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Revisiting Affiliated Ute: Back In Vogue In The 9th Circ.

By **Michele Johnson and Colleen Smith**

Law360, New York (May 23, 2017, 1:04 PM EDT) -- Last month marked 45 years since the U.S. Supreme Court's ruling in Affiliated Ute Citizens of Utah v. United States, which established a rebuttable presumption of reliance for securities fraud claims based on omissions of material fact. This Expert Analysis special series explores the decision's progeny in the Supreme Court and various circuits.

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Forty-five years ago, in Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128 (1972), the U.S. Supreme Court grappled with the particular difficulties of proving reliance, a necessary element of a Section 10(b) securities fraud claim, where a plaintiff bases his claim not on a false statement but rather on a defendant's silence.[1] How can an investor rely on something that was not said? Addressing this burden, the court in Affiliated Ute created a limited presumption of reliance in cases that challenge primarily a failure to disclose, rather than an affirmative false statement. This presumption arises where (1) the defendant had a duty to disclose facts but did not, and (2) the withheld facts are material, such that a reasonable investor might have considered them important in deciding whether to trade.[2]

After Affiliated Ute, courts were charged with determining when to apply the presumption. When do a plaintiff's claims involve "primarily" a failure to disclose, as opposed to an affirmative misrepresentation? As the lower courts quickly recognized, making this distinction is not straightforward, as nearly all allegations of fraud encompass some degree of concealment.[3] Indeed, where a statement is purportedly materially misleading because it is incomplete, it often seems reasonable to characterize the statement either as a misrepresentation or as containing an omission.[4]

Consider the following example: a plaintiff alleges that a company's statement that it was profitable, made in its publicly filed annual report, was false and misleading because the company failed to report that it had not established adequate inventory reserves — and if it had done so, the company would have reported a loss. Has the plaintiff alleged a misrepresentation (that the company's statement of its profitability was false), or rather, an omission (that the company failed to disclose its lack of adequate

reserves, which if taken would have rendered the period unprofitable)?

In Blackie v. Barrack, 524 F.2d 891 (9th Cir. 1975), the Ninth Circuit's first decision applying Affiliated Ute, the court held that these allegations properly constituted an omissions claim. The court cast the plaintiff's claim as primarily an alleged omission by focusing on what was not disclosed — the facts regarding the need for reserves — rather than on the allegedly misleading financial figures. Accordingly, the court found that the plaintiffs were entitled to the Affiliated Ute presumption of reliance.[5] Following the Ninth Circuit's Blackie decision, several district courts within the Ninth Circuit applied the Affiliated Ute presumption to similar types of claims.[6]

The Affiliated Ute Presumption Loses Popularity as the Supreme Court Embraces the Fraud-on-the-Market Presumption of Reliance and the Ninth Circuit Limits the Applicability of Affiliated Ute

In 1988, in Basic Inc. v. Levinson, 485 U.S. 224 (1988), the Supreme Court once again addressed the burden of the plaintiff in a private securities fraud action to establish the element of reliance — this time in a case challenging alleged affirmative misrepresentations. In Basic, the court adopted the fraud-on-the-market presumption of reliance, which assumes that in an impersonal public market, investors rely on the integrity of the share price in making their investment decisions. Because shares traded on well-developed markets reflect all publicly available information, the court held, the market price necessarily reflects any material misrepresentations. Thus, investors' reliance on affirmative misrepresentation is presumed.[7]

After Basic, securities fraud plaintiffs widely sought to invoke the fraud-on-the-market presumption to prove reliance by seeking to demonstrate that the relevant securities traded in an efficient market. As more plaintiffs embraced the fraud-on-the-market presumption, the Affiliated Ute presumption fell, relatively speaking, out of frequent use.

Moreover, the generous reading of Affiliated Ute adopted in Blackie was later narrowed by the Ninth Circuit's Binder v. Gillespie, 184 F.3d 1059 (9th Cir. 1999) decision, further hampering the application of that presumption. In Binder, the Ninth Circuit considered whether the Affiliated Ute presumption can apply in a case involving misrepresentations, or at least in cases alleging both omissions and misrepresentations (generally referred to as "mixed" cases). The court held that it could not. The Affiliated Ute presumption should be applied, the court held, only where it would be difficult for a plaintiff to prove that he relied upon something the defendant did not say — a nod to the difficulty of proving a "speculative negative" that drove the Supreme Court's Affiliated Ute decision in the first place. This difficulty is not present where the plaintiff alleges a misstatement. [8] As other Ninth Circuit opinions have since clarified, an allegation that a defendant's statement was misleading because it failed to disclose material facts is not sufficient to trigger the Affiliated Ute presumption of reliance applicable to material omissions.[9]

