Reliance in Securities Fraud Actions

Maintained

by Kenneth P. Held, Fletcher Held, PLLC

This practice note addresses the ***reliance*** element of a ***securities fraud*** ***action*** under Section 10(b) of the Securities Exchange Act of 1934, as amended (Exchange Act) (15 U.S.C. § 78j) and the available arguments against claims of ***reliance***. To state a ***securities fraud*** claim, plaintiffs must demonstrate that they reasonably relied on the alleged misstatement or omission. ***Reliance*** is sometimes referred to as transaction causation. ***In securities fraud*** class ***actions***, plaintiffs typically rely on the rebuttable presumption of ***reliance*** granted to plaintiffs asserting fraud-on-the-market theories or the rebuttable presumption of ***reliance*** on material omissions set forth ***in*** Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128, 152–53 (1972). This note discusses numerous defenses to rebut the presumption of ***reliance*** and provides practical considerations for various stages of litigation.

For further information on ***securities fraud*** claims and related issues and practical guidance on liability provisions and defenses under the federal securities laws, see U.S. Securities Laws, Securities Act and Exchange Act Liability Provisions, Section 11 Elements and Defenses under the Securities Act, Section 12(a)(2) Elements and Defenses under the Securities Act, Control Person Liability, Jurisdictional Defenses under the Exchange Act, Jurisdictional Defenses under the Securities Act, Materiality ***in Securities Fraud Actions***, Scienter Defenses ***in Securities Fraud Actions***, ***Securities*** Litigation under the Private Securities Litigation Reform Act (PSLRA),Special Litigation Committees, U.S. Supreme Court Securities Litigation Decisions, Defense Strategies under the Securities Act, Liability under the Federal Securities Laws for Securities Offerings, and Liability for Securities Offerings Checklist.

Reliance Element under Section 10(b)

Reasonable ***reliance*** on the alleged misrepresentation is an element of a claim for ***securities fraud***. ***In*** cases involving affirmative misstatements, the most direct way to demonstrate ***reliance*** is to show that the plaintiff was aware of a company's statement and engaged ***in*** the relevant transaction based on that specific misrepresentation. Erica P. John Fund, Inc. v. Halliburton Co., 131 S. Ct. 2179, 2185 (2011) (Halliburton I). ***Reliance*** is not reasonable if the plaintiff was aware of the falsity of the statement at the time it purchased the security.

In practice, however, class ***action*** plaintiffs asserting claims under Section 10(b) of the Exchange Act do not seek to prove that they read a company's statement and relied upon it. Instead, they invoke presumptions to show ***reliance*** because:

- They cannot demonstrate that they actually read the statements at issue and, therefore, relied upon them.
- Demonstrating individual ***reliance*** often defeats the class certification requirement under Federal Rule of Civil Procedure 23(b)(3) that common questions predominate over individual questions. Fed. R. Civ. P. 23.

Plaintiffs most often rely on one of the following two presumptions of ***reliance***:

- ***In*** cases asserting affirmative misrepresentations, the rebuttable presumption of ***reliance*** granted to plaintiffs asserting fraud-on-the-market theories
- ***In*** cases asserting omissions of material information that defendant had a duty to disclose, the *Affiliated Ute* presumption of ***reliance***

The fraud-on-the market presumption of ***reliance*** applies only to securities traded ***in*** an efficient market. The fraud-on-the-market theory is based on the idea that, ***in*** an open and developed securities market, the price of a

company's stock incorporates all available material information regarding the company, and misleading statements will therefore defraud purchasers of stock even if they do not directly rely on the misstatements. These presumptions can often be defeated as follows:

- It is often possible to show (frequently with the support of expert opinions) that the securities were not traded ***in*** an efficient market.
- Moreover, even ***in*** an efficient market, the presumption of ***reliance*** remains rebuttable and can be rebutted by showing that the alleged misrepresentation had no impact on price.
- Finally, the *Affiliated Ute* presumption applies only ***in*** omissions cases and generally does not apply ***in*** cases concerning primarily misrepresentations.

