Clients&FriendsMemo

# Securities Litigation Update: Courts of Appeals Weigh in on *American Pipe* Tolling and the *Affiliated Ute* Presumption of Reliance

*The Third Circuit extended* American Pipe *tolling to the period before a decision on class-certification, opening a new avenue for potential class members to assert otherwise untimely individual securities claims. The Ninth Circuit narrowed availability of* Affiliated Ute *presumption of reliance, creating a hurdle for claims of securities fraud based on a mix of affirmative misstatements and omissions.*

**July 15, 2021**

Last month, the U.S. Courts of Appeals for the Third and Ninth Circuits issued decisions interpreting two significant doctrines affecting federal securities law litigants: (1) *American Pipe* tolling—a doctrine that suspends (or "tolls") the running of the statute of limitations applicable to the claims of potential class members while a putative class action is in progress, and (2) the *Affiliated Ute* presumption of reliance—a substitute at the motion to dismiss and class certification stages for the otherwise required direct proof of reliance in claims asserted under Section 10(b) of the Securities and Exchange Act of 1934 (Exchange Act) involving "primarily a failure to disclose."

In *Aly v. Valeant Pharmaceuticals International Inc.*,[1] a panel of the Third Circuit held that *American Pipe* tolling applies to individual actions filed in advance of a district court's class-certification decision. Prior to the decision, potential class members seeking to assert individual claims would have to file either shortly after commencement of the class-action suit (within the limitations periods applicable under the Securities Act of 1933 (Securities Act) and Exchange Act, respectively), or else wait for a court to issue its decision on class certification, a process that often takes years. Now, under *Aly*, class members' claims also are tolled prior to (as well as after) a class certification decision, meaning that they now are able to bring concurrent individual suits at any point prior to resolution of class certification without statute of limitation concerns. In opening up wide terrain for individual claims during the pendency of a class action, the decision arguably conflicts with the Supreme Court's 2018 decision in *China Agritech*, which declined to extend *American Pipe* tolling where its purposes—"efficiency and economy of litigation"—were not served. The decision also may contribute to a trend of increasing numbers of opt-out plaintiffs in securities class actions. At

[1] -- F.4th --, 2021 WL 2448108 (3d Cir. June 16, 2021).

minimum, at least in the Third Circuit, *Aly* stands to complicate the defense of class actions in the period before resolution of class certification—a period previously focused on the class action itself, including class discovery and the motion for class certification—with the prospect of costly, duplicative litigation and uncertainty for plaintiffs and defendants alike.

Meanwhile, in *In re Volkswagen "Clean Diesel" Marketing, Sales Practices, and Products Liability Litigation*,[2] a divided panel of the Ninth Circuit reversed a district court order denying summary judgment to Volkswagen AG and subsidiaries in a long-running securities fraud suit premised on the automobile manufacturer's alleged use of "defeat devices" to skirt emissions tests. Over a vigorous dissent, the majority denied plaintiff a presumption of reliance under *Affiliated Ute Citizens of Utah v. United States*.[3] The majority reasoned that the complaint alleged that plaintiff "reviewed and relied upon" numerous affirmative misstatements regarding Volkswagen's compliance with environmental regulations, and therefore the case was not primarily based on alleged omissions. *Volkswagen* thus limits availability of the powerful *Affiliated Ute* presumption to cases that "primarily allege omissions," where reliance is nearly impossible to prove, casting doubt on its application in "mixed cases" involving both affirmative misstatements and omissions. Questions will persist, however, as to where to draw the line between cases that "primarily" involve omissions, and those that do not.

## I. *Aly v. Valeant*: Third Circuit Extends *American Pipe* Tolling to the Period Before a Decision on Class Certification

### A. Background

In *American Pipe and Construction Co. v. Utah*, the Supreme Court held that the start of a class action tolls the statute of limitations for all members of the putative class until the court either denies class certification or they "cho[o]se not to continue" as class members.[4] A contrary rule, the Court explained, would undermine the goals of "efficiency and economy of litigation" that underpin the class-action mechanism: otherwise, potential class members would have to file needless, duplicative litigation early in a case simply to preserve the ability to enforce their rights down the road if class certification ultimately were denied.[5] Although *American Pipe* specifically addressed potential class members' ability to intervene after denial of class certification, the Court since has clarified that the doctrine also protects plaintiffs who file individual lawsuits after they "opt out" of a

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[2] -- F.4th --, 2021 WL 2621171 (9th Cir. June 25, 2021).

