CORPORATE LITIGATION:

REBUTTAL OF THE FRAUD ON THE MARKET PRESUMPTION OF RELIANCE

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Federal securities claims require proof of investor reliance on the alleged misrepresentations. Class certification in securities actions often turns on whether a presumption of classwide reliance is applicable to the claims alleged; if a traditional showing that each investor was aware of the challenged statements and entered into a transaction because of them is necessary, individual questions of reliance will overwhelm questions common to putative class members and foreclose class certification. The availability of a presumption of classwide reliance on alleged misrepresentations is frequently the most sharply contested class certification issue in securities actions.

In *Basic v. Levinson*, 485 U.S. 224 (1988), the U.S. Supreme Court observed that most modern securities markets are based not on face-to-face transactions but on transactions intermediated by the pricing mechanism of the market. Consequently, *Basic* held that reliance may be presumed under a "fraud on the market" economic theory if the plaintiffs satisfy certain conditions, including that the relevant security traded in an efficient market, i.e., one in which the security's price rapidly incorporates material public information relating to the security. From its start, the *Basic* presumption has been rebuttable by "[a]ny 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." In *Halliburton Co. v. Erica P. John Fund*, 134 S. Ct. 2398 (2014) (*Halliburton II*), the Supreme Court clarified that the presumption is only an indirect proxy for proof that alleged misrepresentations affected the security's price, and that defendants may rebut the *Basic* presumption at the class certification stage with evidence that "the asserted misrepresentation (or its correction) did not affect the market price of the defendant's stock." 134 S. Ct. at 2414. Post-*Halliburton II* decisions have reached varying results on how defendants may rebut the presumption, with most imposing challenging rebuttal burdens on defendants. Last month, the U.S. Court of Appeals for the Second Circuit held as a matter of first impression in this circuit that direct evidence of price impact is not always necessary to demonstrate market efficiency (as required to invoke the *Basic* presumption), and a defendant's rebuttal burden is one of persuasion (not production), and defendant must show the absence of price impact by a preponderance of the evidence. *Waggoner v. Barclays PLC*, 875 F.3d 79, 95 (2d Cir. 2017).

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'Waggoner'

Waggoner was brought on behalf of a putative class of Barclays' American Depository Shares on the heels of a New York Attorney General suit against Barclays under the Martin Act, which alleged that Barclays concealed information about the operation of a private "dark pool" trading system. The *Waggoner* plaintiffs alleged that defendants made material misrepresentations and omissions regarding the safety of one of its alternative trading systems from predatory trading, and Barclays' risk controls generally.

Waggoner contains a number of significant holdings affecting securities plaintiffs' ability to invoke a classwide presumption of reliance at the class certification stage. The court first reinforced the limited application of the separate *Affiliated Ute* presumption of reliance, emphasizing that it does not apply to claims that are primarily based on alleged misstatements, not omissions. Second, to invoke the *Basic* presumption, *Waggoner* holds that a plaintiff (1) need not always provide empirical evidence of price impact through a statistical event study to show that the market for the relevant securities was efficient during the class period, and (2) need not offer any directional direct evidence of price impact, as long as other indicia of market efficiency are present. If not modified, this ruling will make it more challenging, particularly for large issuers, to successfully contest market efficiency, even where it is undisputed that challenged statements did not affect the stock price. Third, once invoked, defendants must rebut the *Basic* presumption by disproving reliance by a preponderance of the evidence.

The *Basic* presumption, like all presumptions, is governed by Federal Rule of Evidence 301. Under Rule 301, a presumption is not evidence, nor does it shift the burden of proof. Rule 301, entitled "Presumptions in Civil Cases Generally," provides that "the party against whom a presumption is directed has the burden of producing evidence to rebut the presumption," in the absence of a statutory directive to the contrary. Fed. R. Evid. 301. Whereas the burden of persuasion requires a party in a civil case to establish it is more likely than not that a fact exists, the burden of production is met if a reasonable jury could find the nonexistence of the presumed fact. See *ITC Ltd. v. Punchgini*, 482 F.3d 135, 149 (2d Cir. 2007). Consistent with Rule 301, the defendants in *Waggoner* argued that defendants seeking to rebut the *Basic* presumption must meet only a burden of production.