The Fraud-on-the-Market Theory of *Reliance* for Affirmative Misrepresentations

In most federal ***securities fraud*** class ***actions***, plaintiffs rely on the fraud-on-the-market theory to both:

- Satisfy the requirement that they plead and prove ***reliance***
- Obtain class certification

See *Amgen Inc. v. Conn. Ret. Plans & Trust Funds, 568 U.S. 455, 463 (2013)* ("Absent the fraud-on-the-market theory, the requirement that *Rule 10b-5* plaintiffs establish ***reliance*** would ordinarily preclude certification of a class ***action*** seeking money damages because individual ***reliance*** issues would overwhelm questions common to the class."); *Basic v. Levinson, 485 U.S. 224, 242 (1988)*; ***In*** *re Am. Int'l Grp. Secs. Litig., 689 F.3d 229, 241 (2d Cir. 2012)*.

The fraud-on-the-market theory is critical to plaintiffs because it is relatively rare for plaintiffs to allege that they actually read the documents alleged to be misleading and, even if they did, individualized issues of ***reliance*** would preclude certification of a class because ***reliance*** would not be subject to common proof. See *1 Litigating Securities Class **Actions** § 2.08* (2020). Fraud-on-the-market theory creates a rebuttable presumption that includes both of the following:

- Misrepresentations by an issuer affect the price of securities traded ***in*** the open market.
- Investors rely on the market price of securities as an accurate measure of their intrinsic value.

See *Miles v. Merrill Lynch & Co. (**In** re Initial Pub. Offering Sec. Litig.), 471 F.3d 24, 42, 55 (2d Cir. 2006)* (quoting *Hevesi v. Citigroup Inc., 366 F.3d 70, 77 (2d Cir. 2004))*. See generally *Semerenko v. Cendant Corp., 223 F.3d 165, 178–80 (3d Cir. 2000)*.

"Price impact may arise from misstatements taking either of two forms: (1) those that fraudulently introduce inflation into the stock price ('inflation introduction'), or (2) those that fraudulently maintain an already inflated stock price ('inflation maintenance')." ***In*** *re Goldman Sachs Grp., Inc. Sec. Litig., 579 F. Supp. 3d 520, 526 (S.D.N.Y. 2021)*.

Fraud-on-the-Market and the Efficient Market Hypothesis

The seminal decision on the fraud-on-the-market theory is *Basic Inc. v. Levinson*, ***in*** which the Court held:

> "The fraud on the market theory is based on the hypothesis that, ***in*** an open and developed securities market, the price of a company's stock is determined by the available material information regarding the company and its business . . . Misleading statements will therefore defraud purchasers of stock even if the purchasers do not directly rely on the misstatements." *Basic, 485 U.S. at 241–42* (citation omitted).

In *Halliburton Co. v. Erica P. John Fund, Inc., 573 U.S. 258 (2014)* (Halliburton II), the Supreme Court reaffirmed the holding ***in*** *Basic*, and stated that for the presumption to apply, a plaintiff must show all of the following:

- The alleged misrepresentations were publicly known.

- The alleged misrepresentations were material.
- The stock traded ***in*** an efficient market.
- Plaintiff traded the stock between the time the misrepresentations were made and when the truth was revealed.

Halliburton II emphasized that the presumption was rebuttable by a showing of either of the following:

- The alleged misrepresentation did not affect the market price.
- Plaintiff would have bought or sold even had it been aware that the stock's price was tainted by fraud.

Notably, the Court held that defendants can introduce evidence to rebut the presumption at the class certification stage, as opposed to having to wait until it files a motion for summary judgment or trial. This enables defense counsel to challenge ***reliance*** at the class certification stage before full merits discovery takes place and before the class is certified. Once a class is certified, plaintiffs' settlement leverage increases substantially.

