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# Rebutting Fraud On The Market

*Law360, New York (July 31, 2015, 4:13 PM ET) --*

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On July 25, 2015, Judge Barbara Lynn of the Northern District of Texas issued a formative opinion in the class actions securities arena. The case, The Erica P. John Fund Inc. et al. v. Halliburton Co. et al., No. 3:02-CV-1152-M, is viewed as a bellwether among securities class actions due to its treatment of novel issues regarding, among other things, a defendant's ability to disprove reliance — i.e., a causal link between alleged misrepresentations and an eventual drop in stock prices upon correction — for purposes of class certification.

Rather than requiring plaintiffs to prove reliance for each individual shareholder, securities class action cases have long permitted a more efficient approach to establish the necessary causal link. This approach, set forth in Basic v. Levinson, 485 U.S. 224 (1988), invokes a rebuttable "fraud-on-the-market" presumption in favor of reliance if four elements are met: (1) the alleged misrepresentations were publicly known; (2) they were material; (3) the stock traded in an efficient market; and (4) the plaintiff traded the stock between the time the misrepresentations were made and when the truth was revealed.

Recently, in connection with the Halliburton case, the U.S. Supreme Court held this presumption can be rebutted if a defendant shows an alleged misrepresentation did not, for whatever reason, actually affect the market price of a security. 134 S. Ct. 2398, 2408 (2014). If the presumption is rebutted, the class cannot be certified.

In the July 25 opinion, the Halliburton court addressed one of the key questions left open after the Supreme Court's ruling: What level of proof is necessary to rebut this fraud-on-the-market presumption? After considering plaintiffs' motion for class certification for claims arising from six corrective disclosures of Halliburton, the court granted class certification with respect to one of the alleged disclosures, and denied certification with respect to the remaining five.

In arriving at this decision, the court first concluded that Halliburton, as defendant, bore the burden of both production and persuasion. This meant Halliburton was required to "persuade the Court that its expert's event studies are more probative of price impact than [the plaintiffs'] expert's event studies." The court also declined to consider Halliburton's argument that the alleged disclosures were not

"corrective," because such an argument went to the underlying merits of the claim and was more properly considered at a later stage of the litigation.

Regarding evidence of price impact (i.e., impact of alleged disclosures on the market price of Halliburton shares), the court conducted a careful analysis of the evidence and expert testimony presented by both sides. One noteworthy aspect of the court's analysis is its endorsement of a "multiple comparison adjustment" advocated by the defendants' expert, despite acknowledging that such adjustments are rarely utilized in event studies for securities litigation. The court indicated its decision to apply these adjustments, which help mitigate the risk of relying on "statistical flukes," was due to the substantial number of comparisons being tested for statistical significance in the plaintiffs' expert's analysis.

The court's decision was also at least partially influenced by allegations from Halliburton that plaintiffs reverse-engineered their claims by initially running a statistical comparison to uncover 35 dates found to have a statistically significant price movement and, from these dates, selecting events to allege misstatement based on their coinciding with news releases.

Other determinations by the court included utilizing an additional "analyst index" advocated by plaintiffs to measure the statistical significance of stock price movement. The plaintiffs argued this additional index, consisting of companies identified by analysts as the defendants' peers, was more effective at explaining its stock price movements than were the indices utilized by the defendants' expert, which only looked at energy industry subsets of S&P 500 and Fortune 1000 companies. The court also determined it would consider the effects of events on the market price of stock with reference to a one-day, rather than a two-day, window following the announcement or event in question. In applying this shorter window, the court noted "[a]n efficient market is said to digest or impound news into the stock price in a matter of minutes."

Utilizing these methods, the court examined the six disclosures alleged by the plaintiffs as having an impact on the market price of Halliburton stock. The court divided the events at issue into two broad categories: (1) fixed-price construction contracts and (2) asbestos disclosures.

The first category consisted of only one event: a Dec. 21, 2000, press release allegedly correcting Halliburton's previous representations that it would only include claims in revenues when collection was deemed probable. The court agreed with the defendants' expert that the disclosure had no price impact on Halliburton's stock. The court gave little weight to the competing opinion of the plaintiffs' expert, who analyzed the market impact of the disclosure through a two-day window, and who only reported at a 90 percent confidence level of a statistically significant price reaction. This failed to reach "the 95% confidence level both experts require in their regression analyses and which the Court finds is necessary."

The second category of events included five disclosures related to Halliburton's exposure based on various asbestos litigation cases and claims. For several of these dates, the court found that, after applying statistical adjustments that the court deemed appropriate, there was no statistically significant price impact under either expert's model. This included applying adjustments advocated by either expert to the other's statistical model.

In at least one instance, however, the court had little choice but to address the merits of the plaintiffs' claims. That claim involved an Aug. 9, 2001, disclosure in which Halliburton acknowledged an upward trend in the rate of new asbestos claims and explained its gross asbestos liability had grown to nearly $700 million. While the plaintiffs' expert reported with 99.99 percent confidence that this disclosure

had a material price impact, Halliburton argued the announcement could not possibly have had an impact because the information had previously been publicly disclosed. Giving credit to this argument, the court sided with the defendants' expert, finding no statistically significant price reduction.

The lone disclosure upon which the court granted class certification was for the latest date alleged by the plaintiffs. That disclosure involved Halliburton's announcement on Dec. 7, 2001, that it was liable for $30 million resulting from a jury verdict in an asbestos litigation case. The plaintiffs argued this disclosure "corrected" Halliburton's previous disclosures that it was not exposed to significant liability in asbestos cases and was efficiently handling such litigation. Despite Halliburton's argument that this drop was caused by events other than the disclosure plaintiffs alleged, the court found Halliburton failed to meet "its burden of showing lack of a price impact" with respect to the Dec. 7 announcement. This finding led the court to grant the plaintiffs' motion to certify with respect to only the Dec. 7 disclosure.

The most recent Halliburton class certification decision is not altogether unsurprising: it likely reflects the decision of a judge whose class certification decisions were twice reversed by the U.S. Supreme Court. The decision is a win for the plaintiffs, who finally obtained class certification after a seven-year battle. The defendants, however, are well-positioned going forward since they successfully defeated five of the six corrective disclosures and are now left with a single corrective disclosure to attack on summary judgment. Judge Lynn's analysis will likely be a road map for both securities class action plaintiffs and defendants in evaluating class certification in the future.

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