Following Binder, district courts within the Ninth Circuit have applied the Affiliated Ute presumption to claims that allege silence in the face of an affirmative duty to speak, and not to claims that are based on an affirmatively misleading statement or a statement that is rendered misleading by what it does not disclose.[10] Some district courts have been willing, however, to apply the Affiliated Ute presumption in cases involving a "half-truth" — an affirmative statement that is materially misleading because the defendant failed to make an additional disclosure — reasoning that a half-truth involves primarily, even if not exclusively, an omission because the plaintiff's grievance is that the defendant withheld material facts.[11]

The Halliburton II Decision May Invite Omissions Claims, and May Compel the Ninth Circuit to Reconsider the Proper Scope and Application of Affiliated Ute

Despite these hurdles, the Affiliated Ute presumption may yet come back into fashion. In the Supreme Court's recent landmark ruling in Halliburton Co. v. Erica P. John Fund Inc., 134 S. Ct. 2398 (2014) ("Halliburton II"), the court opened the door for defendants to rebut the fraud-on-the-market presumption by demonstrating that an alleged misrepresentation did not impact the stock price.[12] Recognizing the possibility that the fraud-on-the-market presumption may be rebutted in cases alleging affirmatively misleading statements, enterprising plaintiffs may more frequently attempt to frame their claims under an omissions theory, or (to hedge their bets) to pursue both omission and misstatement claims, in an effort to invoke the less rebuttable Affiliated Ute presumption.

The Ninth Circuit has not yet had occasion to address the Affiliated Ute presumption of reliance since the Supreme Court's 2014 Halliburton II decision. And while there are still very few district court decisions within the Ninth Circuit to have analyzed the relationship between the Affiliated Ute and the fraud-on-the-market presumptions of reliance since Halliburton II, plaintiffs are increasingly attempting to plead both theories, as demonstrated by several recent decisions. Where both presumptions are potentially in play, courts have generally presumed reliance under the fraud-on-the-market presumption, and have either found it unnecessary to consider Affiliated Ute[13] or concluded that it does not apply.[14]

At least one recent district court opinion has applied both presumptions. In In re Montage Technology Group, the plaintiffs alleged that the defendant-company's public filings stated that it had transacted with an independent distributor, where instead it had transacted with a related party.[15] The defendants argued that the Affiliated Ute presumption was inapplicable because the allegations challenged an affirmative misstatement (that the company transacted with an independent party), and thus, the plaintiffs' claims were mixed at best. The court disagreed, holding that this "wrangling about words" could apply to most omission cases, and reasoning that because the company had an obligation to disclose its dealings with a related party, the plaintiffs pled an omissions case. Thus, Affiliated Ute applied. The court then also found that the plaintiffs were entitled to invoke the fraud-on-the-market presumption of reliance because the company's stock traded in an efficient market.

Thus far, the Montage decision appears to be an outlier. Other district courts have declined to invoke both presumptions of reliance, and in cases involving factual allegations similar to those in Montage, courts have held that Affiliated Ute does not apply. For instance, in Loritz v. Exide Technologies Inc., the plaintiffs alleged that the defendant-company's publicly filed annual report disclosing that it was complying with environmental requirements was false and misleading because the company omitted to disclose that regulators had noted major environmental compliance deficiencies. The court found that Affiliated Ute was not applicable, because the plaintiffs were alleging not that they relied upon the company's silence, but instead that the company made affirmative misstatements about environmental and regulatory issues. Thus, unlike in Montage, the court held that the plaintiffs had not pled primarily an omissions case.[16]

The Montage and Exide decisions highlight the difficulty of distinguishing between omissions and misrepresentations. Given the inconsistency in courts' opinions about the applicability of Affiliated Ute, and in light of Halliburton II, securities class action plaintiffs may become emboldened to attempt to invoke the Affiliated Ute presumption by styling a claim as an omission rather than as a misstatement rendered misleading for failing to disclose the same omitted facts.

* * *

For the moment, the scope of the Affiliated Ute presumption of reliance remains fairly narrow in the Ninth Circuit, and is limited to claims that plead primarily an omissions theory, as opposed to claims asserting affirmative misrepresentations. That said, determining whether a case involves primarily omissions remains difficult, and, indeed, courts within the Ninth Circuit have come to differing conclusions. This ambiguity leaves room for plaintiffs seeking to avoid the rebuttable Basic/Halliburton II fraud-on-the-market presumption to attempt to cast their claims as primarily involving omissions — when perhaps their allegations do not squarely fit within that category.

