United States owning equities either directly or through mutual funds or retirement accounts, its importance has increased.²³⁰ Indeed, although investor protection is at the core here, the impulse extends beyond the traditional issuer/investor, purchaser/seller context, to a larger

220. *See id.*

221. *Id.*; *see also* Fox, *supra* note 203, at 312–18 (analyzing benefits of public disclosure system); Velikonja, *supra* note 218, at 1929–38.

222. J. Robert Brown, Jr., *Of Brokers, Banks and the Case for Regulatory Intervention in the Russian Securities Markets*, 32 STAN. J. INT'L L. 185, 250–53 (1996).

223. *See id.* at 186.

224. COFFEE & SALE, *supra* note 207, at 8.

225. *See id.* at 5–9.

226. *See* H.R. REP. NO. 73-85 (1933).

227. *See id.*

228. *Basic Inc. v. Levinson*, 485 U.S. 224, 247 (1988) (quoting *Schlanger v. Four-Phase Sys., Inc.*, 555 F. Supp. 535, 538 (S.D.N.Y. 1982)).

229. COFFEE & SALE, *supra* note 207, at 2.

230. INVESTMENT CO. INST., EQUITY AND BOND OWNERSHIP IN AMERICA, 2008 1, 6 (2008).

concern about markets generally, as well as the deadening effect of crashes on growth. This is yet another example of how, as the number of investors increases and the concerns about market and economic growth broaden, publicness acquires a greater importance in the regulatory scheme.

In fact, when Congress described the necessity for regulation in the 1934 Act, its focus was not just investor effects but “[n]ational emergencies, which produce widespread unemployment and the dislocation of trade, transportation, and industry, . . . and adversely affect the general welfare.”²³¹ The national economic collapse that followed the financial crisis in 2008, and the Dodd-Frank Act enacted in response to it, reflected a similar publicness focus, with the added concerns of systemic risk and financial stability.

These latter concerns are arguably the most robust in terms of publicness.²³² In many financial institutions, securities transactions are intertwined with those in adjacent regulatory areas; when one collapses (or comes near to collapse), others can as well.²³³ The result, as in 2008, is financial instability and systemic risk, and the prescription in Dodd-Frank in 2010 was regulatory oversight.²³⁴ There are many critics of the regulatory system and of whether the United States has achieved an appropriate regulatory structure and balance;²³⁵ nevertheless, there is general agreement that oversight is necessary to help prevent excessive risk taking and the jeopardy to stability that risks can create.²³⁶ As a result, regulation and publicness go hand in hand.

B. Market-Efficiency Theory, Market Intermediation, Deterrence, and Securities Regulation

The key means to achieving the securities regulatory goals just described have been disclosures coupled with effective enforcement of those obligations.²³⁷ The Rule 10b-5 class action is key to the private

231. 15 U.S.C. § 78(b) (2014); *see also* Urska Velikonja, *Distortion Apart from Price Distortion*, 93 WASH. U. L. REV. (forthcoming 2015) (discussing the distortions that fraudulent disclosures can cause in employment and firms across the market).

232. *See* Langevoort & Thompson, *supra* note 18, at 374.

233. Sale, *The New “Public” Corporation*, *supra* note 18, at 138–39; Langevoort & Thompson, *supra* note 18, at 371.

234. Langevoort & Thompson, *supra* note 18, at 374.

235. *Id.* at 373.

236. *Id.* at 373–75.

237. Louis Loss’s classic description of securities regulations was “disclosure, again disclosure, and still more disclosure.” 1 LOUIS LOSS, *SECURITIES REGULATION* 21 (2d ed. 1961). There are other means, of course, including broker-dealer regulation, other limits on the sales process, and internal controls, that are left for discussion elsewhere. *See* COFFEE & SALE, *supra* note 207, at 54–73.

enforcement of those obligations.²³⁸ We begin this section by exploring the role that market efficiency has played in both disclosure and enforcement. To do so, we develop the concept of market intermediation, focusing on the market as an essential actor and accepted intermediary between issuers and investors, both in enforcement and disclosure. The direct contact between buyer and seller visible in the structure of the original securities laws has given way to a mostly indirect relationship intermediated through markets. As a result, investor communication has moved far from its original, direct-contact approach, and fraud enforcement has come to focus on the collective relationship more than the individual. The result has been a reshaping of the expectations about and the theoretical foundations of the private cause of action, with market-efficiency concepts playing an important role on both the front end and back end of securities regulation.

In the middle part of this section we set out the hybrid rationale that has replaced the compensation theory and is based on deterrence to provide the desired enforcement. Deterrence here follows from private class actions pursued by investors who have economic losses and Rule 10b-5 standing, but whose claims are bounded by procedural limits to prevent the possibility of over-deterrence through excessive payments to mostly diversified claimants. Finally, we argue that the collective focus flowing from the market-based intermediation characteristics of today's securities transactions, combined with deterrence enforcement concerns, push the traditional investor protection goals of securities regulation much closer to the construct of publicness goals we elucidated above.

Securities disclosure regulations have evolved to reflect, to a much greater degree than at their origins, the intermediary role of the market, with market efficiency as a proxy just as it is in the class-action context. Consider, first, the initial (1933) approach to offering disclosures. Required disclosures had to be complete and distinct from any other disclosure regardless of issuer size. Documents had to be placed into the hands of potential and actual investors.²³⁹ Today, the integrated disclosure system means that information required by the 1933 Act can be met by disclosures pursuant to the 1934 Act, and these disclosures no longer need

238. Public enforcement has been a topic of increased recent attention that is not our focus here. See John C. Coffee, Jr., *Law and the Market: The Impact of Enforcement*, 156 U. PA. L. REV. 229, 302–06 (2007).

239. Thompson & Langevoort, *supra* note 205, at 1575 (describing purposes of American securities regulation).

to be provided directly to prospective purchasers.²⁴⁰ One of the key aspects of the integrated disclosure reforms is the Form S-3, the filing required for equity issuances by large issuers like Halliburton.²⁴¹ Form S-3 greatly abbreviated the disclosures required for offerings by eligible filers, allowing them to incorporate prior filings by reference.²⁴² The idea here is that those companies are heavily traded, and followed, and release considerable information that is impounded into stock prices and into the market on a regular basis.²⁴³

The SEC's adopting release for the integrated-disclosure regulations specifically cited the efficient-market theory in support of its deregulatory changes.²⁴⁴ The release, in fact, went even further, stating that the "market operates efficiently for" S-3 companies,²⁴⁵ and disclosures from the companies are "disseminated and accounted for by the market place."²⁴⁶ This is an information-impoundment theory of market efficiency. The explicit reliance on the efficient-market theory, even if overstated,²⁴⁷ lends support to our theory that belief in some measure of market efficiency through information impoundment, and the correlative innovation and growth, is both a front-end and a back-end aspect of securities regulation and, arguably, important to the publicness aspect of the market.²⁴⁸

The SEC's reliance on market efficiency in propounding this rule change is important for another reason as well. It reveals industry's reliance on market intermediation. The SEC adopted this rule change in response to deregulatory pressure, and reliance on the theory of market

240. Adoption of Integrated Disclosure System, 47 Fed. Reg. 11,380 (Mar. 16, 1982); Jeffrey N. Gordon & Lewis A. Kornhauser, *Efficient Markets, Costly Information, and Securities Research*, 60 N.Y.U. L. REV. 761, 810–12 (1985).