In *Goldman Sachs Grp., Inc. v. Arkansas Tchr. Ret. Sys., 141 S.Ct. 1951 (2021)* (*Goldman Sachs*), the Supreme Court clarified a number of questions regarding how to rebut the *Basic* presumption of ***reliance*** at the class certification stage. First, the Court held that the defendants bear the burden of persuasion to prove a lack of price impact (circuit courts had been split on this issue). The Court noted, however, that "the allocation is the burden is unlikely to make much difference" because plaintiffs and defendants "typically submit competing expert evidence on price impact." *141 S.Ct. 1951, 1963*. Second, the Court held that the trial court can consider the generic nature of the statements, ***in*** this case Goldman Sachs' statements that it had controls to address conflicts of interest, that clients' interests come first, and that "integrity and honesty are at the heart of our business." The Court held, "The generic nature of a misrepresentation often will be important evidence of a lack of price impact, particularly ***in*** cases proceeding under the inflation maintenance theory." *141 S.Ct. 1951, 1962*. The Court remanded the case for further consideration, and the trial court ultimately held that defendants failed to rebut the presumption of ***reliance***. ***In*** re Goldman Sachs Group, Inc. Sec. Litig. 579 Supp. 2d 520 (2021). The Second Circuit, however, reversed and found that class certification was improper. *Arkansas Tchr. Ret. Sys. v. Goldman Sachs Grp., Inc., 77 F.4th 74, 105 (2d Cir. 2023)*. The Court found that none of the alleged corrective disclosures matched the company's generic statements about business principles and conflicts of interest. The district court had acknowledged a "considerable gap ***in*** specificity between the corrective disclosures and alleged misrepresentations," but it failed to follow Goldman Sachs' guidance when it reasoned that investors would have relied on more specific statements concerning the details and severity of the company's alleged misconduct. This was error because the district court substituted the details and severity of the misconduct ***in*** place of the challenged generic statements, which undermined an inference that a back-end price drop equaled the alleged front-end inflation. There was an insufficient link between the corrective disclosures and the alleged misrepresentation to make such a conclusion.

The Threshold Question: Is the Security Trading in an Efficient Market?

The fraud-on-the-market presumption is available only where the plaintiff can show that the security is actively traded ***in*** an efficient market. There is no single test for market efficiency. Many courts, including the First, Second, Third, Fourth, Fifth, Sixth, and Ninth Circuits, follow the five-factor test set forth ***in*** *Cammer v. Bloom* and look at:

- The average weekly trading volume of the stock
- The number of securities analysts following and reporting on the security at issue
- The extent to which market makers traded ***in*** the stock
- The issuer's eligibility to file a registration statement on Form S-3 with the Securities and Exchange Commission
- The demonstration of a cause and effect relationship between unexpected, material disclosures and changes ***in*** the stock's price

Cammer v. Bloom, 711 F. Supp. 1264, 1286–87 (D.N.J. 1989). See, e.g., *Waggoner v. Barclays PLC, 875 F.3d 79 (2d Cir. 2017)* (adopting *Cammer* factors).

Many courts also consider the following three factors set forth ***in*** *Krogman v. Sterritt*:

- The capitalization of the company
- The bid-ask spread of the stock
- The percentage of stock not held by insiders (the float)

Krogman v. Sterritt, 202 F.R.D. 467, 477–78 (N.D. Tex. 2001).

Courts often find that stock that is widely traded on a public exchange is traded ***in*** an efficient market. Even with respect to stock traded on public exchanges, however, courts have found that the market was not efficient where there is low trading volume, limited analyst coverage, trading primarily on foreign exchanges, or other similar factors. These can be potent arguments for defendants to defeat a finding that an efficient market exists, thus denying plaintiffs the presumption of ***reliance***, as the following courts found:

- ***In*** ***In*** *re PolyMedica Corp. Sec. Litig., 453 F. Supp. 2d 260, 278 (D. Mass. 2006)*, the court held that plaintiff's expert had failed to show that the market for a security with a weekly trading volume of more than 4 million shares was efficient ***in*** part because the expert, though showing that the price of the stock moved ***in*** response to certain announcements, had failed to explain why the stock did not move on other days ***in*** which there were also significant announcements or how the stock performed on non-news days.
- ***In*** *Bricklayers & Trowel Trades Int'l Pension Fund v. Credit Suisse Sec. (USA) LLC, 752 F.3d 82 (1st Cir. 2014)*, the First Circuit affirmed the district court's conclusion that plaintiff failed to show that AOL traded ***in*** an efficient market where there was a significant lag between new information and the market's reaction and the market reacted to disclosures that did no more than put a gloss on information that was already public.