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[1] See 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b–5; Affiliated Ute, 406 U.S. at 152–54.

[2] See Affiliated Ute, 406 U.S. at 151–54. The duty to disclose "arises from a specific relationship between two parties." Chiarella v. United States, 445 U.S. 222, 227–31, 233 (1980); accord SEC v. Talbot, 530 F.3d 1085, 1091 (9th Cir. 2008).

[3] See, e.g., Desai v. Deutsche Bank Sec. Ltd., 573 F.3d 931, 940–41 (9th Cir. 2009); Little v. First Cal. Co., 532 F.2d 1302, 1304 n.4 (9th Cir. 1976); see also Loritz v. Exide Techs., No. 2:13-cv-02607-SVW-E, 2015 WL 6790247, at *20 (N.D. Cal., July 21, 2016).

[4] See Little, 532 F.2d at 1304 n.4.

[5] Blackie, 524 F.2d at 905-06.

[6] See, e.g., In re United Energy Corp. Solar Power Modules Tax Shelter Inv. Sec. Litig., 122 F.R.D. 251, 254-55 (C.D. Cal. 1988); Weinberger v. Jackson, 102 F.R.D. 839, 846 (N.D. Cal. 1984); Beebe v. Pac. Realty Trust, 99 F.R.D. 60, 69-70 (D. Or. 1983); but see Lubin v. Sybedon Corp., 688 F. Supp. 1425, 1447 (S.D. Cal. 1988) (declining to apply Affiliated Ute in a "mixed case" involving both omissions and misrepresentations).

[7] See Basic, 485 U.S. at 245-46.

[8] Binder, 184 F.3d at 1063-65.

[9] See Poulos v. Caesars World Inc., 379 F.3d 654, 667 (9th Cir. 2004).

[10] See, e.g., Anderson v. McGrath, No. CV-11-01175-PHX-DGC, 2013 WL 1249154, at *6 (D. Ariz. Mar. 26, 2013) (dismissing complaint and finding presumption inapplicable where complaint alleged "numerous misrepresentations"); In re Allstate Life Ins. Co. Litig., Nos. CV-09-8162-PCT-GMS, CV-09-8174-PCT-GMS, 2011 WL 6012985, at *2–4 (D. Ariz. Dec. 2, 2011) (denying class certification, and finding presumption inapplicable to mixed claims where "the omission was simply a means of concealing the inflated projections which constituted the affirmative misstatements"); George v. Cal. Infrastructure & Econ. Dev. Bank, No. 2:09-cv-01610-GEB-DAD, 2010 WL 2383520, at *6–9 (E.D. Cal. June 10, 2010) (dismissing complaint and finding presumption inapplicable where plaintiff neither "argued, nor demonstrated" that the mixed case primarily alleged omissions); McPhail v. First Command Fin. Planning Inc., 247 F.R.D. 598, 602–03, 613–14 (S.D. Cal. 2007) (finding presumption inapplicable where alleged omissions were premised on failure to disclose facts necessary to make representations not misleading, but certifying class in part on other grounds).

[11] See, e.g., Kreek v. Wells Fargo & Co., 652 F. Supp. 2d 1053, 1056, 1063 (N.D. Cal. 2009) (denying motion to dismiss and applying presumption because alleged omissions relating to secret revenue-sharing agreements resulted in "half truths" in prospectus disclosures); Siemers v. Wells Fargo & Co., No. C 05-04518 WHA, 2006 WL 2355411, at *10–11 (N.D. Cal. Aug. 14, 2006) (denying motion to dismiss in part, and applying presumption to mixed claims where alleged omissions rendered affirmative statements misleading and "result[ed] in half truths").

[12] Halliburton II, 134 S. Ct. at 2417; see, e.g., IBEW Local 98 Pension Fund v. Best Buy Co., 818 F.3d 775, 782 (8th Cir. 2016) (holding that defendants adequately rebutted the fraud-on-the-market presumption by showing that the alleged misstatements had no stock price impact).

[13] See, e.g., In re Intuitive Surgical Sec. Litig., No. 5:13-cv-01920-EJD, 2016 WL 7425926, at *10 n.11 (N.D. Cal. Dec. 22, 2016).

[14] Exide, 2015 WL 6790247, at *15, *20–21 (certifying class in part based on fraud-on-the-market presumption, and refusing to apply Affiliated Ute where alleged omitted facts rendered affirmative statements misleading).

[15] In re Montage Tech. Grp. Ltd. Sec. Litig., No. 14-cv-00722-SI, 2016 WL 1598666, at *1, *6–7 (N.D. Cal. Apr. 21, 2016).

[16] Exide, 2015 WL 6790247, at *20–21.
