The fraud on the market presumption and the establishment of causality in investor actions

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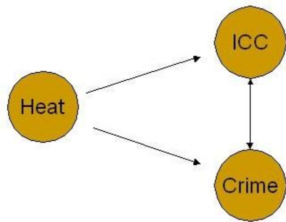
A. Causal Connection

1. Causal connection between two events:

(i) A breach of the statutory transparency obligation of an issuer listed in a regulated market (this breach may alternatively consist in omitting a required disclosure, delaying a disclosure, making a false or inaccurate disclosure, or making an incomplete disclosure); AND

(ii) The damage sustained by those investors that have acquired or disposed of securities of the issuer in the secondary market from the moment the deficient disclosure has been released

B. Causation under US law



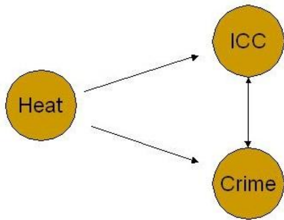
1. Reliance, or **transaction causation**, or but/for causation, *vs.* **loss** proximate causation, loss causation

Transaction causation: has an investment or divestment decision has been caused by the deficient disclosure?

2. Alternative reasons for investment/divestment= no transaction causation is established:

- index investing
- divestment for liquidity purposes portfolio diversification
- achieving favorable tax treatment
- transactions made for compliance reasons
- transactions prompted by tailor-made services furnished by investment advisers
- revelation of the truth in the market by sources unrelated to the issuer latter was

B. Causation under US law



3. “Fraud on the market presumption”

(i) Relieving investors from a heavy burden of proof. What must be proved, instead, is that when making its decision, the investor relied on the integrity of market prices as a credible proxy of all information publicly available in the secondary market

(ii) Facilitating the certification of investors belonging to a “class” (Section 23 (b) (3) of the US Federal Rules of Civil Procedure)

C. Theoretical underpinnings of the “fraud on the market presumption”

The “**efficient capital markets hypothesis**”: capital markets are efficient, they tend to “absorb” all publicly available information and to incorporate them into adjusted security prices.

C. Theoretical underpinnings of the “fraud on the market presumption”

Is the “efficient capital markets hypothesis” subject to **restrictions**?

(i) The “efficient capital markets hypothesis” and the “fraud on the market presumption” should apply only in line with the **characteristics of each market**, as well as qualitative and quantitative data pertaining to the securities and their issuer.

(the weekly trading volume of all securities listed in that market expressed as a percentage of the total outstanding shares in that market; the size of each issuer’s capitalization; the type of securities of the issuer; the frequency of securities analysts following and reporting on that stock; the extent to which market makers and arbitrageurs trade in the stock; the existence of empirical facts showing a cause and effect relationship between unexpected corporate events or financial releases and an immediate response in price; the “bid-ask” spread for stock sales; and, finally, the float, that is the stock’s trading volume).

C. Theoretical underpinnings of the “fraud on the market presumption”

(ii) The efficiency of the market is not uniform for every piece of information released in it

(iii) Not all investors trust the integrity of the market, and therefore do not rely on it when making their investment decisions. (“value investors”) To the extent that it is rebuttable, defendant issuers will always be able to prove that plaintiff investors did not rely on the integrity of market prices when trading, precisely because they are classified as “value investors”

(iv) And a side effect: filing of class actions in *terrorem*

D. How has the presumption been applied by US courts?

(i) *Basic v. Levinson* (1988): in impersonal and developed capital markets, investors rely on the integrity of the prices of listed securities, before deciding to invest in or to divest such securities; investors indirectly rely also on the information that the efficient market has already integrated into those prices

(ii) *Halliburton* (2014): a more rational version of the ECMH and a more restricted and less absolute application of the "fraud on the market presumption" that will now be subject to conditions

No relaxation of the standards of issuer liability under rule 10b-5. The presumption is just an alternative means of satisfying the transaction causation requirement

(iii) *Amgen* (2014): the "materiality" requirement of rule 10b-5 of the Securities Exchange Act need not be satisfied at the class certification stage as part of the "fraud on the market presumption"

E. Transaction causation in European jurisdictions

(i) German law

The plaintiff investor still bears an excessive proof burden to meet, that of individual reliance

Recent jurisprudence of the German Cassation Court (IKB): the burden of transaction causation may be met with only proof of the impact of the deficient information on the price of securities purchased or sold by the investor; therefore no evidence on individual reliance is necessary.

(ii) French law

Causation should be based on specific indices: the temporal proximity between the release of the deficient information; the purchase or sale of securities investor's behavior prior to the purchase or sale of securities

Part of the jurisprudence concludes that the release of every deficient information in the market automatically leads to an investor's "*perte de chance*" (loss of an opportunity)

F. Greek Law

(i) The "fraud on the market presumption" could qualify as a "**judicial presumption**" based on "the teachings of common experience" or "technical knowledge embedded specialized experience" (article 336 par. 3 of the Greek Code of Civil Procedure).

(ii) The use of the presumption could turn out to be useful as the trend in EU law is towards **recognizing some forms of collective redress**, involving a large number of investor plaintiffs Cf. the EU Commission's Recommendation regarding common principles for injunctive and compensatory collective redress mechanisms in the Member State.

F. Greek Law

(iii) The presumption could be considered as **compatible with Greek legal theory** ("adequate cause" theory: an event or a conduct be objectively liable, in the normal course of things, and taking into consideration the facts of each particular case, to result in a specific harmful result.

(iv) **A single reference** to "fraud on the market" in a Supreme Court decision (2009). But this was only a verbatim quote of what a fraud on the market is, rather than a standard of proof for causal connection.

Thank you