241. Adoption of Integrated Disclosure System, 47 Fed. Reg. at 11,381; see also Henry T.C. Hu, *Efficient Markets and the Law: A Predictable Past and an Uncertain Future*, 4 ANN. REV. FIN. ECON. 179, 184 (2012).

242. Adoption of Integrated Disclosure System, 47 Fed. Reg. at 11,392.

243. Reproposal of Comprehensive Revision to System for Registration of Securities Offerings, 46 Fed. Reg. 41,902, 41,905 (Aug. 18, 1981).

244. See Adoption of Integrated Disclosure System, 47 Fed. Reg. at 11,382; see also Langevoort, *supra* note 51, at 876.

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

246. *Id.*

247. See Langevoort, *supra* note 51, at 876 (asserting that "it is clear that the adoption of Form S-3 rests very weakly—if at all—on the efficient market hypothesis"); see also *id.* at 877 (describing the SEC's reliance on the efficient-market hypothesis as "largely unnecessary").

248. *Id.* at 873–81 (critiquing the SEC's reliance as misplaced and critiquing "legal" understandings of market efficiency more generally).

efficiency helped to justify a pro-industry change.²⁴⁹ As a result, integrated disclosure became a cost-savings measure for issuers and is now an ingrained aspect of our regulatory system. Thus, for the issuers who rely on this front-end, market-intermediation measure, it is arguably disingenuous to claim a lack of similar intermediation on the back end, when deterrence and enforcement—and belief in the market—are at stake.²⁵⁰

Form S-3 and integrated disclosure are not the only places where market intermediation plays a front-end, offering-based role. Consider Rule 415 for shelf offerings.²⁵¹ This Rule is also part of the integration reforms, and here, too, the SEC referred explicitly to market efficiency in its adopting release.²⁵² This Rule allows issuers to register securities on a delayed basis, essentially stating that the issuer plans, at some point when the market is favorable, to sell securities, and the continuous disclosure regime of the 1934 Act provides the requisite disclosures.²⁵³ The provision increases issuer flexibility and options, as well as increasing cost savings.²⁵⁴ It, too, was premised on the connection between information impoundment and stock prices,²⁵⁵ and it is now an ingrained part of the regulatory system.

Similarly, the 2005 offering reforms, which provided fewer restrictions on the offering process for publicly-traded companies than for their counterparts making their initial public offerings, are also arguably based on market intermediation, even if not explicitly.²⁵⁶ Thus, the argument goes, the informational asymmetries and other investor-protection concerns are fewer, and the need for regulatory layers less.²⁵⁷ The same might also be said of the decision to decrease holding periods for the resale of restricted securities of companies making required periodic

249. See Adoption of Integrated Disclosure System, 47 Fed. Reg. at 11,382; see also Ronald J. Gilson & Reinier Kraakman, *Market Efficiency After the Financial Crisis: It's Still a Matter of Information Costs*, 100 VA. L. REV. 313, 373–74 (2014) (arguing that the theory of market efficiency “was the intellectual basis for advancing” the deregulatory agenda).

250. See *Cammer v. Bloom*, 711 F. Supp. 1264 (D.N.J. 1989) (implicitly recognizing this argument when it included S-3 filings as one measure of market efficiency).

251. 17 C.F.R. § 230.415 (2016).

252. Adoption of Integrated Disclosure System, 47 Fed. Reg. at 11,382.

253. See 17 C.F.R. § 230.415(a)(1)(x) (Rule 415(a)(1)(x)).

254. 17 C.F.R. § 230.415 (1982); Adoption of Integrated Disclosure System, 47 Fed. Reg. at 11,383–85.

255. Adoption of Integrated Disclosure System, 47 Fed. Reg. at 11,382.

256. See Securities Offering Reform, 70 Fed. Reg. 44,722 (Aug. 3, 2005).

257. See Gilson & Kraakman, *supra* note 55, at 621; see also Langevoort, *supra* note 51, at 881.

disclosures to the market.²⁵⁸ As a result, these provisions rely at least indirectly on the market-intermediation and the market-efficiency theory. Here, too, the idea is that information on these companies is already available and a market already exists for their securities.²⁵⁹ In short, information impoundment, market efficiency, and market intermediation loom in the background of many front-end offering regulations and reforms.

To be sure, our understanding of market efficiency, or at least that of the finance theorists, has changed since the time of *Basic*.²⁶⁰ We know that the assumptions undergirding the theory of market efficiency—complete information and rational actors—are more nuanced than some of the initial broad presentations of the theory. Information is costly.²⁶¹ Transaction costs exist.²⁶² Noise plays a role in the markets.²⁶³ And, people trade in securities for many reasons that are not rational.²⁶⁴ Nevertheless, our reliance on these market theories remains, both on the front-end, offering side, and, as *Halliburton II* made clear, on the back-end, enforcement side.

The reason for this continued reliance, we believe, is that the goals for regulation, both investor-oriented and publicness in nature, as well as the need for belief in market efficiency and fairness, are too important to discard. As a result, the regulatory system deploys market efficiency to elide gaps in theory, to enable both capital raising and deregulation. A similar pattern is visible on the deterrence/enforcement side, with litigation that supports the goals of securities regulation. Efficiency on the front end thus implies efficiency on the back end, an example of the type

258. Thompson & Langevoort, *supra* note 205, at 1623 (describing purposes of American securities regulation).

259. See generally Gilson & Kraakman, *supra* note 55, at 626; Langevoort, *supra* note 51.

260. Langevoort, *supra* note 51, at 902–03; see also William T. Allen, *Securities Markets as Social Products: The Pretty Efficient Capital Market Hypothesis*, 28 J. CORP. L. 551, 553–55 (2003) (analyzing the developments in market-efficiency theories since their early impoundment into corporate and securities law); Gilson & Kraakman, *supra* note 249 (providing historical analysis of growth and use of efficient-capital-markets hypothesis in regulation and litigation).

261. See Gilson & Kraakman, *supra* note 55, at 552–54; see also Langevoort, *supra* note 51, at 852 n.6 (citing Sanford J. Grossman & Joseph E. Stiglitz, *On the Impossibility of Informationally Efficient Markets*, 70 AM. ECON. REV. 393, 405 (1980)).

