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Class Certification Denied? Courts Denied Class Certification in Fewer Than 24 Securities Actions

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The Petitioners focus principally on the flawed economic theory underlying the fraud-on-the-market presumption. They contend that markets are not fundamentally efficient and information is often not incorporated into the price quickly. They argue that markets are, in fact, increasingly ***irrational***. In sum, they contend that the fraud-on-the-market presumption is both over- and under-inclusive. It is over-inclusive by certifying classes where the market may be well developed but there is no indication that the alleged misrepresentation actually affected market price. It is under-inclusive by denying certification in cases where the stock was thinly traded but clearly impacted by the alleged fraud (e.g., a classic pump and dump scheme).

The statutory argument is set forth in an amicus brief filed by law professors and former Securities and Exchange Commission (SEC) commissioners led by Stanford's Professor Grundfest. They contend that to create a private cause of action, the Court should look to the most analogous express right, which they contend is Section 18(a) of the 1934 Act. Section 18(a) is a fraud-based cause of action explicitly reserved for investors who relied on any misstatement filed with the SEC, but it is one that expressly requires proof of actual reliance. This statutory interpretation would likely further restrict Section 10(b) actions, particularly given that Section 18 is limited to actual filings with the SEC and would eliminate liability for any alleged oral misrepresentations or statements in the press outside of filings with the SEC.

The other amici focus on policy arguments, arguing that securities class actions fail to effectively compensate investors and fail to deter fraud. They suggest that deterrence of fraud should be left to the SEC.

Despite indication from four of the justices in recent decisions that they may be willing to reconsider the holding of *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988), the likelihood of the Supreme Court completely overturning its precedent is somewhat uncertain. Petitioners' alternative argument—that defendants be allowed to rebut the presumption and put on evidence that the alleged fraud did not impact the price—may be more palatable to judges committed to *stare decisis*. Yet this approach seems to be the other side of the coin of materiality and loss causation, a view that was rejected in prior terms. *Amgen, Inc. v. Connecticut Retirement Plans and Trust Funds* (No. 11-1085) (Feb. 27, 2013) (holding that plaintiffs were not required to show materiality at class certification) and *Erica P. John Fund Inc. v. Halliburton Co.*, No. 09-1403 (June 6, 2011) (holding that plaintiffs were not required to show loss causation at class certification). Some amici argue that event studies should be the only accepted methodology to establish a presumption of reliance, while others contend that even price movement does not necessarily demonstrate that the alleged misrepresentation affected market price. *Compare* Brief of Law Professors as Amici Curiae *with* Brief of the Securities Industry & Financial Markets Association as Amicus Curiae.

The stakes for both sides are high and it is uncertain if overturning *Basic* would even be considered a victory by the defense bar in the long run. We will update you with views from the plaintiffs' bar next month.

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