[3] 406 U.S. 128 (1972).

[4] *See Am. Pipe & Constr. Co. v. Utah*, 414 U.S. 538, 551-54 (1974). A statute of limitations is "a statute establishing a time limit for suing in a civil case, based on the date when the claim accrued (as when the injury occurred or was discovered)." Black's Law Dictionary (11th ed. 2019).

[5] *See Am. Pipe*, 414 U.S. at 553.

certified class or the court denies class certification.[6] In recent years, however, the Supreme Court has declined to broaden the doctrine, holding in 2017 that it does not apply to the three-year statute of repose under the Securities Act (*CalPERS v. ANZ Securities*)[7] and in 2018 that it does not apply to a "follow-on" class-action suit, *i.e.*, a class action commenced after a prior class action (*China Agritech, Inc. v. Resh*).[8]

While it is firmly established that *American Pipe* tolling applies *after* resolution of class certification, it is less clear what happens if a class member files suit before then but after the statute of limitations has run. That was the situation in *Aly*, where, in October 2015, a plaintiff filed a class-action complaint against Valeant Pharmaceuticals asserting violations of Sections 10(b) and 20(a) of the Exchange Act.[9] Before the court decided plaintiff's motion for class certification, a group of putative class members filed a separate action asserting the same claims on December 19, 2018—after lapse of the two-year statute of limitations under the Exchange Act. The U.S. District Court for the District of New Jersey dismissed the individual suit as untimely, rejecting plaintiffs' argument that the *American Pipe* doctrine tolled the statute of limitations on their claims. According to the district court, "expansion of the *American Pipe* doctrine . . . would not promote 'efficiency and economy of litigation,' one of the purposes of the *American Pipe* doctrine" because it could "encourage additional individual actions to be brought prior to class-certification."[10] That would force the court "to deal with dispositive motions rehashing legal and factual issues the Court previously addressed"—a "turn of events" that is "neither efficient, nor a wise use of limited judicial resources."[11] The plaintiffs appealed.

### B. The Third Circuit's Decision

A panel of the Third Circuit vacated the order, holding that *American Pipe* tolling applies regardless of whether a class member files an individual action before or after a decision on class certification.

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[6] *See Eisen v. Carlisle & Jacquelin*, 417 U.S. 156, 176 n.13 (1974) (*American Pipe* dispels argument that "class members will not opt out because the statute of limitations has long since run out on the claims of all class members other than" named plaintiff); *Crown, Cork & Seal Co. v. Parker*, 462 U.S. 345, 354 (1983) ("Once the statute of limitations has been tolled [under *American Pipe*], it remains tolled for all members of the putative class until class certification is denied. At that point, class members may choose to file their own suits or to intervene as plaintiffs in the pending action.").

[7] 137 S. Ct. 2042, 2052 (2017).

[8] 138 S. Ct. 1800, 1804 (2018).

[9] The complaint alleged that Valeant relied on a secret, Valeant-controlled pharmacy network that allowed it to charge third-party purchasers and patients higher prices for its drugs than they otherwise could. Following a government investigation, Valeant began disclosing its practices in late 2015. The value of Valeant's stock price dropped almost 90% by August 2016, resulting in a loss of over $76 billion in market capitalization.

[10] *N.W. Mut. Life Ins. Co. v. Valeant Pharm. Int'l Inc.*, No. 18-15286 (MAS) (LHG), 2019 WL 4278929, at *10 (D.N.J. Sept. 10, 2019), *adopted by Aly v. Valeant Pharm. Int'l, Inc.*, No. 18-17383 (MAS) (LHG), 2019 WL 4278045, at *4 (D.N.J. Sept. 10, 2019).

