No. 17-1209

In the Supreme Court of the United States

BARCLAYS PLC, ET AL., PETITIONERS,

v.

JOSEPH WAGGONER, ET AL., RESPONDENTS.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF OF FINANCIAL ECONOMISTS AND LEGAL SCHOLARS AS AMICI CURIAE IN SUPPORT OF PETITIONERS

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INTEREST OF *AMICI*[1]

Amici are:

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[1] This brief has been filed after providing notice to the parties over 10 days prior to the due date and with the written consent of the parties; and, pursuant to Supreme Court Rule 37.6 counsel for *amici* affirms that no counsel for a party authored this brief in whole or in part, nor did any person or entity, other than *amici* or their counsel, make a monetary contribution to the preparation or submission of this brief.

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Amici are academic financial economists and legal scholars who teach and write about the public securities markets. *Amici* are very familiar with the economic concept of market efficiency and believe that courts should continue to give significant consideration to economic principles when defining the legal standard for identifying efficient markets. Many of the current *amici* also

submitted a brief to this Court addressing that topic in connection with *Halliburton Co. v. Erica P. John Fund, Inc.*, ___ U.S. __, 134 S. Ct. 2398, 2410, 189 L. Ed. 2d 339 (2014) ("*Halliburton II*") (citing Brief of Financial Economists as *Amici Curiae* in Support of Respondents in *Halliburton Co. v. Erica P. John Fund, Inc.*, 134 S. Ct. 2398 (2014) ("Economists' Amicus in *Halliburton II*")).

Amici submit this brief to express their view that, in a decision reported at 875 F.3d 79, Pet. App. 1a. the United States Court of Appeals for the Second Circuit erred by holding that a plaintiff can establish market efficiency absent a showing that the price of a security generally responds to new, material information, but instead can rely solely upon so-called "indirect" factors.[2]

SUMMARY OF ARGUMENT

Under the precedents of this Court, securities fraud plaintiffs invoking *Basic Inc.* v. *Levinson*'s[3] "fraud-on-the-market" presumption of reliance must prove that the subject securities trade in an efficient market, *i.e.*, that the market price of the securities predictably absorbs and reflects all public material information.

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[2] All *amici* share the view that the "indirect" factors relied upon by the Second Circuit are not sufficient to demonstrate the efficiency of the market for a security, although each individual signatory may not endorse to the same degree every statement of economic theory or practice made in this brief.

[3] 485 U.S. 224 (1988).

This is because, as this Court explained in *Halliburton II*, the fraud-on-the-market presumption is grounded on the "modest premise" of financial economics that an efficient market reasonably promptly reflects publicly disseminated information through market pricing, *i.e.*, through "price impact." 134 S. Ct. at 2410, 2414 (citing Economists' Amicus in *Halliburton II*). In the absence of a cognizable showing of "price impact, *Basic*'s fraud-on-the-market theory and presumption of reliance collapse." *Id.* at 2414.

In *Waggoner*, however, the Second Circuit held that a plaintiff can benefit from the fraud-on-the market presumption of reliance absent *any* showing of predictable market price impact. Thus, the court below concluded that a plaintiff can invoke the presumption based *solely* upon so-called "indirect" factors, such as the existence of large trading volumes, analyst coverage or an issuer's eligibility for a form of simplified SEC registration.

None of the "indirect" factors that the Second Circuit held to be sufficient to establish the fraud-on-the-market presumption examines the actual market price performance of a security; therefore, from the perspective of financial economists, *none* of them can establish whether a security actually trades in an efficient market.

Amici respectfully submit that the Second Circuit erred in *Waggoner*, and indeed that its decision is directly at odds with the foundational economic premises on which the rule of *Basic* is expressly grounded.

ARGUMENT

THE SO-CALLED "INDIRECT" FACTORS CANNOT SUBSTITUTE FOR A SHOWING THAT A SECURITY'S PRICE ACTUALLY RESPONDS TO NEW, MATERIAL INFORMATION

Economists have debated various aspects of the efficient market hypothesis for decades, and continue to do so today.[4] But there is one "modest premise" on which nearly all economists agree: the foundational condition for an efficient market is the reasonably prompt movement of the market price of a security in a predictable manner in response to unexpected material information, *i.e.*, what this Court has characterized as "price impact." *See* Economists' Amicus in *Halliburton II*, at 3, 9-14.[5]

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[4] There are, for example, ongoing debates about how fully and quickly markets reflect all publicly available information about a security and whether prices reflect the fundamental, or "accurate," value of the underlying stock. *See, e.g.,* Eugene Fama, *Efficient Capital Markets: II*, 46 J. Fin. 1575, 1575 (1991) ("I take the market efficiency hypothesis to be the simple statement that security prices fully reflect all available information . . . . A weaker and economically more sensible version of the efficiency hypothesis says that prices reflect information to the point where the marginal benefits of acting on the information (the profits to be made) do not exceed the marginal costs."); Robert J. Shiller, *From Efficient Markets Theory to Behavioral Finance*, 17 J. Econ. Persp. 83, 84 (2003).

[5] Economic scholarship has demonstrated the importance of considering unexpected material information, rather than just material information, when analyzing market responses. *See, e.g.*, Sanjai Bhagat, David Hirshleifer, Ming Dong & Robert

As this Court explained in *Halliburton II*, such price impact is likewise foundational to the presumption of reliance test announced in *Basic*; indeed, "[i]n the absence of price impact, *Basic*'s fraud-on-the-market theory and presumption of reliance collapse." *Id.* at 2414.