262. See Gilson & Kraakman, *supra* note 55, at 578; Langevoort, *supra* note 51, at 870 n.61 (citing Andrei Shleifer & Lawrence H. Summers, *The Noise Trader Approach to Finance*, 4 J. ECON. PERSP. 19, 20–21 (1990)).

263. See Gilson & Kraakman, *supra* note 55, at 578; Langevoort, *supra* note 51, at 871.

264. See Lynn A. Stout, *The Mechanisms of Market Inefficiency: An Introduction to the New Finance*, 28 J. CORP. L. 635, 660–61 (2003) (discussing behavioral finance and shifts in the understanding about investor rationality); see also generally ROBERT J. SHILLER, *IRRATIONAL EXUBERANCE* (2000) (arguing that prices may not reflect intrinsic value when investor enthusiasm plays a role); Langevoort, *supra* note 51, at 858–65.

of second-best theoretical solution that is the nature of the regulatory enterprise and litigation more generally.

Class-action theory has easily adjusted to the widespread acceptance of the intermediary role of the market in disclosure and enforcement just discussed. But some effects of the growth in the sophistication of markets and their participants since the inception of the federal securities laws have created additional challenges for theories seeking to explain the class action. As discussed in Part II, a compensation theory alone cannot support the class-action mechanism as it currently works.²⁶⁵ It is widely understood that the investors who receive payments receive only a small percentage of their alleged losses.²⁶⁶ Payments in this context tend to be circular, with today's shareholders paying the settlement costs of harms to yesterday's, with attorneys' fees reducing the payments.²⁶⁷ In short, compensation really does not occur and, as a result, cannot be used as a justification for the class-action regime.

The same, however, cannot be said of deterrence. Indeed, Congress reiterated the role of deterrence and the importance of the class action in that space when it passed the PSLRA.²⁶⁸ The Supreme Court did the same in opinions discussed in this Article.²⁶⁹ Even if less than "optimal," deterrence, whether actual or perceived, continues to have considerable traction in the debates about the class action.²⁷⁰ This is true even though it is well understood that the lack of payments by individual officers and directors, and the role of insurance, likely diminish the specific deterrence value of the claims,²⁷¹ and that the specific application of deterrence theories lacks the necessary nuance to sustain a general theory.²⁷²

265. See *supra* notes 42–48 and accompanying text. It also cannot support government enforcement. See William B. Rubenstein, *On What a "Private Attorney General" Is—and Why it Matters*, 57 VAND. L. REV. 2129, 2140–42 (2004); see also COFFEE & SALE, *supra* note 207, at 1–9.

266. See Janet Cooper Alexander, *Rethinking Damages in Securities Class Actions*, 48 STAN. L. REV. 1487, 1507 (1996).

267. Fox, *supra* note 203, at 303–04, 306.

268. See H.R. REP. NO. 104-369, at 31–48 (1995) (Conf. Rep.); see also Stephen B. Burbank & Sean Farhang, *Class Actions and the Counterrevolution Against Federal Litigation* (Univ. of Pa. Law Sch., Pub. Law and Legal Theory Research Paper Series, Research Paper No. 15-12) (discussing enforcement aspects of class action mechanism), available at <http://ssrn.com/abstract=2622201>.

269. See, e.g., *Amgen Inc. v. Conn. Ret. Plans & Trust Funds*, 133 S. Ct. 1184, 1200 (2013); *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 345 (2005).

270. See, e.g., Fox, *supra* note 203, at 304, 321; Ramirez, *supra* note 203, at 724–25.

271. See, e.g., Amanda M. Rose, *The Multienforcer Approach to Securities Fraud Deterrence: A Critical Analysis*, 158 U. PA. L. REV. 2173 (2010). Courts can, of course, do more to manage the insurance and other downsides. See generally, e.g., Hillary A. Sale, *Judges Who Settle*, 89 WASH. U. L. REV. 377 (2011); Tom Baker & Sean J. Griffith, *How the Merits Matter: Directors' and Officers' Insurance and Securities Settlements*, 157 U. PA. L. REV. 755 (2009).

272. Compare the Canadian approach, which generally imposes a damages cap based on the size

Many academics have raised these concerns. Professors Jackson and Roe describe the conventional academic view of securities litigation as “seriously compromised.”²⁷³ Professor Fisch presents the academic literature as reflecting a “general consensus that the traditional justifications for private litigation are deficient, and that the rationale for private litigation must be reconsidered.”²⁷⁴ And there have been many proposals for what would work better: enhanced government enforcement, SEC approval of class actions,²⁷⁵ stock exchanges in charge of deterrence,²⁷⁶ sanctions against managers personally,²⁷⁷ or regulation of incentives of those who bring suits.²⁷⁸

The Supreme Court is seemingly untroubled by such inconsistencies, and Congress has hardly batted an eye toward any of the alternative solutions. Instead, what we have is a hybrid private class action with elements of deterrence as a form of enforcement and some minimal compensation, built on the framework of what has gone before and adapted to do justice in the securities-transaction world we have. In short, class actions provide shareholders recovery (and attorneys with a share of it) for losses after misrepresentations. But they also function as a necessary and effective deterrent of misconduct that adversely affects the market as a whole. Indeed, the class action has become a known commodity in the deterrence arsenal in a way that public enforcement has not matched. Now, investors who purchased or sold after a misrepresentation, and who meet the elements of Rule 10b-5, have standing to bring a cause of action under the holding of *Blue Chip Stamps*,²⁷⁹ assuming they have an economic loss meeting the prerequisites

of the company. See A.C. Pritchard & Janis P. Sarra, *Securities Class Actions Move North: A Doctrinal and Empirical Analysis of Securities Class Actions in Canada*, 47 ALBERTA L. REV. 881, 903 (2010). For a broader overview of what a remedial scheme should be, see Easterbrook & Fischel, *supra* note 50, at 639–44 (explaining the challenges of deterrence in secondary-markets fraud, where there are matched gains and losses, but leaving room for deterrence-based recovery in a system that includes scienter limitations).

273. Jackson & Roe, *supra* note 203, at 209.

274. Fisch, *supra* note 203, at 334 (citing, for example, the work of John Coffee and Don Langevoort).

275. See, e.g., Amanda M. Rose, *Reforming Securities Litigation Reform: Restructuring the Relationship Between Public and Private Enforcement of Rule 10b-5*, 108 COLUM. L. REV. 1301 (2008).

276. A.C. Pritchard, *Markets as Monitors: A Proposal to Replace Class Actions with Exchanges as Securities Fraud Enforcers*, 85 VA. L. REV. 925, 983 (1999).

277. Donald C. Langevoort, *On Leaving Corporate Executives “Naked, Homeless and Without Wheels”*: Corporate Fraud, Equitable Remedies, and the Debate over Entity Versus Individual Liability, 42 WAKE FOREST L. REV. 627, 639–40 (2007).