[11] *Id.*

The Court explained that nothing in the Supreme Court's precedents suggested an exception to the *American Pipe* doctrine prior to a class-certification decision, and there was no good reason to create one. Such a rule, according to the Court, would not advance the purpose of a statute of limitations—to prevent "surprise" revival of old claims—since the class-action defendants already are defending the same claims. Nor would it be sensible to lock putative class members indefinitely into a class action they do not want to be a part of—potentially for "years"—when the sole result would be to delay resolution of individual claims that they would bring anyway. According to the Court, the purpose of *American Pipe* was to "protect class members from being *forced* to file individual suits in order to preserve their claims."[12] Yet, paradoxically, the rule adopted by the district court would *punish* class members by dismissing their claims if they file too early.

The Court also offered a pragmatic reason for applying *American Pipe* before a certification decision: the possibility that a statute of repose otherwise would bar the claims outright. Unlike statutes of limitations, statutes of repose "reflect a policy determination that defendants 'should be free from liability after the legislatively determined period of time'"; *American Pipe* tolling, therefore, does not apply.[13] Further, a five-year statute of repose applies to securities fraud claims under the Exchange Act, and an amicus brief cited 92 recent cases in which class certification was not resolved within that period.[14] Absent *American Pipe* tolling in such cases, putative class members who do not file within the two-year limitations period would be barred from asserting individual claims by the time a court finally issues its decision on class certification. The Court was "not convinced that the Supreme Court intended or envisioned such a result."[15]

### C. Implications

It is unlikely that *Aly* will result in a flood of new individual actions during the pendency of putative class actions. *Aly* extends *American Pipe* tolling only to a limited period between lapse of the statute of limitations and the decision on class certification; up to now, potential class members have been able to file individual actions before or after that period. And even though potential class members now may file individual suits at any point before a court renders its decision on class certification, there are still practical reasons for plaintiffs to stand on the sidelines until that time: By declining to file suit, "[t]he parties and courts will not be burdened by separate lawsuits, which, in any event, may evaporate once a class has been certified."[16] Further, "[a]t the point in a litigation

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[12] *Aly*, 2021 WL 2448108, at *5, 7 (quoting *In re WorldCom Sec. Litig.*, 496 F.3d 245, 256 (2d Cir. 2007)) (emphasis in original).

[13] *Id.* at *4 (quoting *CalPERS*, 137 S. Ct. at 2049).

[14] *Id.* at *9.

[15] *Id.*

[16] *Wyser-Pratte Mgmt. Co. v. Telxon Corp.*, 413 F.3d 553, 568–69 (6th Cir. 2005) (quoting *In re WorldCom, Inc. Sec. Litig.*, 294 F. Supp. 2d 431, 452 (S.D.N.Y. 2003)).

when a decision on class certification is made, investors usually are in a far better position to evaluate whether they wish to proceed with their own lawsuit, or to join a class, if one has been certified."[17]

Still, *Aly* threatens to impose on defendants the prospect of costly, duplicative individual suits during a period previously devoted to class discovery and the class-certification motion. There is often a fairly long period of time between lapse of the statute of limitations (one year under the Securities Act and two years under the Exchange Act) and issuance of a decision on class certification.[18] According to one study, between 2000 and 2018, the time between filing a securities class action and decision on class certification exceeded two years in over 71% of cases, three years in over 37% of cases, four years in 18% of cases, and five years in 11% of cases.[19] If reported decisions are any indication, moreover, it is not uncommon for class members, dissatisfied with the pace of the class-certification process, to commence individual lawsuits in the interim: two such suits were commenced in the Valeant matter alone.[20] *Aly* expands the ability of plaintiffs to commence these types of suits.

Moreover, opt-out cases already had been becoming increasingly common in federal securities class actions. Prior to 2014, the percentage of class action opt-out cases had been 3.4%; from 2014 to 2018, that percentage increased to 8.9%.[21] *Aly* could accelerate that trend. More opt-out litigation would be a significant development: courts may struggle with a larger case load, and defendants may have to spend more on legal fees and face greater uncertainty from defending multiple suits, potentially in different jurisdictions, arising from the same allegations.[22]

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[17] *Id.*

[18] *See* 15 U.S.C. § 77m (claims under Sections 11 and 12(a)(2) of the Securities Act must be brought "within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence"); 28 U.S.C. § 1658(b)(1) (fraud claims under the Exchange Act must be brought within "2 years after the discovery of the facts constituting the violation").