Securities that are not widely traded on a public exchange have been subjected to a much more rigorous analysis and are frequently found not to trade ***in*** an efficient market. Examples include certain mortgage-backed certificates, corporate bonds, initial public offering (IPO) shares, shares of open-ended mutual funds, and stocks traded on over-the-counter bulletin boards:

- ***In*** *Miles v. Merrill Lynch & Co. (****In*** *re Initial Pub. Offering Sec. Litig.), 471 F.3d 24 (2d Cir. 2006)*, the Second Circuit held that "the market for IPO shares is not efficient"—***in*** part because analysts are prohibited from publishing research ***in*** the first 25 days after an IPO and ***in*** part because plaintiffs themselves alleged that widely known information was incorporated into the price of the securities very slowly. *Miles, 471 F.3d at 42–43*.
- ***In*** *Teamsters Local 445 Freight Div. Pension Fund v. Bombardier, Inc., 546 F.3d 196 (2d Cir. 2008)*, the Second Circuit affirmed the lower court's holding that certificates secured by pools of manufactured housing installment sales contracts and mortgage loans did not trade ***in*** an efficient market. The court based its decision on the absence of analysts following the certificates, the absence of market makers trading ***in*** the certificates, and the failure to demonstrate a causal relationship between the disclosure of material information about the certificates and their prices.
- ***In*** *Freeman v. Laventhol & Horwath, 915 F.2d 193, 199 (6th Cir. 1990)*, the court concluded that tax-exempt municipal bonds did not trade on an efficient market.
- ***In*** ***In*** *re Am. Int'l Group, Inc. Sec. Litig., 265 F.R.D. 157, 180 (S.D.N.Y. 2010)*, vacated and remanded, *689 F.3d 229 (2d Cir. 2012)*, the trial court, ***in*** refusing to certify a settlement class, found that certain corporate bonds did not trade ***in*** an efficient market because of the lack of: transparency, evidence of trading volumes commensurate with securities that have been found to trade ***in*** efficient markets, research analysts following the bonds, trading on many days during the class period, and price fluctuations ***in*** those bonds of statistical significance caused by company-related events. Because the Second Circuit held that the presumption of ***reliance*** is not required for settlement classes, it reversed the trial court's ruling. Other courts have found that certain bonds did trade ***in*** an efficient market. See ***In*** *re Winstar Communications Sec. Litig., 290 F.R.D. 437 (S.D.N.Y. 2013)*.

- ***In*** *Krogman v. Sterritt*, the court found that stock traded on the over-the-counter bulletin board did not trade on an efficient market because, among other things, the turnover ***in*** the stock was low, there were no independent analysts following the stock, the bid-ask spread was relatively high, and the public float of the stock was low. See also *Salvani v. ADVFN PLC, 50 F. Supp. 3d 459 (S.D.N.Y. 2014)* (same).
- ***In*** *IBEW Local 90 Pension Fund v. Deutsche Bank AG, 2013 U.S. Dist. LEXIS 155136 (S.D.N.Y. Oct. 29, 2013)*, the court declined to find the existence of an efficient market where plaintiff's expert failed to consider the primary foreign market ***in*** which the company's securities traded, failed to take into account the ban on short sales during the class period, and analyzed only 12 trading days out of 515. The court emphasized that defendants did not have the burden of proving the market was inefficient; rather, it was enough that they showed that plaintiff's expert's analysis of the market was flawed.
- ***In*** ***In*** *re Van Wagoner Funds, Inc. Sec. Litig., 382 F. Supp. 2d 1173, 1188 (N.D. Cal. 2004)*, the court found that the fraud-on-the-market theory does not apply to open-ended mutual funds because their share price was not determined by the market but by the underlying asset value.

