

Second Circuit: (1) *Affiliated Ute* Presumption of Reliance Does Not Apply If Plaintiffs' Claims Are "Primarily Based on Misstatements," and (2) Plaintiffs May Be Able to Establish Market Efficiency Without Direct Evidence of Price Impact

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On November 6, 2017, the Second Circuit held that the presumption of reliance established in *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128 (1972) for omission-based Section 10(b) claims "does not apply" if plaintiffs' claims "are primarily based on misstatements." *Waggoner v. Barclays*, 2017 WL 5077355 (2d Cir. 2017) (Droney, J.). The court further held that "direct evidence of price impact is not always necessary to demonstrate market efficiency." In addition, the Second Circuit ruled that "defendants seeking to rebut" the presumption of reliance established in *Basic v. Levinson*, 485 U.S. 224 (1988) "must do so by a preponderance of the evidence."

***Affiliated Ute* Presumption of Reliance Applies Only in Cases That Primarily Involve Omissions**

The Second Circuit explained that *Affiliated Ute* "allows the element of reliance to be presumed in cases involving primarily omissions, rather than affirmative misstatements, because proving reliance in such cases is, in many situations, virtually impossible." The Second Circuit noted that it has twice found the *Affiliated Ute* presumption inapplicable where "the claims of fraud at issue were not based primarily on omissions."

In *Wilson v. Comtech Telecommunications Corp.*, 648 F.2d 88 (2d Cir. 1981), plaintiff alleged that sales and earnings projections "became misleading when subsequent corrective information was not timely disclosed." *Waggoner*, 2017 WL 5077355 (discussing *Wilson*, 648 F.2d 88). The court found the *Affiliated Ute* presumption inapplicable because "the omissions alone were not the actionable events and proving reliance on them was therefore not 'impossible.'" *Id.* (discussing *Wilson*, 648 F.2d 88). The *Wilson* court reasoned that in "many instances, an omission to state a material fact relates back to an earlier statement, and ... the omission may also be termed a misrepresentation."

Similarly, in *Starr ex rel. Estate of Sampson v. Georgeson Shareholder*, 412 F.3d 103 (2d Cir. 2005), the court found the *Affiliated Ute* presumption did not apply to claims concerning defendants' alleged failure to correct misstatements. Plaintiffs contended that defendants' alleged omissions "exacerbated the misleading nature of the affirmative misstatements," but did not base their claims "primarily" on

omissions.

Relying on its prior holdings in *Wilson* and *Starr*, the Second Circuit in *Waggoner* found the *Affiliated Ute* presumption inapplicable because plaintiffs alleged “numerous affirmative misstatements” and the claimed omissions were “directly related” to those misstatements. The Second Circuit underscored that “[t]he *Affiliated Ute* presumption does not apply to earlier misrepresentations made more misleading by subsequent omissions, or to what has been described as ‘half-truths,’ nor does it apply to misstatements whose only omission is the truth that the statement misrepresents.”

Direct Evidence of Price Impact Is Not Always Required to Establish Market Efficiency at the Class Certification Stage

To demonstrate market efficiency, a prerequisite for the *Basic* presumption of reliance, plaintiffs’ experts typically rely on some combination of the five factors set forth in *Cammer v. Bloom*, 711 F. Supp. 1264 (D.N.J. 1989) and the three factors enumerated in *Krogman v. Sterritt*, 202 F.R.D. 467 (N.D. Tex. 2001). Only one of these factors — *Cammer* 5 — is a direct measure of market efficiency.

The Second Circuit held that “direct evidence of price impact under *Cammer* 5 is not always necessary to establish market efficiency and invoke the *Basic* presumption.” The court explained that “[t]he *Cammer* and *Krogman* factors are simply tools to help district courts analyze market efficiency in determining whether the *Basic* presumption of reliance applies in class certification decision-making.” The court emphasized that these factors “are no more than tools,” and stated that “certain factors will be more helpful than others in assessing particular securities and particular markets for efficiency.”

The Second Circuit made it clear that its decision should not be read to “imply that direct evidence of price impact under *Cammer* 5 is never important.” The court observed that “[d]irect evidence of an efficient market may be more critical, for example, in a situation in which the other four *Cammer* factors (and/or the *Krogman* factors) are less compelling in showing an efficient market.” The court noted that in *Teamsters Local 445 Freight Division Pension Fund v. Bombardier*, 546 F.3d 196 (2d Cir. 2008), it placed great weight on *Cammer* 5 because “certain of the indirect factors did not demonstrate market efficiency.” *Waggoner*, 2017 WL 5077355 (discussing *Bombardier*, 546 F.3d 196).

Here, however, the Second Circuit found the district court was not obligated to consider direct evidence of market efficiency under *Cammer* 5 because the remaining four *Cammer* factors and the *Krogman* factors “weighed so clearly in favor of concluding that the market ... was efficient” that defendants had not even challenged the expert’s analysis of those factors.

Defendants Seeking to Rebut the *Basic* Presumption Bear the Burden of Persuasion to Disprove Reliance

The Second Circuit also held the district court did not err “by shifting the burden of persuasion, rather than the burden of production, to rebut the *Basic* presumption.”

The court explained that in *Halliburton Co. v. Erica P. John Fund*, 134 S. Ct. 2398 (2014) (*Halliburton II*), the Supreme Court stated that “any showing that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff, or his decision to trade at a fair market price, will be sufficient to rebut the presumption of reliance.” The Second Circuit found “[t]his Supreme Court guidance indicates that defendants seeking to rebut the *Basic* presumption must demonstrate a lack of price impact by a preponderance of the evidence at the class certification stage.”

The Second Circuit reasoned that “the phrase ‘[a]ny showing that severs the link’ aligns more logically with imposing a burden of persuasion rather than a burden of production.” The court found *Halliburton II* “requires defendants to do more than merely produce evidence that *might* result in a favorable outcome; they must demonstrate that the misrepresentations did not affect the stock’s price by a preponderance of the evidence.”^[1]

In the case before it, the Second Circuit found the district court did not abuse its discretion in holding that defendants had not met their burden of persuasion. The Second Circuit explained that “the district court was well within its discretion in concluding that the lack of price movement on the dates of the alleged misrepresentations [did] not rebut the *Basic* presumption” because plaintiffs had “proceeded on a price maintenance theory.” That theory “recognizes ‘that statements that merely maintain inflation already extant in a company’s stock price, but

do not add to that inflation, nonetheless affect a company’s stock price.” *Id.* (quoting *In re Vivendi*, 838 F.3d 223 (2d Cir. 2016)).

The Second Circuit further held that defendants’ burden was not met by demonstrating the existence of “a contributing factor to the decline” in the stock price. The court reasoned that “merely suggesting that another factor *also* contributed to an impact on a security’s price does not establish that the fraudulent conduct complained of did not also impact the price of the security.”

[1] The Second Circuit distinguished the Eighth Circuit’s decision in *IBEW Local 98 Pension Fund v. Best Buy Co.*, 818 F.3d 775 (8th Cir. 2016). There, the Eighth Circuit found defendants had successfully rebutted the *Basic* presumption by presenting “overwhelming evidence” that the alleged misstatements had no impact on Best Buy’s share price. The Second Circuit explained that it did not “read the Eighth Circuit’s decision as being in direct conflict with [its] holding” because “the Eighth Circuit’s ruling did not depend on the standard of proof.” Please [click here](#) to read our prior discussion of the Eighth Circuit’s decision.

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