[19] S. Boettrich & S. Starykh, NERA Economic Consulting, Recent Trends in Securities Class Action Litigation: 2018 Full-Year Review, at 22 (2019), https://www.nera.com/content/dam/nera/publications/2019/PUB_Year_End_Trends_012819_Final.pdf.

[20] *See Aly*, 2019 WL 4278045, at *1; *N.W. Mut. Life Ins.*, 2019 WL 4278929, at *2. Additionally, in recent years, the issue was litigated in securities cases involving Ocwen Financial Corporation, BP, and certain high-yield investment funds. *See Broadway Gate Master Fund, Ltd. v. Ocwen Fin. Corp.*, No. 16-80056-CIV-WPD, 2016 WL 9413421, at *11 (S.D. Fla. June 29, 2016); *In re BP p.l.c. Sec. Litig.*, MDL No. 10-md-2185, 2014 WL 4923749, at *3-4 (S.D. Tex. Sept. 30, 2014); *Stein v. Regions Morgan Keegan Select High Income Fund, Inc.*, 821 F.3d 780, 789-92 (6th Cir. 2016).

[21] A. Rozen et al., Cornerstone Research, Opt-Out Cases in Securities Class Action Settlements, at 3 (2014-2018 Update), https://www.cornerstone.com/Publications/Reports/Opt-Out-Cases-in-Securities-Class-Action-Settlements-2014-2018.

[22] *Id.* at 2, 8. Based on publicly available information, from 1996-2018, the largest set of opt-out settlements was *AOL Time Warner Inc.*, where the total dollar value of opt-out settlements was $764 million, 30.6% of the size of the class-action settlement. *Id.* at 4.

Citing like-minded decisions by the Second, Ninth, and Tenth Circuits, the *Aly* Court discounted the degree to which federal courts disagree about application of *American Pipe* tolling prior to a class-certification decision.[23] In fact, however, before a favorable Second Circuit decision in 2007, most federal district courts refused to apply *American Pipe* tolling during that period on the grounds that "[a]pplying the tolling doctrine to separate actions filed prior to class certification would create the very inefficiency that *American Pipe* sought to prevent."[24] The First and Sixth Circuits have echoed that reasoning, with the Sixth Circuit restating its holding in 2016 and noting that it is "controlling law" in that circuit.[25] And, in *China Agritech*, the Supreme Court arguably validated the concerns of these courts, reaffirming that "[t]he watchwords of *American Pipe* are efficiency and economy of litigation" and declining to extend the doctrine to a situation—follow-on class actions—where those purposes were not served.[26] Given the relevance of *American Pipe* tolling to securities and non-securities class actions alike, the Supreme Court may choose to weigh in on its application prior a decision on class certification, whether in *Aly* or a different case.

## II. *In re Volkswagen*: Ninth Circuit Narrows Availability of *Affiliated Ute* Presumption of Reliance

### A. Background

An essential component of a securities fraud claim under Section 10(b) of the Exchange Act is the element of reliance.[27] To establish reliance, plaintiffs are typically required to show that they were "aware of a company's statement and engaged in a relevant transaction—*e.g.*, purchasing common stock—based on that specific misrepresentation."[28] That is often a difficult task, given the many alternative reasons (such as price or market trends) that may lead an investor to purchase or sell a security. Easing the burden on plaintiffs in certain circumstances are two "presumptions" of reliance established by the Supreme Court: the "fraud-on-the-market" (or *Basic*) presumption and the *Affiliated Ute* presumption at issue in *Volkswagen*.