In Martinek v. AmTrust Fin. Servs., Inc., the court applied the Cammer factors as a guide to find that preferred stock traded on the NYSE traded ***in*** an efficient market, notwithstanding certain weaknesses ***in*** plaintiffs' expert's analysis. *Martinek v. AmTrust Fin. Servs., Inc., No. 19 CIV. 8030 (KPF), 2022 U.S. Dist. LEXIS 20056, at *18 (S.D.N.Y. Feb. 3, 2022)*.

Courts have found that stocks were not trading ***in*** an efficient market where the market was disrupted by a "short squeeze" that caused significant volatility. *Bratya SPRL v. Bed Bath & Beyond Corp., 2024 U.S. Dist. LEXIS 175313, at *64 (D.D.C. Sept. 27, 2024)*.

Rebutting the Presumption of Reliance by Showing Alleged Misrepresentation or Omission Did Not Impact Price of Security

In *Halliburton II*, the Court held that even when the elements of the fraud-on-the-market theory are satisfied, a defendant can rebut the presumption of ***reliance*** by showing with direct or indirect evidence that the alleged misrepresentation had no material impact on the price of the securities. *Halliburton Co., 573 U.S. at 279*. The Court explained that *Basic*'s presumption of ***reliance*** is an "indirect proxy for price impact," and does not preclude direct evidence of a lack of price impact. *Halliburton Co., 573 U.S. at 281*. Importantly, *Halliburton II* held that defendant is entitled to make this showing not only at the merits stage, but also at the earlier class certification stage. Even though price impact is relevant to the element of materiality (which is not an appropriate consideration at the class certification stage), price impact is also relevant to the class-wide presumption of ***reliance***, which is a factor ***in*** class certification. See also *Goldman Sachs Grp., Inc. v. Arkansas Tchr. Ret. Sys., 141 S.Ct. 1951, 1959 (2021)*.

Both plaintiffs and defendants typically submit event studies prepared by expert witnesses to analyze market efficiency and price impact. See *Carpenters Pension Trust Fund for N. Cal. v. Allstate Corp. (**In** re Allstate Corp. Sec. Litig.), 966 F.3d 595, 613 n.6 (7th Cir. 2020)* ("[S]ince *Basic*, event studies have come to be treated as the sine qua non for proving or disproving price impact and loss causation."). An event study is an empirical statistical analysis by which experts may "disentangle[ ] the effects of two types of information on stock prices—information that is specific to the firm under question . . . and information that is likely to affect stock prices marketwide." ***In*** *re Vivendi, S.A. Sec. Litig., 838 F.3d 223, 253* (quoting Mark L. Mitchell and Jeffry M. Netter, The Role of Financial Economics ***in*** ***Securities Fraud*** Cases: Applications at the Securities & Exchange Commission, *49 Bus. Law. 545, 556–57 (1994)*). A recent Michigan federal court decision provides a thorough analysis of the factors to determine whether an event study is reliable and admissible. *Shupe v. Rocket Companies, Inc., 2024 U.S. Dist. LEXIS 178076 (E.D. Mich. Sept. 30, 2024)*.

Appellate and trial court decisions applying *Halliburton II* and *Goldman Sachs* to price impact analyses ***in*** class certification decisions are instructive:

- The Eighth Circuit reversed the district court's decision to certify a securities class ***action*** because defendants had successfully rebutted plaintiffs' price impact allegations by showing that the allegedly inflated price was established by non-fraudulent press releases, rather than allegedly fraudulent

statements made two hours later ***in*** a conference call. *IBEW Local 98 Pension Fund v. Best Buy Co., 818 F.3d 775 (8th Cir. 2016)*.