In *Waggoner*, however, the Second Circuit concluded that a market in the securities of a large, publicly traded company may be deemed "efficient" in the absence of *any* actual showing of price impact whatsoever. Pet. App. 36a. Thus, the court below concluded that efficiency can be found based *solely* upon certain so-called "indirect" factors. Pet. App. at 36a-37a. *Amici* disagree.

The "indirect" factors at issue include: the subject securities' average weekly trading volume; the number of analysts covering the issuer; the number of market makers transacting in the issuer's securities; whether the issuer was eligible to file the SEC's simplified security registration form; the capitalization of the issuer; the bid-ask spread of the subject securities; and the percentage of the subject securities not held by insiders.[6]

Noah, *Do Tender Offers Create Value? New Methods and Evidence*, 76 J. Fin. Econ. 3 (2005); Sanjai Bhagat & R.H. Jefferis, *Voting Power in the Proxy Process: The Case of Antitakeover Charter Amendments*, 30 J. Fin, Econ. 193 (1991).

[6] *See* Pet. App. 28a-29a (decision of court below citing *Cammer v. Bloom*, 711 F. Supp. 1264, 1287 (D.N.J. 1989) and *Krogman v. Sterritt*, 202 F.R.D. 467 (N.D. Tex. 2001)).

None of the foregoing factors involves an analysis of whether the market price of a security actually moves predictably in response to the dissemination of unexpected material information, *i.e.*, whether such information has "price impact."

Indeed, a scholarly article the Second Circuit cited in a related decision respecting market efficiency[7] makes this very point. Its authors state that they are unaware of *any* "peer-reviewed study in the finance literature that uses the [indirect] factors to test whether a security traded in an efficient market or not." Alon Brav & J. B. Heaton, *Event Studies in Securities Litigation: Low Power, Confounding Effects, and Bias*, 93 Wash. U. L. Rev. 583, 601 n.39 (2015) (quoted in *Petrobras*, 862 F.3d at 278-79).[8]

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[7] *In re Petrobras Sec. Litig.*, 862 F.3d 250 (2d Cir. 2017). The Second Circuit has explained that its holding in *Waggoner*, that the "indirect" factors can suffice to establish market efficiency, "buil[t] on" its prior holding in *Petrobras*, which likewise discounted the importance of an actual showing of price impact. *Id.* at 97.

[8] *See also* Alon Brav & J. B. Heaton, *Market Indeterminacy*, 28 J. Corp. L. 517, 535 (2003) ("[D]ecisions [using the indirect factors] reveal considerable lack of scientific sophistication, poor appreciation of market efficiency theory, and arbitrary variation from case to case."); *id.* at 236 ("[W]e doubt such tests as are common in fraud on the market cases should pass a serious reliability review under *Daubert v. Merrell Dow Pharms., Inc.*"). *Amici* are likewise aware of no finance literature endorsing the use of any of the indirect factors to demonstrate whether a security trades in an efficient market. To the contrary, there is literature suggesting the opposite. *See, e.g.*, Brad M. Barber,

Financial economists do not rely on the indirect factors for good reason: The indirect factors are insufficient to establish market efficiency. Reliance upon them, and not upon a showing of whether the market price of a security actually responds to unexpected material information, will lead to both false positives and false negatives—*i.e.*, conclusions that some inefficient markets are efficient and that some efficient markets are inefficient.

As to the false positives, virtually *every* large, publicly traded company will satisfy all or most of the indirect factors.[9] Yet it is well established that the securities of such large companies do *not* all trade in efficient markets.[10] The Second Circuit

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et al., *The Fraud-on-the-Market Theory and the Indicators of Common Stocks*, 19 J. Corp. L. 285, 307, 310 (1994) ("firm size, percentage bid-ask spread, return volatility, price, and institutional holdings . . . either fail the significance test or yield results counter to our expectations. . . . [Moreover,] the number of market makers and institutional holdings do not [even] marginally contribute to distinguishing efficient from inefficient firms.").

[9] Geoffrey C. Rapp, *Proving Markets Inefficient: The Variability of Federal Court Decisions on Market Efficiency in Cammer v. Bloom and Its Progeny*, 10 U. Miami Bus. L. Rev. 303, 322 (2002).

[10] *See, e.g.*, Paul C. Tetlock, *All the News That's Fit to Reprint: Do Investors React to Stale Information?*, 24 Rev. Fin. Stud. 1481 (2011) (finding evidence of overreaction to stale news in large cross-section of stocks); Gur Huberman & Tomer Regev, *Contagious Speculation and a Cure for Cancer: A Nonevent that Made Stock Prices Soar*, 56 J. Fin. 387 (2001); Owen A. Lamont & Richard H. Thaler, *Anomalies: The Law of One Price in Financial Markets*, 17 J. Econ. Persp. 195 (2003); Owen A. Lamont & Richard H. Thaler, *Can*

recognized as much in *Waggoner*. *See* App. 39a n.29.

Conversely, reliance on the indirect factors will also generate false negatives. The majority of small publicly traded companies will not satisfy most or all of the "indirect" factors. Yet some such companies' securities likely trade in efficient markets.

Accordingly, grounding the test for market efficiency solely upon the "indirect" factors will, inevitably, lead to findings that securities trade in efficient markets when, as a matter of fact, they do not, and vice versa.

In sum, because the Second Circuit's holding stands directly at odds with the settled economic premises that provide the foundation for the fraud-on-the-market presumption of *Basic* and its progeny, *amici* submit that this Court should reject the lower court's holding that the "indirect" factors can substitute for a cognizable demonstration of market price impact.

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the Market Add and Subtract? Mispricing in Tech Stock Carve-Outs, 111 J. Pol. Econ. 227 (2003).

CONCLUSION

For the foregoing reasons, *amici* respectfully submit that this Court should grant a writ of certiorari.

Respectfully submitted,

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