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[23] *See WorldCom*, 496 F.3d at 255 ("Nothing in the Supreme Court decisions described above suggests that the rule should be otherwise for a plaintiff who files an individual action before certification is resolved."); *In re Hanford Nuclear Rsrv. Litig.*, 534 F.3d 986, 1009 (9th Cir. 2008) ("We find the Second Circuit's reasoning persuasive and adopt it."); *State Farm Mut. Auto. Ins. Co. v. Boellstorff*, 540 F.3d 1223, 1228 (10th Cir. 2008) (same).

[24] *WorldCom*, 294 F. Supp. 2d at 451 (collecting cases).

[25] *Stein*, 821 F.3d at 789; *see also Glater v. Eli Lilly & Co.*, 712 F.2d 735, 739 (1st Cir. 1983) ("The policies behind Rule 23 and *American Pipe* would not be served, and in fact would be disserved, by guaranteeing a separate suit at the same time that a class action is ongoing.").

[26] *China Agritech*, 138 S. Ct. at 1811.

[27] *Erica P. John Fund, Inc. v. Halliburton Co. (Halliburton I)*, 563 U.S. 804, 810 (2011).

[28] *Id.*

The Supreme Court has discussed the *Basic* presumption at length, including last month in its decision in *Goldman Sachs Group, Inc. v. Arkansas Teacher Retirement System*.[29] By now, it is well settled that a plaintiff may invoke the *Basic* presumption by proving "(1) that the alleged misrepresentation was publicly known; (2) that it was material; (3) that the stock traded in an efficient market; and (4) that the plaintiff traded the stock between the time the misrepresentation was made and when the truth was revealed."[30] It is equally well settled that a defendant may rebut the presumption by proving, by a preponderance of the evidence, "that an alleged misrepresentation did not actually affect the market price of the stock."[31] However, if any of the predicate elements of the presumption are not satisfied, the plaintiff must prove "direct reliance" in a traditional manner—a requirement often fatal in class actions.[32] In practice, this means that, absent an established efficient market for the subject security (*e.g.*, trading on the New York Stock Exchange or NASDAQ), it is exceedingly difficult for plaintiffs to recover in Section 10(b) cases.

The only practical alternative way to establish reliance before trial is the *Affiliated Ute* presumption applicable to "omissions." Decided by the Supreme Court in 1972, *Affiliated Ute* involved claims that bank employees violated Section 10(b) by inducing members of the Ute Tribe to dispose of stock without disclosing that the employees were market makers who stood to profit from the sales. The Supreme Court held that, in such circumstances "involving primarily a failure to disclose," a plaintiff is not required to present "positive proof" of reliance, an element of a Section 10(b) claim.[33] Rather, "[a]ll that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision."[34] The rationale for the presumption, as construed by some courts and commentators, is that in cases like *Affiliated Ute*

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[29] 141 S. Ct. 1951 (2021). For a complete discussion of the *Goldman* decision, see our memo *Goldman Sachs Group, Inc. v. Arkansas Teacher Retirement System: Supreme Court Vacates Class Certification Order in Decade-Long Class Action, Clarifying That Courts May Consider the Materiality of Alleged Misstatements in Applying Fraud-on-the-Market Presumption* (June 30, 2021), https://www.cadwalader.com/resources/clients-friends-memos/goldman-sachs-group-inc-v-arkansas-teacher-retirement-system-supreme-court-vacates-class-certification-order-in-decade-long-class-action.

[30] *Goldman*, 141 S. Ct. at 1958.

[31] *Id.* at 1959 (quoting *Halliburton Co. v. Erica P. John Fund, Inc. (Halliburton II)*, 573 U.S. 258, 284 (2014)).

[32] *See Halliburton I*, 563 U.S. at 810 ("[R]equiring proof of individualized reliance from each member of the proposed plaintiff class effectively would prevent such plaintiffs from proceeding with a class action, since individual issues would overwhelm [ ] the common ones.") (citation, internal quotation marks omitted).

[33] *Affiliated Ute*, 406 U.S. at 153.