278. Merritt B. Fox, *Civil Liability and Mandatory Disclosure*, 109 COLUM. L. REV. 237 (2009).

279. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 731–32 (1975).

of *Dura*.²⁸⁰ Nevertheless, the scienter pleading requirements and other provisions of the PSLRA permit the weeding out of many questionable suits before discovery and its expense even begin.²⁸¹ Further, the elements of materiality and loss causation, even though pushed back to a later time in the litigation process, shape anticipated damages for any settlement discussions. These changes have combined to diminish, but not eliminate, the circularity concerns of the diversified investors—including attorneys’ fees and litigation costs—who are potentially on both sides of these cases. For these, we are left with a choice: deterrence through litigation, as compared to the costs and benefits of other alternatives, including, for example, the development of a merits-based, front-end regulatory system—a choice the United States has eschewed in favor of disclosure and back-end fraud enforcement.²⁸²

Finally, this is where our expansion of the theory of the securities regulatory impulse to include publicness goals comes into play. The reason for the resilience of deterrence and the role it plays, we posit, is that it is connected to the goals of investor protection and market regulation and to publicness. And, here is where the class action has evolved and where our understanding of deterrence must also evolve. We need to assure all investors, not just individual ones or even issuer-specific ones, that the market is “policed” so that they will be encouraged to invest.²⁸³ Additionally, deterrence matters for those not in the market but impacted by crashes and downturns. Enforcement and deterrence thus go hand in hand. In that sense, then, deterrence, even if not easily measured, accomplished, or tied to specific harms, remains vital to the securities regulatory goals, including the increasing role of publicness in those goals. Securities fraud, if unchecked, creates a market in which no one—not offerors, buyers, or sellers—wants to participate. Simply put, fairness, and the belief in it, matters to market participants and, thus, to growth and innovation.

280. *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 342–46 (2005).

281. See Easterbrook & Fischel, *supra* note 50, at 644 (stating that “[t]he interaction of the scienter requirement with the damages rule should get rid of excessive (or, what is the same thing, inaccurate) enforcement,” but also cautioning that “[i]f the scienter rule does not filter out dubious cases . . . then loss-based damages are far too high, and it is necessary to put a more modest remedy in their place”).

282. The number of lawsuits has stayed relatively constant or declined in the twenty years since the PSLRA; the number of lawyers bringing these suits is small, and these suits have not raised the level of concern, unlike, for example, merger suits in state court in the last few years or derivative suits during the last century. See Bratton & Wachter, *supra* note 203, at 75–76 (pushing for public enforcement).

283. See *Dura Pharms.*, 544 U.S. at 345–46.

The answer to the application of *Halliburton II*, and the role of the securities class actions more generally, then, lies in our acceptance of the need for strong securities markets that help to generate innovation and growth. Class actions, as we have argued, play an important role in policing and protecting the market and ensuring its strength. The market works to allocate capital from investors to users. Issuers rely on the market, and indirectly, its efficiency and intermediation, to access capital. Capital allocation, in turn, supports growth and innovation, but only when belief in the market's fairness is sustained. The result is that class actions have evolved to encompass publicness, and therefore the emphasis on specific investor harm/compensation has diminished while the focus on deterrence of harm to the market or to a larger class of diversified investors has grown.

Of course, our concerns about fairness, innovation, and growth, as well as about information as a public good, support the disclosure, or front-end regulatory side we previously discussed.²⁸⁴ Importantly, however, they also support the back-end enforcement aspect as well—by providing a mechanism to deter fraudulent disclosures, which harm the market, and belief in it, as a whole. Viewed through the publicness lens, then, class actions play not just a direct, investor-protection role, but also a larger role in policing and supporting the market, which in turn fuels growth and innovation. It is for those reasons, we posit, that the securities-fraud class action endures and receives continued support from Congress and the Court. Although not free from downsides, the class action is an important part of the mechanisms that protect the market and thereby make it function as a place that attracts capital, issuers, and investors, which, in turn, promotes innovation and growth for investors and citizens alike. In short, however messy, the class action arguably endures because:

1. a strong market is important to growth through innovation and capital allocation;
2. a belief in a “fair” and “efficient” market is a predicate to a strong market; and
3. an enforcement regime, both public and private (class actions), is a predicate to a belief in a strong market.

284. See *supra* Part IV.A.

C. The Role of Market Intermediation in Reliance and Price Impact

As we noted earlier, the Rule 10b-5 class action is a back-end enforcement tool that has endured repeated assaults by judges, legislators, regulators, practitioners, and academics. *Dura*, *Amgen*, and both *Halliburton* cases are recent examples of the Court's reluctance to make wholesale changes to it in the post-PSLRA era. This reluctance is tied to both the goals of regulation and the endurance of deterrence and enforcement concerns. Yet, like the regulatory goals and the accompanying front-end regulatory structure, the class action's role, as well as its shape and requirements, have been shifting over the years. The evolving cause of action and the role of the market in that evolution are where we turn next.

1. Market Intermediation and the Evolution of 10b-5 Claims

The fraud-on-the-market theory generally, and the role of reliance more specifically, have both developed along with the securities markets. Understanding the evolution of the cause of action requires an examination of open-market trading and the role it plays in linking buyers and sellers, both with respect to reliance and the measure of damages. Given the realities of open-market, anonymous transactions, some aspects of the traditional common-law tort of fraud do not, and cannot, directly apply. The claims of individual investors, even if made in direct reliance on a misstatement, are rarely worth the cost of litigating and therefore are not litigated. As previously stated, the class action remedies this collective-action problem and plays an important enforcement role.²⁸⁵ The traditional understanding of reliance, however, was a challenge to the development of an effective open-market collective claim. Its role was to provide a link between purchasers and misstatements that would address concerns about overcompensation and circularity, but it is not subject to proof in a traditional common-law manner and, even if it were, would be different for each and every person. As a result, it would defeat the predominance requirement and, thereby, class certification. Here is where the fraud-on-the-market presumption does its work. It facilitates the class action and thus provides enforcement and a deterrence check on fraud.²⁸⁶

285. See *supra* Part II.

286. Arguably, it also supports the decision not to develop a merits-based regulatory system on the front end. See *supra* note 282 and accompanying text.

These are the key core principles the Court reaffirmed in the cases discussed in this Article.²⁸⁷ *Halliburton II* made clear that *Basic*'s presumption remains sound. As a group, the opinions reiterate the policy reasons undergirding the fraud-on-the-market approach. In short, relying on the market as an intermediary for the purposes of the reliance element is both necessary and appropriate for open-market transactions.²⁸⁸

To say that the fraud-on-the-market theory is necessary and appropriate, however, is insufficient. Its existence means that we have already decided that reliance is necessarily different here than in traditional fraud cases. Open-market transactions are understandably distinct from their common-law counterparts. Market intermediation intervenes and leaves us with the question of whether a causal connection should be required at all and, if so, what it should look like.

