EVENT STUDIES IN
SECTION 10(B) CLASS ACTIONS

Samuel R. Henninger*

If you are interested in billions of dollars in lost money,¹ a conspiracy to mislead the public,² and Dick Cheney,³ then this topic is for you. In Part I, I discuss section 10(b) class actions. In Part II, I discuss the Halliburton litigation. In Part III, I discuss event studies.

I. SECTION 10(B) CLASS ACTIONS

On June 6, 1934, President Franklin D. Roosevelt signed the Securities Exchange Act of 1934 into law.⁴ This law established the Securities and Exchange Commission.⁵ Congress decided to regulate “transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets [because they] are effected with a national public interest.”⁶ To serve that purpose, it enacted section

---

* Candidate for J.D., The University of Tennessee College of Law (2019); B.A., The University of Tennessee (2016). The author will serve as a 2019–2020 Term Law Clerk for Chief United States Bankruptcy Judge Marcia Phillips Parsons of the Eastern District of Tennessee following his graduation. In September 2020, he will join Waller Lansden Dortch & Davis, LLP as an Associate in the Finance & Restructuring Group.


² Id. at 2–3 (“This action arises out of a scheme to manipulate and falsify Halliburton’s 98-01 financial results and statements, including a series of false and misleading statements that misrepresented the condition and success of Halliburton’s business, including its construction operations, the benefits of its acquisition of Dresser, its exposure to asbestos liabilities, Halliburton’s financial condition and results of operations and its future business and financial prospects.”).

³ Id. at 2 (“[The individual defendants in the Halliburton litigation] operated under the leadership of Richard Cheney, who became CEO/Chairman of Halliburton in 8/95 and served as its CEO/Chairman until 7/00, when he left to run for Vice President – hailed on his departure as a successful corporate executive who had turned Halliburton around, reorganized its construction businesses, made a very successful acquisition, [and] led Halliburton to record profitability and positioned Halliburton to continue to achieve growing profits going forward.”).


This section prohibits the use of “any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe.”

In 1942, to exercise its power under section 10(b), the Securities and Exchange Commission adopted rule 10b-5. This rule makes the following activity illegal:

[A]ny person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

A private plaintiff may bring a damages action under this statute and rule. A securities fraud class action is an example of a damages action that a private plaintiff may bring under this statute and rule.

II. HALLIBURTON LITIGATION

In 2002, the Erica P. John Fund and other plaintiffs filed a securities fraud class action against Halliburton. The plaintiffs purchased common stock of Halliburton between June 3, 1999, and December 7, 2001. They claimed that they suffered significant damages because of

7 § 10(b), 48 Stat. at 891.
8 Id.
12 Id. at 339, 341.
14 Fourth Amended Complaint, supra note 1, at 2.
“defendants’ scheme to defraud and the resulting artificial inflation in Halliburton’s stock price due to defendants’ financial falsifications and other misleading statements.” During the class period, Halliburton’s stock dropped from a high of $56 per share to $10 per share. Plaintiffs alleged that the stock price fell because “defendants’ prior manipulations, misrepresentations and other fraudulent conduct were revealed.” The lawsuit was originally filed in the United States District Court for the Northern District of Texas, and it reached the United States Supreme Court twice.

The Supreme Court decided Halliburton I on June 6, 2011. Chief Justice John Roberts wrote the unanimous opinion. At the district court level, the lead plaintiff, Erica P. John Fund, Inc. (EPJ Fund), defeated Halliburton’s motion to dismiss. Next, the district court found that the EPJ Fund’s proposed class under Federal Rule of Civil Procedure 23 met the requirement in section (a) but failed to meet the requirement in section (b)(3). To certify the EPJ Fund’s proposed class, the district court held that it needed to see evidence of “loss causation with respect to any” of its claims.

The United States Court of Appeals for the Fifth Circuit affirmed. It held that the district court properly refused to grant class

---

15 Id. at 3.
16 Id. at 4.
17 Id. at 3–4.
20 Id. at 806.
21 Id. at 807–08.
22 Id. at 808.
23 Id. “The elements of a private securities fraud claim based on violations of § 10(b) and Rule 10b-5 are: (1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation.” Id. at 809–10 (internal quotations omitted) (citations omitted).
24 Id. at 809.
certification because the EPJ Fund failed to prove “that the corrected truth of the former falsehoods actually caused the stock price to fall and resulted in the losses.”

And to “resolve a conflict among the Circuits as to whether securities fraud plaintiffs must prove loss causation in order to obtain class certification,” the Supreme Court granted the EPJ Fund’s appeal from the Fifth Circuit.