[34] *Id.* at 153-54. Like the *Basic* presumption, courts have recognized that the *Affiliated Ute* presumption may be rebutted where the defendant proves "by a preponderance of the evidence that the plaintiff did not rely on the omission [at issue] in making his investment decision." *Waggoner v. Barclays PLC*, 875 F.3d 79, 102 (2d Cir. 2017) (citation, quotation marks omitted); *see also Greening v. Litton Indus. Automation Sys., Inc.*, 53 F.3d 331 (Table), 1995 WL 94743, at *2 (6th Cir. Mar. 6, 1995) ("[T]his presumption is rebuttable upon a showing that plaintiff's decision would have been no different had the material fact been disclosed.").

where "no positive statements exist," "reliance as a practical matter is impossible to prove."[35] The Supreme Court, however, has offered scant further guidance on the presumption in nearly 50 years since its decision.

*Volkswagen* arose from allegations that the company concealed from regulators emissions of Nitrogen Oxides (NOx)[36] on diesel automobiles that exceeded lawful/regulatory limits by cheating on emissions tests through the use of "defeat devices" on vehicles. On September 18, 2015, the EPA and California Air Resources Board issued notices of violation relating to the practice. Alleging that Volkswagen bonds then dropped below par value, the plaintiff, a public pension fund, filed a putative class action in the Northern District of California asserting claims for violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 thereunder. According to plaintiff, the offering memorandum for the bonds contained "numerous materially false and misleading statements and omissions" suggesting that Volkswagen was "environmentally friendly" and compliant with emissions regulations, when in fact the defeat devices concealed NOx emissions over 40 times in excess of legal limits. The defendants eventually moved for summary judgment, arguing that plaintiff failed to offer proof that it had relied on the alleged misrepresentations in acquiring the bonds. The district court (Hon. Charles R. Breyer) rejected the argument, holding that because "the heart of the case" was an omission—failure to disclose use of the defeat devices—the *Affiliated Ute* presumption applied; therefore, plaintiff did not have to prove reliance for its claims to survive.[37] Defendants appealed.[38]

### B. The Ninth Circuit's Decision

A divided panel of the Ninth Circuit reversed.[39] Reviewing *Affiliated Ute* and subsequent Ninth Circuit precedent, the majority explained that the *Affiliated Ute* presumption is "narrow" in scope: it exists because "reliance is impossible or impractical to prove when no positive statements were

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[35] *Wilson v. Comtech Telecommc'ns Corp.*, 648 F.2d 88, 93 (2d Cir. 1981) (citing 3 A. Bromberg & L. Lowenfels, Securities Fraud & Commodities Fraud § 8.6(1), at 209 ("In nondisclosure cases, reliance has little if any rational role")).

[36] "Nitrogen Oxides are a family of poisonous, highly reactive gases. These gases form when fuel is burned at high temperatures. NOx pollution is emitted by automobiles, trucks and various non-road vehicles (*e.g.*, construction equipment, boats, etc.) as well as industrial sources such as power plants, industrial boilers, cement kilns, and turbines." EPA, Nitrogen Oxides (NOx) Control Regulations, https://www3.epa.gov/region1/airquality/nox.html.

[37] *In re Volkswagen "Clean Diesel" Mktg., Sales Practices, & Prods. Liab. Litig.*, MDL 2672 CRB (JSC), 2019 WL 4727338, at *1 (N.D. Cal. Sept. 26, 2019).

[38] In a previous round of briefing, defendants had successfully argued that the *Basic* presumption did not apply because plaintiff acquired the subject bonds in a Rule 144A private placement—not an efficient market. *See In re Volkswagen "Clean Diesel" Mktg., Sales Pracs., & Prod. Liab. Litig.*, MDL 2672 CRB (JSC), 2018 WL 1142884, at *7 (N.D. Cal. Mar. 2, 2018). Although plaintiff argued in favor of the *Basic* presumption on appeal, the Ninth Circuit did not squarely address the issue.

