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PLUS
PROFESSIONAL LIABILITY UNDERWRITING SOCIETY
Journal
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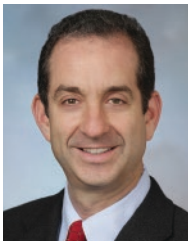

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Emerging Issues in Challenging the *Basic* Presumption of Reliance

by David H. Topol & Jennifer A. Williams

Securities class action cases involve a number of complex legal questions, and one of the issues litigated frequently in recent years has been how plaintiffs can establish at the class certification stage that the entire proposed class relied on the defendants' misrepresentations, such that common factual and legal issues predominate over individualized ones, as required by Federal Rule of Civil Procedure 23. This issue has come to the forefront recently as lower courts interpret and implement the Supreme Court's 2014 decision in *Halliburton Co. v. Erica P. John Fund, Inc.* (*Halliburton II*).[1]

Section 10(b) of the Securities Exchange Act of 1934 and corresponding SEC Rule 10b-5 prohibit the making of any material misstatement or omission in connection with the purchase or sale of any security. Although Section 10(b) itself does not expressly create a private cause of action, the courts have long recognized an implied private cause of action to enforce these provisions. To recover damages for violations of Section 10(b) and Rule 10b-5, a plaintiff must prove: (1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation.[2]

Because almost all Section 10(b) cases are pursued as class actions, much of the case law in this subject area involves the overlay of the requirements for class certification on these elements of proof. Federal Rule of Civil Procedure 23 requires a plaintiff seeking to certify a class to plead and prove: (1) the class is so numerous that joinder of all members is impractical (numerosity); (2) there are questions of law or fact common to the class (commonality); (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class (typicality); (4) the representative parties will adequately protect the interests of the class (adequacy of representation); and (5) at least one of the requirements in Rule 23(b)— most frequently in securities actions that common questions of law or fact predominate, and a class action is superior to individual actions.

The requirements of commonality and the predominance of those common issues are where the heart of the battle over class certification in many Section 10(b) cases lies, and one of the most litigated issues recently has been how plaintiffs may demonstrate that the necessary 10(b) element of reliance on a defendant's misrepresentation is common to the class, and thus that common issues of law and fact predominate. Reliance intuitively can seem like an individualized issue—did a particular plaintiff see or hear the defendant's misrepresentation, believe that misrepresentation, and in reliance make a decision to buy or keep his or her shares of the company? However, economics gives us the theory of fraud-on-the-market—that is, the price of a

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Congratulations to 2016 PLUS Award Recipients!

Founders Award

The Founders Award recognizes a member of PLUS who has made lasting and outstanding contributions to the Society. The Award is presented in honor of PLUS Founder Angelo J. Gioia. Criteria used when selecting the Founders Award recipient include membership in PLUS, participation in PLUS activities, creativity and innovation when needed to address PLUS tasks, amount of time and effort dedicated to the organization, promotion of PLUS in the industry and to the public in general, or other contributions to the image of PLUS, and involvement in developing, implementing, improving and/or continuing PLUS programs.

The recipient of the 2016 Founders Award is...

Phil N. Norton, PhD - President, Professional Liability Division,
Arthur J. Gallagher Risk Managment Services Inc.

Phil Norton is the Vice Chairman of the Midwest Region for Arthur J. Gallagher & Co. as well as a National Managing Director for the Management Liability Practice of Gallagher. His responsibilities include leadership for all specialty insurance placements and related risk management consulting. Phil is widely regarded as one of the world's leading authorities on Directors and Officers Liability (D&O), Fiduciary Liability and Employment Practices Liability (EPL), having published and spoken on these subjects throughout the United States, Canada, United Kingdom, Switzerland, Mexico, Bermuda, Japan, China and Germany. Dr. Norton has more than twenty-five years of experience in the insurance industry, consulting with corporations of all sizes on D&O, M&A products, Cyber and other financial risk programs. He currently focuses on consulting and placement activities for select clients.

PLUS1 Award

The PLUS1 Award is presented to a person whose efforts have contributed substantially to the advancement and image of the professional liability industry. Criteria used when selecting the PLUS1 Award winner include reputation and success in the professional liability industry, history of lectures and service on panels addressing topics in the industry, current activity in professional liability, activity and involvement in PLUS, longevity in the insurance industry, and measure of impact on the professional liability industry.

The recipient of the 2016 PLUS1 Award is...