The Second Circuit disagreed, stating briefly that the judicially-created *Basic* presumption was "pursuant to federal securities laws," and therefore "sufficiently link[ed] to those statutes to meet Rule 301's statutory element requirement." Rule 301, however, does not impose a statutory "requirement" for the application of a presumption, but rather allows for statutory *exceptions* to a general rule providing that the burden of production is all that is required to rebut an otherwise applicable presumption. By the express terms of Rule 301, the burden of persuasion "remains on the party who had it originally." Fed R. Evid. 301. In the context of establishing the class certification requirements of Rule 23, that party is plaintiff. *See Comcast Corp. v. Behrend*, 133 S. Ct. 1426, 1432 (2013).

The Second Circuit instead grounded its burden holding in the language of *Halliburton II* and *Basic*. Neither decision expressly specifies the standard applicable to a defendant's rebuttal burden. In the Second Circuit's view, *Basic*'s direction—reiterated in *Halliburton II*—that "[a]ny *showing* that *severs the link* between the alleged misrepresentation and … the price received (or paid) by the plaintiff … will be sufficient to rebut the presumption of reliance" reflected the Supreme Court's intent that a burden of persuasion apply. *Basic*, 485 U.S. at 248 (emphasis added); see also *Halliburton II*, 134 S. Ct. at 2408. The court interpreted "[a]ny showing that severs the link" to require more than "evidence that *might* result in a favorable income": "the showing … must … actually 'sever[] the link' between the misrepresentation and the price." Id. at 101. The

court similarly derived "guidance" from *Halliburton II*'s statement that defendants could rebut the *Basic* presumption with "direct, more salient evidence showing" no price impact. Id. at 103.

The court also consulted its own prior decisions in *duPont v. Brady*, 828 F.2d 75, 78 (2d Cir. 1987); *Black v. Finantra Capital*, 418 F.3d 203, 209 (2d Cir. 2005); and *Salomon Analyst Metromedia Litig.*, 544 F.3d 474, 483 (2d Cir. 2008)). In *duPont*, an individual securities action, it had held that a preponderance of the evidence is required to rebut the *Affiliated Ute* presumption of reliance. See 828 F.2d at 78. But there, the plaintiff had first "proven" materiality and scienter by a preponderance. Id. In *Black*, another individual suit, the Second Circuit held on a post-trial motion that the district court properly instructed the jury that defendants can overcome the presumption of reliance on a security's market price by a preponderance of contrary evidence. 418 F.3d at 209. It went on to hold that a "reasonable juror" could have found reliance on the basis of facts proven at trial. See id.

The applicability of these decisions to class claims arguably is limited in light of the Supreme Court's subsequent decision in *Amgen v. Connecticut Retirement Plans and Trust Funds*, which held that plaintiffs need not establish materiality to obtain class certification. 133 S. Ct. 1184, 1191 (2013). For that reason, the *Waggoner* court's citation to its own dictum in *Salomon* that defendants bear "the burden of *showing* that there was no price impact" is not controlling: As in *duPont*, *Salomon* assumes that plaintiff would first prove the materiality of the statement relied upon. See *Waggoner*, 875 F.3d at 102 & n.34 (emphasis added) (citing *Salomon*, 544 F.3d at 483). The *Waggoner* decision acknowledges that *Amgen* abrogated *Salomon* with respect to the materiality showing previously required at the class certification stage, but does not question whether *Salomon*'s discussion of reliance can be separated from its materiality analysis.