Consider the development of market intermediation in securities-fraud claims. Movement away from the strictures of common law and toward recognition of the nature of market-based transactions was occurring in the federal courts for more than two decades before *Basic*.²⁸⁹ The Supreme Court first relaxed the reliance standard in securities claims in 1970.²⁹⁰ The specific use of fraud on the market in 10b-5 cases was already well accepted by the lower federal courts when the Supreme Court embraced it.²⁹¹ Academics had also begun to support its adoption. For example, Professor Dan Fischel saw fraud on the market as an appealing approach to securities fraud and the element of reliance as inconsistent with it.²⁹² He was later joined in this view by his frequent co-author and now federal judge, Frank Easterbrook.²⁹³ The result was that the requirement of a transactional connection between fraudster and plaintiff gave way to a market-based adaptation.²⁹⁴

287. See *supra* Part III.

288. See Langevoort, *supra* note 13, at 58–59.

289. See, e.g., *Green v. Wolf Corp.*, 406 F.2d 291, 301 (2d Cir. 1968).

290. *Mills v. Elec. Auto-Lite Co.*, 396 U.S. 375 (1970).

291. See, e.g., *Peil v. Speiser*, 806 F.2d 1154 (3d Cir. 1986); *Lipton v. Documation, Inc.*, 734 F.2d 740 (11th Cir. 1984).

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

293. See *Flamm v. Eberstadt*, 814 F.2d 1169, 1179–80 (7th Cir. 1987). Professor Margaret Sachs has examined Judge Easterbrook's more restrictive look at the interaction of the merits and procedure after his academic writing with Fischel and before his 2010 opinion in *Schleicher v. Wendt*, 618 F.3d 679 (7th Cir. 2010), an opinion that is favorably cited in the *Halliburton* cases. Margaret V. Sachs, *Superstar Judges as Entrepreneurs: The Untold Story of Fraud-on-the-Market*, 48 U.C. DAVIS L. REV. 1207, 1233–54 (2015).

294. See Fisch, *supra* note 13, at 913–15.

That an adaptation should occur is not surprising—both in light of the way that torts have evolved more generally²⁹⁵ and the larger goals of securities and market regulation discussed earlier. Torts scholars John Goldberg and Benjamin Zipursky describe how *Basic* replaced a cause of action based on the injury of deceit, or being tricked to buy stock, with one based on economic harm resulting from price distortions that follow defendant's misrepresentations—irrespective of reliance.²⁹⁶ This theory provides a broader notion of what can count as wrongful injury, where reliance is not required, but the cause of action is still legitimate given congressional and Court action.²⁹⁷

Within the securities academy, some scholars have argued that the only link necessary to satisfy reliance is one to a distortion in market price.²⁹⁸ Others have suggested eliminating reliance entirely.²⁹⁹ The focus for the securities scholars, as for the torts scholars, is that the investors' relation to the fraud is intermediated through the market.³⁰⁰ This difference matters because it shifts our focus from the personal to the market and from compensation to deterrence, the theory we have described as key to market protection in a world of publicness.

This debate centers on whether the original purpose of reliance, linking a defendant's wrongdoing to a change in behavior of a specific injured party, is as important as it once was. The work that reliance does in this market-centered circumstance is to prevent misrepresentors from becoming insurers to all market purchasers.³⁰¹ The concern lurking behind the reliance link is about overcompensation with respect to individual purchasers who are now grouped into a class.³⁰² Those concerns have, however, been addressed in multiple ways. Recall the role of the PSLRA

295. See generally Goldberg & Zipursky, *supra* note 29.

296. *Id.*

297. See *id.* at 1782–1805.

298. Lucian A. Bebchuk & Allen Ferrell, *Rethinking Basic*, 69 *BUS. LAW.* 671, 696 (2014).

299. See Fischel, *supra* note 292, at 7–8.

300. See Langevoort, *supra* note 35, at 176 (discussing *Basic* as providing investors a right to rely on undistorted price).

301. Eliminating or eliding reliance arguably pushes our understanding of the claim toward one about deterrence rather than compensation. See Amanda M. Rose, *Fraud on the Market: An Action Without a Cause*, 160 *U. PA. L. REV.* 87, 96 (2011).

302. *Amgen Inc. v. Conn. Ret. Plans & Trust Funds*, 133 S. Ct. 1184, 1200–01 (2013). Concerns about whether permitting open-market traders, trading with anonymous investors in the market, who are neither the defendants nor connected to them other than through trades on distorted prices, creates a risk of overcompensation has been the topic of much scholarly literature. See, e.g., Bratton & Wachter, *supra* note 203; Velikonja, *supra* note 218. The money to pay these investors comes from the corporate treasury of the investors' own company or insurance policies purchased with company dollars, which compounds the worry. See Fischel, *supra* note 203, at 337.

in dealing with overcompensation and the perceived strike-suit value of these claims. Lead plaintiffs must now receive court approval. Complaints must survive stringent pleading standards and are subject to a stay on discovery until they do so. Further, plaintiffs must still prove loss causation, which provides a connection to the harm, as well as materiality and scienter.³⁰³ Although these reforms have generally been debated in the context of strike suits and compensation when no fraud occurred, in fact, all of these reforms also help to diminish the likelihood of overcompensation through circularity. After all, if we sort good from bad claims at the front end of the litigation, and there is evidence that the process has improved,³⁰⁴ it is reasonable to be less concerned about the damages on the back end. That argument is, at least in part, what undergirds theories that support the elimination of reliance as an element in market-based situations.

The growth in scholarly literature against reliance in a market-based 10b-5 claim, along with what we now know was a vigorous debate among the justices in the majority in *Basic*, nevertheless supports a continuing, if increasingly limited, role for reliance by providing for the fraud-on-the-market presumption to be rebuttable.³⁰⁵ The majority in *Halliburton II* provides for this rebuttal to be contested at the class-certification point of litigation.³⁰⁶ Yet, it turns out that in light of the opinions we have analyzed in this Article, and the role of the market as intermediary, the rebuttal space is appropriately narrowly cabined.

As a result, the argument about reliance now goes something like this: scienter-based, material misrepresentations that distort the market price usually give rise to a cause of action, but some are too remote. The three examples that the Court provided in *Basic*³⁰⁷ tell us something about what was worrying the Court. The first two indicate that the “remote” group includes misrepresentations by defendants that are effectively countered by other information, either from “market makers” who already know the

303. *Halliburton II*, 134 S. Ct. 2398, 2407 (2014).