John Q. Doyle, President, *Marsh*

Mr. Doyle oversees Marsh's core brokerage business in its six global regions, along with Global Sales, Global Clients and Marsh & McLennan Agency. Prior to joining Marsh in April 2016, Mr. Doyle was Chief Executive Officer for AIG's commercial insurance businesses worldwide with responsibility for AIG's property, casualty, financial lines, specialty lines, institutional markets and mortgage guaranty products and services. Mr. Doyle began his career at AIG in 1986 and held several senior executive positions in management and professional liability, excess casualty, workers' compensation and field management within AIG's domestic commercial property and casualty companies, and he also served as President and Chief Executive Officer of Chartis U.S.

See pg.15 for a list of past Founders Award and PLUS1 Award winners.

Discovering FitBit: How Wearable Tech May Impact Litigation

by Seth L. Laver, Esq. & Timothy M. Gondek, Esq.

Seth L. Laver *is a partner and* **Timothy M. Gondek** *is an associate at Goldberg Segalla LLP. Seth defends attorneys, accountants and other professionals in malpractice matters and provides pre-suit risk consultation. Tim focuses his practice on defending professionals against claims of malpractice and negligence.*

Big Brother is watching, no, counting: every step, every calorie consumed, even sleep patterns are monitored and tracked. This is not a conspiracy theory or a paranoid concern, but rather the byproduct of a new fitness renaissance. Trendy fitness programs such as CrossFit, Zumba, and SoulCycle abound, while many others stick with traditional exercise routines like running, swimming, or biking. Workouts and personal records are celebrated on blogs and social media. The apparent surge in fitness enthusiasm has brought with it a flood of new products designed to take advantage of the market. Perhaps none are more ubiquitous than wearable fitness trackers. These devices —which can track an astounding array of data—are an excellent resource for fitness enthusiasts or anyone looking to create a healthier lifestyle. However, the demand for wearable technology designed to track vital information may also prove crucially important to the manner in which we collect information to be used in litigation.

A decade ago, few could have predicted the impact of social media, let alone how it would change litigation. Who would have guessed that a plaintiff would voluntarily publish her innermost secrets and unsolicited thoughts in a public forum? Who could have imagined that an employee would be subject to termination for posting a photo of his weekend getaway? Many litigators were left either salivating or panicked over the possibilities afforded by a relatively easy glimpse into the otherwise private lives of litigants—lives that previously were nearly impossible to observe firsthand. Few transformations have affected litigation and litigators as swiftly and profoundly as social media.[1] Since social media changed the way people connect, conduct business and communicate, litigators modified their discovery practices in an effort to collect from this treasure trove of data. For years, a focus of many continuing education courses and seminars has been the effective management of the social media content of a client or adversary. Social media's impact on the discovery process is well-documented, but we may be on the verge of a new trend.

Reportedly, Americans are exercising at an increasing rate[2]—and are tracking their results as well. Twelve percent of American consumers own a fitness band or smartwatch of some kind.[3] FitBit is the most popular tracker, nearly doubling its annual sales last year.[4] Initially considered by some to be a niche, current sales of wearable technology suggest that consumers are increasingly gravitating to these tracking devices.[5] The devices monitor various types of information, including fitness level, calories burned, sleep and heart rate monitoring, with particular devices geared toward individual goals or needs. Newer models may include GPS technology, which syncs with the user's e-mail and text functions. Imagine: millions of would-be litigants tracking their every move, both day and night.

Never before has there been such an immediate opportunity to collect unfiltered, daily records of location, level of activity, and general health. In the context of personal injury claims, the vast amount of data collected by these devices could be invaluable to future legal action. Because this practice is so new— he idea of wearing a personal health tracker would have seemed like science fiction even a few years ago—there is an absence of any meaningful legislation addressing the

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SEC Focuses Enforcement on Whistleblower Complaints

by Judy Greenwald

Companies should examine their severance agreements to be sure their confidentiality provisions include a carve-out for whistleblower activity, in light of recent aggressive Securities and Exchange Commission activity in this area.

Recently, the SEC announced enforcement actions against firms that allegedly used severance agreements to waive employees' ability to collect monetary wards if they filed whistleblower complaints with the SEC or other agencies.

Many observers anticipate more such actions as the agency continues to seek to root out severance agreements and other company documents it perceives violate 2011's Rule 21F-17, which implemented the 2010 Dodd-Frank Act's whistleblower provisions.

The SEC's effort in this area parallels similar whistleblower protection activity by other federal agencies, including the National Labor Relations Board and the Occupational Health & Safety Administration.

Whistleblowers who approach the SEC with information that leads to an enforcement action in which more than $1 million in sanctions is ordered can receive awards that range between 10% and 30% of the money collected.