Waggoner's conclusion that "*some* evidence" of no price impact is insufficient rebuttal evidence, id. at 100, also is in tension with the court's prior statements that a presumption "ceases to operate … upon the proffer of contrary evidence," *ITC Ltd.*, 482 F.3d at 148, as well as the Eighth Circuit's recent on-point decision in *IBEW Local 98 Pension Fund v. Best Buy Co.*, 818 F.3d 775 (8th Cir. 2016). In *Best Buy*, the Eighth Circuit agreed with the district court that defendants "had the burden to come forward with evidence showing a lack of price impact" but reversed the court's class certification order, holding that defendants had proffered "strong evidence" there was no impact on Best Buy's stock price at the time misrepresentations were made. Id. at 782.

In a footnote, *Waggoner* read *Best Buy* narrowly, characterizing as "dictum" the Eighth Circuit's statement that defendants have "the burden to come forward with evidence" in light of its ultimate conclusion that "overwhelming evidence" supported a finding of no price impact. 875 F.3d at 103 n.36 (citing *Best Buy*, 818 F.3d at 782). In other words, the *Waggoner* court reasoned, the *Best Buy* court's conclusion would not have altered had it shifted the burden of persuasion as well as the burden of production to defendants. That reading of *Best Buy*, however, does not explain the Eighth Circuit's exclusive reliance on Rule 301 in support of its conclusion that Defendants must "come forward with evidence showing a lack of price impact." *Best Buy*, 818 F.3d at 782. Indeed, at least one court has, unlike the Second Circuit, read *Best Buy* to require only a burden of production to rebut the *Basic* presumption. See *Marcus v. J.C. Penney Company*, 2016 WL 8604331, at *5 n.1 (S.D.N.Y. Aug. 29, 2016).

Rebuttal Evidence of No Price Impact

As is typical in many securities class actions, the *Waggoner* plaintiff had no evidence of "front-end" price impact in response to the alleged misstatements, but did produce expert evidence of "back-end" price impact upon revelation of the "truth" correcting the alleged misstatements. Plaintiff's expert identified a 7.38 percent

stock price decline following a single alleged corrective disclosure in the form of news that regulators had brought suit alleging that defendant had concealed information about its "dark pool" trading system. *Waggoner*, 875 F.3d at 104. Defendants' expert opined that "*some* of the price reaction" and "a portion" of the decrease in price was not due to the alleged misrepresentations, but rather "a response to the regulatory action itself." Id. (alteration in original). The court determined that "merely suggesting that another factor *also* contributed to" price impact is not sufficient to rebut the *Basic* presumption. Id. at 105 (emphasis in original).

Implications

Along with its recent decision, *In re Petrobras Sec. Litig*., 862 F.3d 250, 275 (2d Cir. 2017), which afforded significant latitude to district court "blended consideration of direct and indirect evidence of market efficiency," the Second Circuit in *Waggoner* has parted ways with the Eighth Circuit in *Best Buy* and substantially diluted defendants' rebuttal right recognized by the Supreme Court in *Halliburton II*. The *Waggoner* district court stated that, under current trends, "*Halliburton II*'s holding" permitting defendants to attempt to rebut the presumption by showing no price impact "will not ordinarily present a serious obstacle to class certification," as "the vast majority of courts have found that defendants have failed to meet their burden of proving lack of price impact." *Strougo v. Barclays PLC*, 312 F.R.D. 307, 324 (S.D.N.Y. 2016) (citing authorities pre- and post-*Halliburton II*). Where plaintiffs rely on a price maintenance theory of price impact (positing that alleged false statements have price impact by maintaining the stock at a constant price), *Waggoner* makes it more difficult to rebut the *Basic* presumption at the class certification stage because the Second Circuit will not require plaintiffs to establish any discernible front-end price impact if other indicia of market efficiency are present. Moreover, where back-end price decline is attributable to both a corrective disclosure and non-corrective news, defendants face additional challenges in showing lack of price impact because "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." Even if a class is certified, however, at summary judgment defendants will be able to pursue important defenses regarding materiality, loss causation and damages without having to counter any presumptions.