[39] The majority consisted of Circuit Judge Milan D. Smith, Jr., and Judge Jane A. Restani of the U.S. Court of International Trade, sitting by designation.

made."[40] A court, therefore, should apply the presumption only where plaintiff has the nearly impossible task of proving a "speculative negative," *i.e.*, "that the plaintiff relied on what was not said."[41] According to the majority, that was not the situation in this case, since plaintiff alleged numerous affirmative misrepresentations—*e.g.*, that Volkswagen's "top priority . . . was to develop engines . . . to reduce emissions"—and, notably, that plaintiff "reviewed and relied upon" those affirmative statements.[42] Although plaintiff alleged that the statements were misleading due to Volkswagen's failure to disclose the defeat devices, that was "simply the inverse" of the alleged affirmative representations. As the majority explained, "[a]ll misrepresentations are also nondisclosures, at least to the extent that there is a failure to disclose which facts in the representation are not true."[43] To apply the presumption here, in effect, would open the door to the presumption in all Section 10(b) cases, allowing "the exception [to] swallow the rule."[44]

Contending that the majority's decision "narrow[ed] drastically the availability of the *Affiliated Ute* presumption of reliance,"[45] Judge J. Clifford Wallace dissented. Judge Wallace opined that the presumption should apply not only where "*no positive statements* are made," but also in "mixed cases," such as this one, alleging that omissions of material fact caused affirmative misstatements to be misleading.[46] Otherwise, recovery would be denied to the many investors who purchase securities—not in reliance on an issuer's public statements—but on the "supposition that the market price is validly set and that no unsuspected manipulation has artificially inflated the price, and thus indirectly on the truth of the representations underlying the stock price."[47] That, in Judge Wallace's view, would conflict with the goal of the securities laws "to foster an expectation that securities markets are free from fraud[,] an expectation on which purchasers should be able to rely."[48] Although recognizing that plaintiff's bond purchases did not occur in an open market (and thus, implicitly, that the *Basic* presumption did not apply), Judge Wallace believed that these considerations applied equally in this case: defendants' failure to disclose use of the defeat devices was "clearly material," and "a bond purchaser would not take on the significant risk of purchasing corporate debt from a business that is deceiving government regulators worldwide and

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[40] *Volkswagen*, 2021 WL 2621171, at *5 (citing *Blackie v. Barrack*, 524 F.2d 891, 907-08 (9th Cir. 1975)).

[41] *Id.* (quoting *Binder v. Gillespie*, 184 F.3d 1059, 1064 (9th Cir. 1999)).

[42] *Id.* at *7.

[43] *Id.* at *8 (quoting *Little v. First Cal. Co.*, 532 F.2d 1302, 1304 n.4 (9th Cir. 1976)).

[44] *Id.*

[45] *Id.* at *12 (Wallace, J., dissenting).

[46] *Id.* at *8, 10 (emphasis in original).

[47] *Id.* at *10 (quoting *Blackie*, 524 F.2d at 907).

[48] *Id.* (quoting *Blackie*, 524 F.2d at 907).

would be penalized when discovered."[49] Accordingly, Judge Wallace would have applied the presumption here.

### C. Implications

If the dissent's criticism of *Volkswagen* is correct—that it unduly restricts the *Affiliated Ute* presumption to "pure omissions" cases—the decision will substantially constrain plaintiffs' ability to establish reliance in Section 10(b) cases. A "pure omissions" case is relatively rare, since there is generally no duty to speak absent an express obligation under a statute or regulation or fiduciary-type relationship.[50] A more common scenario is a "mixed" case involving both affirmative misstatements and omissions, since issuers have an "ongoing duty to avoid rendering existing statements misleading by failing to disclose material facts."[51] Absent the *Affiliated Ute* presumption in such cases, defendants would have substantial ammunition to defeat certification since plaintiffs would be left with only two avenues for recovering on a Section 10(b) claim: (i) establishing the predicate components of the *Basic* presumption, *i.e.*, "publicity, materiality, market efficiency, and market timing,"[52] or (ii) proving "direct reliance," *i.e.*, that they were "aware of the defendant's statement and thereafter engaged in a relevant transaction, such as purchasing stock"—a difficult task.[53] Moreover, absent a presumption of reliance, it is "usually impossible" to achieve class certification in a securities fraud case "because reliance would have to be proven on a plaintiff-by-plaintiff basis."[54]