304. See generally Pritchard & Sale, *supra* note 72.

305. Zipursky and Goldberg also note that *Basic* does more than create the presumption. See generally Goldberg & Zipursky, *supra* note 29. The Court’s theory also allows plaintiffs to use circumstantial evidence to support their argument that the defendant’s misstatement distorted the market price. It works like this: if the issuer’s securities are traded in an efficient market and a material misstatement is made to the public, it can be presumed that the misrepresentation caused a price distortion. *Id.* at 1782–99.

306. And the chances of Congress acting to “revisit the entire remedial approach in the fraud-on-the-market setting, enabling private litigation but making it more clearly a deterrence-based mechanism,” are nonexistent in the foreseeable future. See Langevoort, *supra* note 13, at 59.

307. *Basic Inc. v. Levinson*, 485 U.S. 224, 248–49 (1988).

correct information or from corrective information that enters the market and dissipates the effect of the misstatement.³⁰⁸ The third is of a plaintiff who knows the defendant's statement is false but trades anyway because of an apparently unrelated motive related to an antitrust problem.³⁰⁹ This last example illustrates what Goldberg and Zipursky describe as a "volenti" concern.³¹⁰ Virtually every tort deems certain actions by the plaintiffs sufficient to limit or foreclose a claim, including consent and unjustified reliance. These tort limitations are usually posed as affirmative defenses and, in securities fraud, allow for situations in which, even if there is a price distortion and the market is efficient, the claim can be foreclosed. That type of plaintiff is a "willing" market participant and, therefore, not entitled to a remedy.³¹¹

Importantly, however, the space covered by these three illustrations has shrunk noticeably in the time since *Basic*—given the precise attention that Congress and the Court have paid to possible overcompensation. More specifically, the first two examples today would likely be addressed by a court under a truth-on-the-market analysis, a materiality question, which, after *Amgen*, we know is not appropriate at class certification.³¹²

Next, recall that in *Amgen* the Court also emphasized that the class-action inquiry is a narrow one.³¹³ The purpose of the inquiry at certification is not to adjudicate the merits of the claim, but to ensure that the requisites of Rule 23(b)(3) are met, with the focus largely on whether questions common to the class predominate.³¹⁴ The purpose is to determine whether a class action is the appropriate method for resolving the claim.³¹⁵ Defendants, of course, are motivated to push forward to class certification any issue on which they can gain traction. *Amgen*, however, made clear that courts should resist efforts to move what are truly issues for trial, or the back end of these cases, to class certification, or the front end of these cases.³¹⁶ The failure of courts to do so will defeat the role and

308. *Id.*

309. *Id.* at 249.

310. Reflecting the Latin term. See Goldberg & Zipursky, *supra* note 29, at 1795.

311. *Basic* presents this example in the context of an individual investor, but in the usual class-action setting it would be relevant for the class as a whole—the defendant would have to show that individual issues predominated over common issues on this question. See *Basic Inc. v. Levinson*, 485 U.S. 224, 249 (1988).

312. See, e.g., *Wielgos v. Commonwealth Edison Co.*, 892 F.2d 509, 516 (7th Cir. 1989).

313. *Amgen Inc. v. Conn. Ret. Plans & Trust Funds*, 133 S. Ct. 1184, 1194–95 (2013).

314. *Id.*

315. *Id.*

316. *Id.*

power of certification, create mini-trials and merit creep, and eliminate the enforcement aspect of the litigation.

Halliburton I and *Amgen* illustrate an additional principle that is important to understanding the price-impact evidence as tied to market efficiency. In *Halliburton I*, the Court rejected the defendants' attempt to require proof of loss causation, a Time 2 issue, and proof of materiality, a Time 1 issue, at class certification.³¹⁷ In doing so, the Court specifically said that proof and these issues were appropriately left to trial.³¹⁸ Yet, the *Halliburton* defendants have now attempted to take the evidence they amassed at Time 2/loss causation and deploy it to disprove market efficiency at Time 1. If sustained, this argument will eliminate the line drawn in *Halliburton I* and allow market-efficiency fights to be consumed with proof on loss causation and debates about materiality. As a result, although defendants now have the opportunity to rebut the market-efficiency presumption at class certification, the space for doing so is, in fact, quite small. Indeed, courts must keep in mind that: (1) the defendants bear the burden of proof; (2) the inquiry is narrow; and (3) the elements of loss causation and materiality cannot be conflated with market efficiency either in fact or in proof. The failure to do so will result in a situation in which the procedure is allowed to swallow the substance.³¹⁹

Finally, the third *Basic* rebuttal issue, the *volenti* context, presents an interesting case. Note that the example in *Basic* (and also the one that Justices Brennan and Blackmun debated in their exchange prior to the decision) related to an individual investor. In the typical class context of 10b-5 litigation, the focus would be on whether such a motivation accrued to the class, or perhaps to enough members of the class that a credible argument could be made that individual issues would predominate over collective ones. A single individual with such a motivation should not, in

317. *Halliburton I*, 131 S. Ct. 2179, 2184–87 (2011).

318. *Id.* at 2185.

319. Early class-certification opinions following *Halliburton II* are beginning to develop some limitations. For example, a Florida trial court ruled that a truth-on-the market defense, which goes to materiality, may not be used at the class-certification stage to prove an absence of price impact and show a lack of predominance. See *Aranaz v. Catalyst Pharm. Partners Inc.*, 302 F.R.D. 657, 671 (S.D. Fla. 2014) (holding that lack of price impact treated as materiality would defeat the arguments of the entire class and is better left for trial stage); see also *Ganino v. Citizen Utils. Co.*, 228 F.3d 154, 167 (2d Cir. 2000) (“[A] misrepresentation is immaterial if the information is already known to the market because the misrepresentation cannot then defraud the market.”); *Local 703, I.B. of T. Grocery & Food Emps. Welfare Fund v. Regions Fin. Corp.*, No. CV-10-J-2847-S, 2014 WL 6661918, at *1, *9 (N.D. Ala. Nov. 19, 2014); *Fisch*, *supra* note 13, at 928 (“Price distortion is closely related to materiality . . .”).

the market-as-intermediary world, block a class, lest the mechanism and enforcement power be defeated.³²⁰

2. *Market Intermediation and Price Impact*

The next step is to take what we know about the market as intermediary and reliance and apply it to price impact. The *Halliburton I* Court described price impact as “the effect of a misrepresentation on a stock price.”³²¹ Questions about burden of proof and other issues should be resolved by reference to the learning about market intermediation in securities class actions as reaffirmed in *Halliburton II* and the other Supreme Court cases discussed in this Article. Lower courts have begun to do exactly that.³²² Courts should beware of conflating price impact with price movement; otherwise, the lack of price movement will result in a finding of lack of price impact, particularly if the price movement analysis focuses only on the time of the initial fraud.³²³ Such an approach is over-inclusive. There are several circumstances in which a price might be impacted by a misstatement and not change or not change much, if measured at the time of the fraud. Consider the following seven situations, only two of which would appropriately be addressed in the price impact space defined by *Halliburton II*.