The Supreme Court held that the Fifth Circuit “erred by requiring EPJ Fund to show loss causation as a condition of obtaining class certification.”

First, the issue addressed by the Supreme Court was whether the EPJ Fund met the requirements for class certification under Federal Rule of Civil Procedure 23(b): “that the questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy.”

In a securities fraud action, a case such as this one, “[w]hether common questions of law or fact predominate . . . often turns on the element of reliance.”

Second, the Supreme Court previously entitled plaintiffs in securities fraud actions to a rebuttable presumption that the element of reliance is met because of the “fraud-on-the-market” theory. To get this rebuttable presumption, however, the EPJ Fund needed to prove the following: “that the alleged misrepresentations were publicly known (else how would the market take them into account?), that the stock traded in an efficient market, and that the relevant transaction took place ‘between the time the misrepresentations were made and the time the truth was revealed.’”

The next part is where the Supreme Court found an error in the Fifth Circuit’s logic.

The Fifth Circuit added an element that the EP] Fund needed to prove at the certification stage: loss causation. The Supreme Court

25 Id.
26 Id.
27 Id. at 813.
28 Id. at 809 (quoting FED. R. CIV. P. 23(b)(3)).
29 Id. at 810.
30 Id. at 811 (citing Basic Inc. v. Levinson, 485 U.S. 224, 250 (1988)).
31 Id. (citing Basic, 485 U.S. at 248 n.27).
32 Id.
33 Id.
found that that additional requirement was “not justified by Basic or its logic.” First, the Supreme Court never required a plaintiff to prove loss causation to invoke the rebuttable presumption under Basic. Indeed, loss causation is never mentioned in the Basic opinion. Second, loss causation is simply different than reliance—leading to the conclusion that proving loss causation could not help to prove reliance. “The fact that a subsequent loss may have been caused by factors other than the revelation of a misrepresentation has nothing to do with whether an investor relied on the misrepresentation in the first place, either directly or presumptively through the fraud-on-the-market theory.”

In sum, the Supreme Court vacated the judgment of the Fifth Circuit after concluding that it erred by placing the burden of proving loss causation on the EPJ Fund at the certification state.

The Supreme Court decided Halliburton II on June 23, 2014. Chief Justice John Roberts wrote the majority opinion. After losing at the Supreme Court in Halliburton I on the issue of loss causation, Halliburton argued on remand that it had rebutted the EPJ Fund’s reliance presumption “because the evidence it had earlier introduced to disprove loss causation also showed that none of its alleged misrepresentations had actually affected its stock price.” But this time, the district court held in favor of the EPJ Fund and certified its proposed class under Rule 23(b)(3). In turn, the Fifth Circuit affirmed. And the Supreme Court granted Halliburton’s appeal from the Fifth Circuit.

---

34 Id. at 812.
35 Id.
36 Id.
37 Id. at 813.
38 Id.
39 Id. at 815.
41 Id. at 2404–05.
42 Id. at 2406.
43 Id.
44 Id.
45 Id. at 2407.
This time, the Supreme Court decided two issues: (1) whether the “presumption of reliance for securities fraud claims that [it] adopted in Basic” should be overruled and (2) “whether securities fraud defendants may attempt to rebut the Basic presumption at the class certification stage with evidence of a lack of price impact.” First, the Supreme Court refused to overturn the reliance presumption under Basic because Halliburton failed to demonstrate a “special justification” for doing so. Halliburton’s argument that “the Basic presumption contravenes congressional intent and has been undermined by subsequent developments in economic theory” failed to convince the Supreme Court to overturn the case.

Second, the Supreme Court considered whether “defendants should at least be allowed to defeat the presumption at the class certification stage through evidence that the misrepresentation did not in fact affect the stock price.” Halliburton sought to present the evidence not only at the merits stage but also at the class certification stage. And the Supreme Court ruled in Halliburton’s favor on this issue: “defendants must be afforded an opportunity before class certification to defeat the presumption through evidence that an alleged misrepresentation did not actually affect the market price of the stock.” One way to do so was described by the Supreme Court. Defendants may present “event studies—regression analyses that seek to show that the market price of the defendant’s stock tends to respond to pertinent publicly reported events.”

