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# Fraud-on-the-Market Liability in the ESG Era

*By Kevin S. Haeberle* March 6, 2023

**Comment**

Fraud-on-the-market ("FOTM") suits are thought to generate considerable benefits for society – namely, those associated with increased stock-market liquidity and price accuracy. But these suits are also said to impose outsized costs. The federal courts have thus long tried to efficiently screen out FOTM claims that do not sufficiently implicate the benefits, even if judges do not always describe their work in these terms.

In *Halliburton II* (2014), the Supreme Court rejected arguments for shifting the relevant FOTM screening framework to an inquiry into price impact (burden on the plaintiff) rather than on the longstanding inquiry into market efficiency (burden also on the plaintiff). Instead, the court reaffirmed the latter approach – albeit while recognizing a window for defendants to rebut the FOTM presumption by proving a lack of price impact at the class-certification stage of the litigation.

In a new article, I argue that the emergence of ESG disclosure should trigger reconsideration of this aspect of *Halliburton II* when it comes to FOTM claims targeting *non-financial* disclosure.

The starting point for the argument is a recognition that the approach centered on the market-efficiency inquiry is far from optimal for FOTM claims targeting *financial* disclosure as well as those targeting *non-financial* disclosure. However, for FOTM cases targeting the former (including those targeting ESG-based *financial* disclosure), that approach may be acceptable enough for now for two main reasons. First, *Halliburton II* represents relatively recent precedent that the Supreme Court is unlikely to revisit for *all* FOTM cases absent a significant enough relevant development. In short, the approach of using the market-efficiency inquiry with pleading-stage tools like puffery doctrine and later-stage ones focused on materiality and loss causation was recently reaffirmed in *Halliburton II*, so options for at least judicially-created change seem limited right now. Second, there's a rough enough justice to this approach for FOTM cases targeting this type of disclosure. When a material misstatement about, for example, a firm's quarterly earnings is made to the public, the chances are perhaps high enough that the statement will be reflected in the market price of the firm's stock when that stock trades in an efficient market. In this way, the market-efficiency showing leads to a one-two punch of logical presumptions that allow courts to certify a class of aggrieved investors: one of price impact and one of reliance. And since *Halliburton II*, defendants in these cases have a perhaps fair enough chance to prove a lack of price impact at the class-certification stage.

In contrast, when it comes to FOTM claims targeting *non-financial* disclosure, it is much harder to reach the same conclusion. The chances of these claims triggering the liquidity and price-accuracy benefits at issue are lower than those for claims targeting the narrow, cash-flow-focused disclosure (i.e., *financial* disclosure) that has traditionally dominated public-company disclosure. All the while, relative to the traditional mix of corporate disclosure, ESG disclosure is far more likely to be motivated by broader social concerns. In other words, ESG disclosure is far more likely to consist of *non-financial* disclosure. It follows that, as the current mix of public-company disclosure shifts in the ESG era to include far more *non-financial* disclosure relative to that included in the traditional mix of corporate disclosure, the extent to which the market-efficiency-centered approach should continue to be used over the price-impact-centered one should be questioned for claims targeting *non-financial* disclosure.

As discussed in the article, proof of price impact by the plaintiff in cases targeting *non-financial* disclosure would ensure the presence of the causal connection between the defendant's misstatement, on the one hand, and the plaintiff's harm, on the other, that sits at the heart of the FOTM theory of liability. If the price-impact inquiry comes early enough in the litigation, the result would thus be the potential to both (1) more efficiently weed out claims targeting *non-financial* disclosure that do not sufficiently implicate the social benefits of attaching FOTM liability to corporate disclosure and (2) more efficiently fast-track those that do sufficiently implicate those benefits past the existing screening hurdles.

This general reasoning, along with the additional benefits and contextual considerations detailed in the article, I argue, support the reconsideration of *Halliburton II* for which I advocate. Moreover, as also discussed in the paper, technical considerations cut in the same direction. For one thing, the claims at issue in *Halliburton* targeted *financial* disclosure. For another, while the peak of the ESG emergence that is altering the total mix of corporate disclosure may be difficult to identify for some time, it is clear that it is in fact current—and thus represents a significant relevant development since *Halliburton II* was handed down almost a decade ago.

*This post comes to use from Professor Kevin S. Haeberle at the William and Mary Law School. It is based on his article, "Fraud-on-the-Market Liability in the ESG Era" available here.*