- The Seventh Circuit reversed a trial court order certifying a class and instructed the trial court on remand to consider evidence of price impact, even if that evidence also touched on materiality. ***In*** *re Allstate Corp. Sec. Litig*.
- Relying on the allocation of the burden of persuasion on the defendant, the court ***in*** ***In*** re EQT Corp. Sec. Litig. Certified a class where defendants' expert failed to conclusively demonstrate that there was no price impact, even though plaintiffs' expert failed to show that there was a price impact. *2022 U.S. Dist. LEXIS 143232, at *18 (W.D. Pa. Aug. 11, 2022)* ("[T]he Court finds that [defendants' expert's] conclusion that one cannot definitively conclude, based upon either his or [plaintiffs' expert's] analyses, that there was price impact at this juncture does not establish that there was, ***in*** fact, no price impact. . . . [Plaintiffs' expert's] methods are sound, and his opinions may carry weight with the factfinder. That said, it is Defendants' burden to establish lack of price impact and to sever the link between a disclosure and a drop ***in*** market price at the class certification stage. Merely attempting to poke holes ***in*** Plaintiffs' failure to definitively establish price impact at the class certification stage is not sufficient to meet this burden, and Defendants have thus not rebutted the Basic presumption by a preponderance of the evidence.").
- Post-*Goldman Sachs*, numerous other district courts have found that defendants failed to rebut the presumption of ***reliance*** and, therefore, granted class certification motions. See *Alpha Cap. Anstalt v. Intellipharmaceutics Int'l Inc., 2021 U.S. Dist. LEXIS 128773, at *6–7 (S.D.N.Y. July 9, 2021)*; ***In*** *re Anadarko Petroleum Corp. Sec. Litig., 2022 U.S. Dist. LEXIS 180240, at *6 (S.D. Tex. Sept. 28, 2022)*; *Strougo v. Tivity Health, Inc., 2022 U.S. Dist. LEXIS 101449, at *9 (M.D. Tenn. June 7, 2022)*, vacated on other grounds by ***In*** *re Tivity Health, Inc. 2022 U.S. App. LEXIS 32125 (6th Cir. Nov. 21, 2022)*, and class certified ***in*** *Strougo v. Tivity Health, Inc., 2023 U.S. Dist. LEXIS 99085 (M.D. Tenn. June 7, 2023)*; ***In*** *re Apple Inc. Sec. Litig., YGR, 2022 U.S. Dist. LEXIS 23771, at *1 (N.D. Cal. Feb. 4, 2022)*; *St. Clair Cnty. Employees' Ret. Sys. v. Acadia Healthcare Co., Inc., 2022 U.S. Dist. LEXIS 178750, at *1 (M.D. Tenn. Sept. 30, 2022)*; ***In*** *re Mattel, Inc. Sec. Litig., 2021 U.S. Dist. LEXIS 194121, at *1 (C.D. Cal. Oct. 6, 2021)*; *Allegheny Cnty. Employees' Ret. Sys. v. Energy Transfer LP, 2022 U.S. Dist. LEXIS 150826 (E.D. Pa. Aug. 23, 2022)*.

Other Means to Rebut the Presumption of Reliance

Defendants can also rebut the fraud-on-the-market presumption of ***reliance*** by 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." *Halliburton II, 573 U.S. at 268–69*. For example, the presumption is rebutted if plaintiff purchased securities because of factors other than the integrity of the market, such as a recommendation from a broker who was acting on inside information. See *Markewich v. Ersek, 98 F.R.D. 9, 10–12 (S.D.N.Y. 1982)*. Similarly, courts have held that short sellers are not entitled to the fraud-on-the-market presumption. See e.g., ***In*** *re Overstock Sec. Litig., 119 F.4th 787 (10th Cir. 2024)* ("Plaintiff cannot have it both ways: if Plaintiff bought its shares to avoid breaching its lending contracts, it cannot also have bought its shares because of Defendant's alleged misstatements."); *Ganesh, L.L.C. v. Computer Learning Ctrs., Inc., 183 F.R.D. 487, 491 (E.D. Va. 1998)*. ***In*** addition, the Second Circuit affirmed a district court's decision concluding, after trial, that a sophisticated institutional investor would have purchased the securities at issue even if it had been aware of the fraud. *GAMCO Investors, Inc. v. Vivendi Universal, S.A., 838 F.3d 214 (2d Cir. 2016)*.