1. Misstatement, but allegation that there is not an efficient market (for example, not enough analysts following a stock or enough liquidity to generate sufficient information for efficient trading).

320. The separate question as to whether the individual plaintiff can be the class representative has been carved away by *Amgen* and *Halliburton II*. See *supra* Part III.B.

321. *Halliburton I*, 131 S. Ct. at 2187.

322. The holding of the *Halliburton* trial court on remand after *Halliburton II* seems consistent with this narrow space for the rebuttal of the presumption, but still leaves room for additional litigation based on dueling event studies. The trial court measured the absence of price impact at the time of the correction, not the time of the misrepresentation, and it placed the burden of proof on the defendant to prove the lack of price impact. It then certified the class as to one of the asbestos misrepresentations when the company’s price had dropped 40%, but found the defendants had rebutted the presumption on five other dates. See *Erica P. John Fund, Inc. v. Halliburton Co.*, 309 F.R.D. 251, 255 (N.D. Tex. 2015) (relying in substantial part on Fox, *supra* note 63); see also sources cited *supra* note 319.

323. The *Halliburton* defendants argued for visible and statistically significant price movement both when they were asserting that plaintiffs must prove price impact and later in seeking to rebut the presumption. See Defendants’ Brief on Price Impact Demonstrating that Class Certification Must Be Denied at 2, *Erica P. John Fund, Inc. v. Halliburton Co.*, 309 F.R.D. 251 (N.D. Tex. 2014) (No. 3:02-CV-1152-M), 2014 WL 4473340 (“If the ‘stock price did not increase’ following the alleged misrepresentation, that is evidence of no price impact.”); Transcript of Oral Argument at 40, *Halliburton I*, 131 S. Ct. 2179 (2011) (No. 09-1403), 2011 WL 1541295 (“All they had to do was show one day during that class period statistically significant price movement, and they’re in.”).

This situation is specifically covered by footnote 27 of *Basic* and would seem appropriate for resolution at class certification.

2. Misstatement, but allegation that there was no publicity of the misstatement—even where there is an efficient market for the stock. This is specially covered by footnote 27 of *Basic* and would seem appropriate for resolution at class certification.

3. Misstatement, but allegation that it was not material. This is also listed in footnote 27 of *Basic*, but given the holding of *Amgen*, would not be appropriate for resolution at class certification.

4. Misstatement, but defendant is not able to prove statistically significant price impact so as to satisfy event study methodology regularly used in modern securities class actions.³²⁴ Given the holding of *Halliburton II*, this context would not be appropriate for resolution at class certification.

5. Misstatement, but the only price impact is attributable to an alternative or intervening cause. Given the holding of *Halliburton I*, this would not be appropriate for resolution at class certification.

6. Misstatement, but the defendant contests it. This would be resolved at motion to dismiss, and, if not, at trial per *Amgen*.

7. Misstatement, but in context of price maintenance (i.e., allegation the misstatement sought to prop up price in the face of new information that would have led to decline). This is not raised in footnote 27, nor *Halliburton II*, but the recent Supreme Court cases evidence this fact pattern, and lower courts have upheld 10b-5 claims in price maintenance cases without price movement at Time 1.

This series of fact patterns illustrates two outcomes as to price impact. First, the effect of the misrepresentation may sometimes occur even though the price itself does not move at the time of the misrepresentation. The result is that rebuttal of the presumption would not be appropriate. Second, class certification cannot, and should not, resolve all issues in which there is no effect of the misrepresentation on price.

324. See Fox, *supra* note 63 (discussing two measures that might be used by courts to determine if the presumption has been rebutted: the first would leave defendants about where they were before *Halliburton II*, and the second would advance the essential issue of loss causation to the class certification point of litigation).

The *Halliburton* facts illustrate the former, which is example 7, even though the Court itself did not address the issue. In *Halliburton*, the plaintiffs' initial allegations fell into three categories: asbestos litigation liability, construction contract revenues, and merger cost savings.³²⁵ With respect to all of the statements, the plaintiffs' claim, whether understating liability or overstating revenues and cost savings, was that the defendants had made the misstatements in order to prevent the market price from dropping.³²⁶ For example, the allegation with respect to the asbestos litigation was that if the issuer had been truthful about the extent of its liability, which turned out to be much higher than publicly stated at Time 1, the stock price would have dropped.³²⁷ The same is true about the revenue-recognition allegation on the construction contracts, where the plaintiffs claimed that the defendants had overstated the revenue and later had to correct it, as well as with respect to the announced cost savings from the merger that were unrealistic.³²⁸ These arguments all depend on information impoundment and market intermediation, but in the price maintenance context.³²⁹

Notice that the structure we have developed so far leaves us with the problem that misrepresentations, scienter, materiality, and market efficiency are tied to Time 1, but fraud visibility and damages generally occur at Time 2. Thus, the liability, construction revenue, and merger misrepresentations all occur at Time 1 points, but because the purpose of these announcements is, through market intermediation, to prevent the price of the company's stock from falling, it is possible for them to distort the price of the stock (or have a price impact) with little or no movement in the stock price.

This pattern is the essence of price maintenance, and the argument, price impact without price movement, was also made in *Dura* and *Amgen*, and is not susceptible to Time 1 price-movement proof. Additionally,

325. *Halliburton II*, 134 S. Ct. 2398, 2405–06.

326. *Id.*

327. *See id.*

328. *See id.*

329. The same is arguably true of *Dura* and *Amgen*. The *Dura* plaintiffs argued that the defendants repeatedly made statements about expected sales and profits, as well as impending drug approval, despite knowing that neither the profits nor the drug approval were likely, including statements about the continued development of the drugs and progress of drug trials. *See* Fourth Consolidated Amended Complaint for Violation of the Securities Exchange Act of 1934 at 1–22, *In re Dura Pharms., Inc. Sec. Litig.*, No. 99-CV-0151-L(WMC) (S.D. Cal. July 21, 2006), 2006 WL 3267513. In *Amgen*, the plaintiffs argued that the defendants continued to make statements about the safety of certain drugs despite growing evidence to the contrary. *See Conn. Ret. Plans & Trust Funds v. Amgen, Inc.*, No. CV 07-2536 PSG (PLAx), 2009 WL 2633743, at *2 (C.D. Cal. Aug. 12, 2009).

price-maintenance situations reveal that it is possible to have an efficient market that shows little or no movement at Time 1 because the distortion occurred through price stabilization. In short, price distortions can exist without price movement. As a result, judicial decisionmaking as to class certification and fights about price impact should reflect an understanding of the types of situations that can occur, the narrowness of the allowed inquiry, and the maintenance issue.³³⁰