---

46 Id.
47 Id. (citing Dickerson v. United States, 530 U.S. 428, 443 (2000)).
48 Id. at 2408.
49 Id. at 2414.
50 Id.
51 Id. at 2417. The parties ultimately “reached a $100 million settlement to resolve [the] long-running securities fraud class action lawsuit against the oilfield services provider that twice reached the U.S. Supreme Court.” Raymond, supra note 18. “Halliburton said the company itself would pay $54 million of the $100 million settlement, while its insurer would fund the rest.” Id.
52 Halliburton II, 134 S. Ct. at 2415.
53 Id. To measure the effect of events on stock prices, “[f]inancial economists use event studies.” Jill E. Fisch, Jonah B. Gelbach & Jonathan Klick, The Logic and Limits of Event Studies in Securities Fraud Litigation, 96 TEX. L. REV. 553, 555 (2018) (“The core contribution of the event study is its ability to differentiate between price fluctuations that reflect the range of typical variation for a security and a highly unusual price impact that often may
III. EVENT STUDIES

A few months after the Supreme Court decided Halliburton II, Halliburton filed its event study at the district court level. The report was prepared by Lucy P. Allen, “a Senior Vice President of NERA Economic Consulting (“NERA”) and member of NERA’s Securities and Finance Practice.” She had “an A.B. from Stanford University, an M.B.A. with a concentration in Finance and Accounting from Yale University, and M.A. and M. Phil. degrees in Economics, also from Yale University.” Before joining NERA, she served on the Council of Economic Advisers for both President George H.W. Bush and President Bill Clinton. At NERA, she served as a consultant and expert witness on issues of securities and financial economics. At the time of the report, her hourly rate at NERA was $725 per hour.

Not including exhibits and appendices, the report was 130 pages long. In sum, Allen’s report found “no price impact from any of the [EPJ Fund’s] alleged misrepresentations.” The report divided these alleged misrepresentations into three categories: (1) “cost savings from Halliburton’s merger with Dresser Industries,” (2) “accounting for unapproved claims on fixed-price construction contracts,” and (3) “reporting of asbestos liability arising out of Halliburton’s exposure to asbestos claims.” To explain why the alleged misrepresentations had no impact on price, she used detailed graphs, tables, and timelines.

reasonably be inferred from a highly unusual price movement that occurs immediately after an event and has no other potential causes.”)

55 Id. at 7.
56 Id.
57 Id.
58 Id.
59 Id. at 8.
60 Id. at 136.
61 Id. at 8.
62 Id. at 9–10.
63 E.g., id. at 11, 25, 29, 50, 84, 111, 116, 125.
First, the EPJ Fund alleged that Halliburton “falsely stated that cost savings from the merger [with Dresser Industries] were expected to be approximately $500 million.”64 Later, as the EPJ Fund alleged, “the truth about the cost savings from the merger was revealed to the market over a series of partial corrective disclosures, causing the stock to decline.”65 None of these partial corrective disclosures, however, revealed “new information regarding the cost savings from the merger.”66 In sum, “there was no statistically significant price reaction after any of the alleged misrepresentations.”67

Second, the EPJ Fund alleged that Halliburton used “unapproved claims for cost overruns on fixed-price construction contracts to increase revenues and inflate the value of its stock.”68 Later, as the EPJ Fund alleged, “the truth behind [Halliburton’s] accounting for unapproved claims was revealed to the market in a series of alleged corrective disclosures, causing the stock price to decline.”69 All of these alleged corrective disclosures, however, “were not, in fact, corrective of any alleged misrepresentation regarding accounting for unapproved claims.”70 In sum, “there was no statistically significant price reaction after any of these alleged misrepresentations (before and after adjusting for multiple comparisons).”71

Third, the EPJ Fund “allege[d] 25 dates on which Halliburton allegedly misrepresented its reported asbestos liability.”72 Later, as the EPJ

---

64 Id. at 24.
65 Id.
66 Id. at 27. These were the six alleged corrective disclosures: (1) “Halliburton announced sale of Dresser joint ventures and lower-than-expected 3Q99 earnings”; (2) “Merrill Lynch and Brown Brothers Harriman reduced their earnings per share estimates”; (3) Halliburton announced it planned to restructure its [Engineering & Construction (E&C)] segment by combining its E&C businesses into one entity”; (4) Halliburton announced a general negative near-term outlook, E&C restructuring, and a total $120 million after-tax charge related to the E&C restructuring and project losses”; (5) “Alleged continuation of 12/21/00 alleged corrective disclosure”; and (6) “Halliburton announced a $193 million pre-tax charge related to the E&C restructuring and project losses.” Id.
67 Id. at 25.
68 Id. at 52.
69 Id.
70 Id. at 55. These six alleged corrective disclosures were the same alleged corrective disclosures as those in the first category of alleged misrepresentations. Id. at 27, 54–55.
71 Id. at 53.
72 Id. at 70.
Fund alleged, Halliburton made “seven partial corrective disclosures . . . regarding asbestos liability.”\textsuperscript{73} Finally, however, “after making the appropriate adjustment for multiple comparisons, there was no statistically significant price reaction after any of the alleged misrepresentations.”\textsuperscript{74}

To draw these conclusions, the report “used a statistical analysis called a regression.”\textsuperscript{75} Sir Francis Galton, half-cousin of Charles Darwin, coined the term “regression” in 1886.\textsuperscript{76}

Galton discovered that the average heights of fathers and sons are linked by a regression equation. He also uncovered an interesting implication of this particular regression model . . . parents who are taller than average will have children who are not quite as tall, while parents who are shorter than average will have children who are a bit taller. . . .