Courts have also allowed defendants to argue "truth on the market" to rebut the presumption of ***reliance*** at the class certification stage. See *Pardi v. Tricida, Inc., 2024 U.S. Dist. LEXIS 175947 (N.D. Cal. Sept. 27, 2024)* (analyzing defendants' truth on the market arguments to rebut presumption of ***reliance*** to defeat class certification, but finding that presumption was not rebutted).

The Affiliated Ute Presumption of *Reliance* on Omissions of Material Fact

In *Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128, 152–53 (1972)*, the Supreme Court held that a presumption of ***reliance*** arises where the defendant had a duty to disclose but said nothing. The rationale is that

reliance may as a practical matter be impossible to prove where no positive statement exists. *Wilson v. Comtech Telecomm. Corp., 648 F.2d 88, 93 (2d Cir. 1981)*. It is worth emphasizing that the Affiliated Ute presumption does not depend on the existence of an efficient market. *Puddu v. NYGG (Asia) Ltd., No. 15CV8061 (DLC), 2022 U.S. Dist. LEXIS 125858, at *2 (S.D.N.Y. July 15, 2022)* ("[T]he Affiliated Ute presumption does not assume an efficient market. . . Accordingly, an investor may still rely on a material omission even if a corrective disclosure does not quickly update the share price.").

The primary argument to avoid application of the *Affiliated Ute* presumption is to argue that plaintiffs' claims are based ***in*** whole or ***in*** part on misrepresentations and not exclusively on omissions. No court has applied the presumption to a case that primarily alleges affirmative misrepresentations and alleges omissions only as additional claims. See, e.g., ***In*** *re InterBank Funding Corp. Sec. Litig., 629 F.3d 213, 219 (D.C. Cir. 2010)*; *Johnston v. HBO Film Mgmt., 265 F.3d 178, 192 (3d Cir. 2001)*; *Akin v. Q-L Invest., Inc., 959 F.2d 521, 529 (5th Cir. 1992)*. Courts have refused to apply the presumption unless the fraud claims are based primarily or exclusively on omissions. See, e.g., *Regents of the Univ. of Cal. v. Credit Suisse First Boston, 482 F.3d 372, 384 (5th Cir. 2007)*; *Binder v. Gillespie, 184 F.3d 1059, 1064 (9th Cir. 1999)*; *Cox v. Collins, 7 F.3d 394, 396 (4th Cir. 1993)*; *Cavalier Carpets, Inc. v. Caylor, 746 F.2d 749, 756 (11th Cir. 1984)*.

The *Affiiliated Ute* presumption does not apply to omissions that merely exacerbate prior misrepresentations: "The *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." *Waggoner v. Barclays PLC, 875 F.3d 79, 96 (2d Cir. 2017)*. See also *Starr v. Georgeson S'holder, Inc., 412 F.3d 103, 109 n.5 (2d Cir. 2005)* (same); ***In*** *re Moody's Corp. Secs. Litig., 2013 U.S. Dist. LEXIS 122449 (S.D.N.Y. Aug. 22, 2013)* (*Affiliated Ute* presumption did not apply where the claims were "primarily built around misrepresentations" and the omissions "merely serve to exacerbate and bolster [plaintiffs'] misrepresentation claims.").

In *Abell v. Potomac Ins. Co., 858 F.2d 1104, 1119 (5th Cir. 1988)*, the Fifth Circuit stressed that "distorted half-truths" do not satisfy the conditions necessary for the *Affiliated Ute* presumption to arise. Rather, there must be no information of any kind disclosed to the plaintiffs:

> "Misrepresentations include statements that are themselves false—outright lies—and true statements that are nonetheless so incomplete as to be misleading, i.e., distorted half-truths. To omit a fact, however, is to say absolutely nothing about matters whose very existence plaintiffs have no reason to consider."