Amgen, *Halliburton II*, and illustration number 4 above also reveal another possibility: there are cases where the price does not move, but the issue should not be resolved at class certification because it does not go to the core class question of whether individual issues predominate. The majority opinion in *Halliburton II* acknowledges via an example that there remains something of a failsafe where the connection of a class of plaintiffs is so insufficiently tied to the alleged fraud that the remnants of reliance might be used to end even an open market fraud case (as opposed to scienter or misrepresentation issues resolved on motion to dismiss or loss causation and materiality resolved at other points in litigation).³³¹ This example seemingly intrudes at least partly on the space occupied by materiality, but the overlap does not seem to be large. Justice Ginsburg, author of the Court's *Amgen* materiality opinion just the term before, concurs in the *Halliburton II* majority, briefly noting that it "should impose no heavy toll on securities-fraud plaintiffs with tenable claims."³³² The two opinions illustrate our argument that the space available to contest efficiency is, in fact, quite small and is supported both by the publicness goals of securities regulation and by the front-end uses of market efficiency to justify deregulation.

In short, reliance and the efficient-market presumption, as well as the narrowness of the rebuttal space for price impact, are supported by a more general understanding of market intermediation and the role it plays in supporting issuers' access to the capital markets. A key prerequisite for the presumption of reliance is the existence of an efficient market. In

330. Many courts have recognized the effect of maintenance, even if the Supreme Court has not yet done so. *See, e.g.*, *FindWhat Investor Grp. v. FindWhat.com*, 658 F.3d 1282, 1317 (11th Cir. 2011) (stating that fraudulent misstatements that prolong inflation can be just as harmful); *McIntire v. China MediaExpress Holdings, Inc.*, 38 F. Supp. 3d 415, 431–35 (S.D.N.Y. 2014); *IBEW Local 98 Pension Fund v. Best Buy Co.*, 958 F. Supp. 2d 1065 (D. Minn. 2013); *In re Pfizer Inc. Sec. Litig.*, 936 F. Supp. 2d 252, 264 (S.D.N.Y. 2013).

331. *Halliburton II*, 134 S. Ct. 2398, 2415–16 (2014).

332. *Id.* at 2417 (Ginsburg, J., concurring). The two views on the causal link that reliance requires may be no further apart than the views of Justices Brennan and Blackmun on the same point in their exchange of memoranda in *Basic* discussed above. *See supra* notes 157–59 and accompanying text.

Halliburton II, the defendants argued that a lack of price movement revealed the market was not efficient, and thus the presumption was rebutted.³³³ Of course, this argument fails to account for price maintenance.

Moreover, if we step back from the econometric studies and consider Halliburton's place in the securities market, it raises the question of whether it passes the straight-face test for a Fortune 500, New York Stock Exchange-traded company to claim that the market for its stock lacks efficiency. Indeed, it is arguably disingenuous for companies who are Form S-3 filers, like Halliburton, to take the front-end, registration-side advantages of market intermediation but deny the enforcement side of it on the back end.³³⁴

This is the point at which our construct of the regulatory goals as being motivated by publicness, along with market intermediation, provides traction. The answer to the specific application of *Halliburton II*, as well as the larger role of the class action more generally, lies in our acceptance of the need for strong securities markets. Class actions, as we have argued, are important for policing and protecting the market and ensuring belief in its strength. This is their enforcement and deterrence role, and that role, in turn, contributes to the belief in the market that attracts capital and creates stability. The market, of course, works to allocate capital from investors to user. Issuers rely on the market, its intermediation, and its efficiency, to access that capital. Capital allocation, in turn, supports growth and innovation. Market intermediation also plays a role in access to capital and offerings, and in deterrence, by providing the necessary reliance bridge for predominance, a requirement for a securities class action. These reasons, in combination with the case law, support our conclusion that although market-efficiency inquiries are allowed at the class-certification stage of the procedure, the inquiry is to be a narrow one that does not conflate loss causation or materiality with market efficiency and is mindful of price maintenance. Insisting on these limitations will help to avoid merit creep and mini trials. It will also help to ensure the market protection essential to innovation and growth.

333. *Halliburton II*, 134 S. Ct. at 2409–10.

334. See *Cammer v. Bloom*, 711 F. Supp. 1264, 1285 (D.N.J. 1989) (implicitly recognizing this argument by including S-3 filings as one measure of market efficiency).

CONCLUSION

This Article develops the role that market intermediation plays in securities regulation—both on the front and back end. On the back end, its role reflects both concerns about the possibility of overcompensation and the place that enforcement plays in ensuring belief in strong securities markets.³³⁵ The front-end regulatory examples reveal how market intermediation facilitates capital formation and deregulation.³³⁶ Here, for example, it replaces other options, including a merits-based regulatory system. On the back end, through litigation and deterrence, market intermediation resolves collective-action problems through the class action. In short, the market-efficiency theory has withstood the test of time for the same reasons that industry has deployed it on the front end: because it is “a reasonable approximation of the truth” that both enables rulemaking and capital raising as well as class-action policing of open-market fraud.³³⁷

In sum, the securities-fraud class action has evolved and endured because of the role it plays in enforcement and the publicness of the markets. It does so through, at least in part, market intermediation. As we explored, the market plays a part as an intermediary and enables securities regulation on the front end and, through deterrence/enforcement, on the back end. Thus, efficiency and intermediation on the front end correlates with efficiency and intermediation on the back end. In today’s world, open-market cases are different from their common-law counterparts, and the *Basic* presumption recognizes that difference. It allows these cases to proceed and to fulfill their enforcement role. Further, the class action as modified by the courts and Congress balances concerns about overcompensation with those about unchecked fraud and, in doing so, makes its own contribution to market efficiency. Congress chose the elements that should be addressed at the motion to dismiss stage and those that belong to the merits stage, resulting in a very stringent inquiry that itself verges on a dispute about the merits. Class certification is not designed to be, and should not be, the same. It should not become the driver, because if it does, procedure, and the Court’s increased willingness

335. It is also the product of cost-benefit analysis. See Lynn A. Stout, *Type I Error, Type II Error, and the Private Securities Litigation Reform Act*, 38 ARIZ. L. REV. 711 (1996); Langevoort, *supra* note 51.

336. Not all S-3 filers, for example, are free of fraud or necessarily good candidates for shelf offerings, but all of them can use the provision because it is more cost effective to regulate in that fashion.

337. Allen, *supra* note 260, at 559.

to indulge in it, will continue to result in added costs and layers of litigation with very little pay off to the litigants, the markets, or the public. Although this means that some cases that survive and settle will have merit and some will not, that is the way the litigation system works. Indeed, viewed in that light, market intermediation, publicness, and the securities class action combine to yield the type of second-best theoretical solution that is the nature of the regulatory enterprise and litigation more generally.