

USSC Decides Securities Fraud Class Action Case By Nahal Bahri, J.D. Candidate 2015 | June 29, 2014

In [*Halliburton Co. v. Erica P. John Fund, Inc.*](#), the Supreme Court decided a much-awaited case regarding the ability of investors to file a class action suit against a company for fraud. The Court [held](#) that “investors can recover damages in a private securities fraud action only if they prove that they relied on the defendant's misrepresentation in deciding to buy or sell a company's stock.”

The ability of investors to sue corporations for misrepresentation was [decided](#) in 1988 in a case called *Basic v. Levinson*, 485 U.S. 224 (1988). There, the Court dealt with the issue of whether investors had to prove that they read and relied on the company's disclosure statements when deciding to buy securities. In a [4-2 split](#) (3 Justices recused themselves), the [Court](#) “held that shareholders did not need to show they had read and relied on a fraudulent statement. Instead, reliance would be presumed because of the so-called efficient market hypothesis.”

This [theory](#) “postulates that in an efficient market, public information is incorporated in the stock price. A share price would naturally adjust based on the information available, and in this case the shareholder was actually relying on the share price itself as holding all information.” The Court believed this was sufficient to show reliance on the part of shareholders.

Critics of the holding in *Basic* argue that the Court made it easier for investors to file class actions and receive class certification by not having to prove actual reliance on company disclosure statements. According to [one critic](#), that holding “helped turn a cottage industry into our current securities fraud industrial complex.”

Stanford Law School conducted a [study](#) on the number of securities class actions filed since 1997 and found that “there were 166 filings in 2013, compared with 216 in 2000 and 174 in 1997.” As a result of all of these filings, settlements amounting to around \$85 billion were paid out to plaintiffs and their attorneys during that time period.

In *Halliburton*, the current Court decided not to overrule *Basic*, which preserves the ability for investors to file class action suits for fraud. The fraud on the market theory is still valid but the Court did make one slight change to the rule. A [company has the ability](#) “to raise the issue that a stock wasn't impacted by the fraudulent statements at the class certification stage.” This means that suits can get thrown out earlier in the process prior to class certification. Ultimately, securities class actions still remain an option for shareholders as a remedy for alleged fraud.