Abell, 858 F.29 at 1119.

Courts have recognized that the distinction between a misstatement and an omission "is often illusory." ***In*** *re Lehman Bros. Secs. & ERISA Litig., 2013 U.S. Dist. LEXIS 152801 (S.D.N.Y. Oct. 22, 2013)*. The key inquiry is whether "***reliance*** as a practical matter is impossible to prove" where, as ***in*** *Affiliated Ute*, "no positive statements exist." ***In*** *re Lehman Bros. Secs. & ERISA Litig., 2013 U.S. Dist. LEXIS 152801 at *10–11*.

Practical Considerations and Defense Strategies

Although the fraud-on-the-market and *Affiliated Ute* presumptions of ***reliance*** are powerful tools for plaintiffs, there are a number of ways you can defeat plaintiffs' showing of ***reliance***, especially at the class certification stage, when you are defending a client ***in*** a ***securities fraud*** claim.

Reliance Arguments in a Motion to Dismiss

You may have difficulty applying the arguments discussed above to negate or rebut the presumption of ***reliance in*** a motion to dismiss context because such arguments often (1) involve fact questions and (2) require an expert opinion (including an event study) to show that the market is not efficient or that the alleged misrepresentation had no impact on price. Moreover, ***in*** arguing a motion to dismiss, it is often advantageous for defendants to assume for the purposes of the motion that the stock was traded ***in*** an efficient market (as alleged ***in*** the complaint) and argue instead that plaintiff cannot demonstrate loss causation under *Dura Pharms., Inc. v. Broudo, 544 U.S. 336 (2005)*

because either (1) the stock price fell prior to the alleged "corrective disclosure" that revealed the allegedly omitted or misrepresentation information was disclosed or (2) the stock price did not fall after the corrective disclosure.

However, depending on the facts of the claim you are defending, you can effectively assert ***in*** a motion to dismiss the argument that the *Affiliated Ute* presumption does not apply because the claims are primarily misrepresentation claims as opposed to omission claims.

***Reliance* Arguments *in* Opposition to Class Certification**

As noted above, a plaintiff must demonstrate that a class-wide presumption of ***reliance*** applies ***in*** order to certify a class under *Federal Rule of Civil Procedure 23*. Otherwise, individual questions of ***reliance*** would predominate over common questions. As the Supreme Court held ***in*** *Halliburton II*, defendants can seek to rebut the presumption of ***reliance*** at the class certification stage, including through the presentation of event studies prepared by experts. Potent arguments you can use include:

- The securities were not traded ***in*** an efficient market, especially if the securities are not traded on a public exchange or, even where the stock is traded on a public exchange, there is low trading volume, limited analyst coverage, trading primarily on foreign exchanges, or other similar factors.
- Even ***in*** an efficient market, the presumption of ***reliance*** does not apply if the alleged misrepresentation had no impact on price.
- The class representative did not rely on the efficient market because it had actual knowledge of the alleged falsity or traded based on information other than the alleged misrepresentation or omission (such as a broker acting on inside information). Such an argument would not only defeat the presumption of ***reliance***, it would also demonstrate that the named plaintiff's claims are not typical of the class members' claims as required for class certification under *Federal Rule of Civil Procedure 23(a)(3)*.

***Reliance* Arguments *in* a Motion for Summary Judgment**

If the class is certified, you can re-urge the arguments above that the class-wide presumption of ***reliance*** does not apply or has been rebutted. ***In*** addition, the motion for summary judgment can include the closely-related arguments that the alleged misrepresentations or omissions were not material and/or did not cause the stock price to fall. These latter two arguments are not widely accepted at the class certification stage but are appropriate for a motion for summary judgment. The impact of alleged misrepresentations or omissions on stock price touches on the three elements of materiality, ***reliance***, and loss causation, and the framing of these three related issues is sometimes more effective when they are presented together.

Current as of: ***01/23/2025***

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