. . . Today, we call this property “regression to the mean.” Regression to the mean is not a causal relationship. Rather, it’s a statistical property of correlated pairs of variables like the heights of fathers and sons. Although fathers’ and sons’ heights are never exactly the same, their frequency distributions are essentially unchanging. This distributional stability generates the Galton regression.\textsuperscript{77}

Regression is a tool that “can have much of the causality-revealing power of a real experiment.”\textsuperscript{78} But presenting a statistical regression

\begin{footnotesize}
\begin{itemize}
\item\textsuperscript{73} Id. at 71. These were the seven alleged corrective disclosures: (1) “Halliburton disclosed that Harbison Walker had asked for financial and asbestos claims management assistance”; (2) “Halliburton’s 2Q01 10-Q states that its reported net liability for known open asbestos claims is $124 million”; (3) “Halliburton announced $21.3 million Mississippi verdict”; (4) “Alleged continuation of 10/30/01 alleged corrective disclosure”; (5) “Halliburton announced Texas judgments”; (6) “Alleged continuation of 12/4/01 alleged corrective disclosure”; and (7) “Halliburton announced $30 million Mary land verdict.” \textit{Id.} at 71–72.
\item\textsuperscript{74} Id. at 73.
\item\textsuperscript{75} Id. at 19.
\item\textsuperscript{77} ANGRIST & PISCHKE, supra note 76, at 80.
\item\textsuperscript{78} Id. at 47.
\end{itemize}
\end{footnotesize}
analysis in an event study is not without its problems. In brief, reasonable people may disagree about the ability of an event study to prove the absence of price impact from alleged misrepresentations.

So should a defendant be allowed to use an event study at the class certification stage to show that an alleged misrepresentation failed to affect the market price of the stock? The Supreme Court said yes, and it made the right decision. The United States of America was founded with a goal of establishing equality. To help ensure equality, the Supreme Court made the right decision. If plaintiffs are entitled to a presumption in class action litigation, defendants ought to be afforded the opportunity to rebut that presumption with direct price impact evidence.

---

79 See, e.g., Jill E. Fisch, *The Future of Price Distortion in Federal Securities Fraud Litigation*, 10 Duke J. Const. L. & Pub. Pol'y 87, 96 (2015) (“The standard event study used in securities litigation only shows the absence of a statistically significant price impact, not the absence of price impact. The difference is critical.”); Michael J. Kaufman & John M. Wunderlich, *Regressing: The Troubling Dispositive Role of Event Studies in Securities Fraud Litigation*, 15 Stan. J.L. Bus. & Fin. 183, 188 (2009) (“[R]equiring an event study at the initial stages of the plaintiffs’ case takes fact questions regarding materiality, reliance, causation and damages from the province of the jury in contravention of the Seventh Amendment right to a jury trial. Additionally, it imposes an unjustifiable barrier to meritorious claims inconsistent with the language of the securities laws. Moreover, any requirement that an expert be called to present a statistical regression analysis to establish materiality, reliance, loss causation, and damages is inconsistent with the policies underlying the federal securities laws.” (footnotes omitted)).


81 See, e.g., *The Federalist* No. 36, at 173 (Alexander Hamilton) (George W. Carey & James McClellan eds., 2001) (“There are strong minds in every walk of life, that will rise superior to the disadvantages of situation, and will command the tribute due to their merit, not only from the classes to which they particularly belong, but from the society in general. The door ought to be equally open to all . . . .”); *The Federalist* No. 80, at 413 (Alexander Hamilton) (George W. Carey & James McClellan eds., 2001) (“And if it be a just principle, that every government ought to possess the means of executing its own provisions, by its own authority, it will follow, that in order to the inviolable maintenance of that equality of privileges and immunities, to which the citizens of the union will be entitled, the national judiciary ought to preside . . . .”); *The Federalist Papers*, Libr. Congress, https://www.loc.gov/rr/program/bib/ourdocs/federalist.html (last visited Nov. 30, 2018) (“The Federalist Papers are considered one of the most important sources for interpreting and understanding the original intent of the Constitution.”)