Nevertheless, the landscape for application of *Affiliated Ute* is far from uniform. Even the *Volkswagen* Court recognized that the presumption applies in cases "that *primarily* allege omissions."[55] The *Volkswagen* Court thus joined the Second, Fifth, Tenth, Eleventh, and D.C. Circuits in adopting a flexible (and vague) rule that requires a court to analytically characterize a

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[49] *Id.*

[50] "[A]n omission is actionable under the securities laws only when the corporation is subject to a duty to disclose the omitted facts." *In re Time Warner Inc. Sec. Litig.*, 9 F.3d 259, 267 (2d Cir. 1993); *see also Basic Inc. v. Levinson*, 485 U.S. 224, 239 n.17 (1988) ("To be actionable, . . . a statement must also be misleading. Silence, absent a duty to disclose, is not misleading under Rule 10b-5."). A duty to disclose may arise, however, (i) "expressly pursuant to an independent statute or regulation," *Thesling v. Bioenvision, Inc.*, 374 F. App'x 141, 143 (2d Cir. 2010), or (ii) where there is a fiduciary-type "relationship of trust and confidence" such as between shareholders and corporate insiders privy to confidential information. *Chiarella v. United States*, 445 U.S. 222, 230 (1980).

[51] *Thesling*, 374 F. App'x at 143; *see also Winer Fam. Tr. v. Queen*, 503 F.3d 319, 329 (3d Cir. 2007) ("As a general matter, an affirmative duty arises only when there is insider trading, a statute requiring disclosure, or an inaccurate, incomplete, or misleading prior disclosure.").

[52] *Halliburton II*, 573 U.S. at 276.

[53] *Brown v. China Integrated Energy Inc.*, CV 11-02559 BRO (PLAx), 2014 WL 12576643, at *4 (C.D. Cal. Aug. 4, 2014) (citing *Halliburton I*, 563 U.S. at 810).

[54] *Waggoner*, 875 F.3d at 95.

[55] *Volkswagen*, 2021 WL 2621171, at *4, 7 (emphasis added).

case as "primarily" involving omissions before applying the *Affiliated Ute* presumption.[56] In contrast, the Fourth Circuit has articulated a bright-line rule—no *Affiliated Ute* presumption "when the plaintiff alleges both nondisclosure and positive misrepresentation instead of only nondisclosure"[57]—while the Third Circuit has contemplated applying the presumption broadly to both "pure" omissions and "true but misleading statements" or "half-truths."[58]

A critical question moving forward, then, is the line between a case that "primarily" alleges omissions and one that does not. The *Volkswagen* Court, however, did not articulate a clear basis for differentiating between the two, nor did it state that *any* allegation of an affirmative misstatement necessarily would defeat the presumption in any case. Moreover, defendants may be successful in limiting the application of *Volkswagen* and distinguishing it from other "mixed" cases, given that plaintiff there not only alleged "more than nine pages of affirmative misrepresentations" but also—in emphasis supplied by the Court—that those misrepresentations were "*relied upon* by Plaintiff and its investment advisor."[59] Thus, although a win for Section 10(b) defendants, it remains to be seen how courts continue to develop the *Affiliated Ute* presumption going forward.

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[56] *See Waggoner*, 875 F.3d at 96; *Regents of Univ. of Cal. v. Credit Suisse First Boston (USA), Inc.*, 482 F.3d 372, 384 (5th Cir. 2007); *Joseph v. Wiles*, 223 F.3d 1155, 1162 (10th Cir. 2000); *Cavalier Carpets, Inc. v. Caylor*, 746 F.2d 749, 756 (11th Cir. 1984); *In re Interbank Funding Corp. Sec. Litig.*, 629 F.3d 213, 219-20 (D.C. Cir. 2010).

[57] *Cox v. Collins*, 7 F.3d 394, 396 (4th Cir. 1993).

[58] *Hoxworth v. Blinder, Robinson & Co.*, 903 F.2d 186, 202 (3d Cir. 1990).

[59] *Volkswagen*, 2021 WL 2621171, at *5 (emphasis in original).