The issue is a challenge for firms that want to balance preventing departing employees from revealing proprietary information to competitors with avoiding SEC scrutiny. Firms may also want to discourage "double-dipping," where an employee seeks to collect a severance, then subsequently an additional SEC bounty.

Experts say it is unclear how many firms have such provisions in their severance agreements, and it is likely there is a continuum ranging from those with vaguely-worded language to others with more explicit anti-whistleblower statements.

The SEC said on Aug. 10 that building products distributor BlueLinx Holdings Inc. would pay a $265,000 penalty to settle charges the Atlanta-based firm's severance agreements required outgoing employees to waive their rights to monetary recovery if they filed charges with the SEC or other federal agencies.

The SEC said the monetary recovery prohibition was added in mid-2013, nearly two years after the agency's 21F-17 implementation.

Then on Aug 16, the agency announced Woodland Hills, California-based Health Net Inc. would pay a $340,000 penalty for requiring outgoing employees to waive their ability to obtain awards from the SEC's whistleblower program.

The agency said while Health Net had removed SEC-specific language from its severance agreements in June, 2013, it had still retained restrictive language until finally striking it in 2015.

Experts point out this was not the first such move by the SEC in this area. In April, 2015 Houston-based global technology and engineering firm KBR Inc. agreed to pay $130,000 to settle SEC charges it had violated Rule 21F-17 by requiring witnesses in certain internal investigations to sign confidentiality agreements that prohibited them from discussing the matter with outside parties without its legal department's prior approval.

Meanwhile, the agency has continued to stress its whistleblower program, with the agency announcing on Aug. 30 that its whistleblower awards had surpassed $100 million.

"The SEC has made it clear it's going to take actions to prevent companies from taking steps to discourage whistleblowing even if there's no evidence" the company has actually discouraged any such activity, said Kevin LaCroix, executive vice president of RT ProExec, a division of R-T Specialty L.L.C. in Beachwood, Ohio.

The SEC wants to avoid having possible whistleblowers tied up with severance or other agreements to the point where the whistleblower program is unstainable over the long run, said Sean X. McKessey, former chief of the SEC's whistleblower office who joined Washington, D.C.-based Phillips & Cohen L.L.P., which specializes in representing whistleblowers, in September.

The SEC's activity reflects a public policy shift, said Earl "Chip" Jones III, co-chair of the whistleblowing and corporate ethics practice group at Littler Mendelson P.C. in Dallas.

With Dodd-Frank's enactment, "public policy has shifted from, 'We trust you to self-regulate' to, 'We no longer trust you to self-regulate. We need to have a way for employees to come forward'" and report problems, said Mr. Jones.

It "is consistent with pressure they've gotten from (plaintiff) law firms and whistleblowers themselves in terms of getting those types of payments processed quicker," said Richard J. L. Lumuscio, a partner with Drinker Biddle & Reath L.L.P. in New York.

But, these severance agreements provisions "have a very legitimate purpose, which is to try to protect confidential information," said Gregory Keating, group practice leader with Choate, Hall & Stewart L.L.P. in Boston.

"A number of employers are getting caught up in this unfortunate frenzy and focus, when the agreements never were intended to muzzle anyone," he said.

One of the problems from the business community's perspective is that investigating a whistleblower claim involves a "fair amount of expense," said Michael E. Clark, special counsel

with Duane Morris L.L.P. in Houston.

'Obviously, if there's a problem that's money well spent." But if the claim is frivolous "there's no financial downside" for the whistleblower. It is a matter of "trying to find a happy medium," Mr. Clark said.

Mr. McKessey said the SEC recognizes companies' legitimate need to have confidentiality provisions and protect trade secrets. Where companies have fallen afoul, he said, is when they "get a little overaggressive" in targeting a possible report to specific agencies.

"There's a way to thread the needle" and protect companies' legitimate interest "while still maintaining the public policy interest by carving out a provision that says nothing prevents individuals from reporting to the SEC," said Mr. McKessey.

Observers disagree as to the likelihood of additional announcements along the lines of the Health Net and BlueLinx fines. "The word has gone out, and I think the message has been received wide and clear," said Ross A. Albert, a former SEC official who is now a partner at defense firm Morris, Manning & Martin L.L.P. in Atlanta.

Mr. Keating said, however, the SEC is "going to continue to look for areas where they believe employers have gone too far, and I think they're taking an expansive view of it."

One possible area where the SEC may do so is company procedural requirements that whistleblowers first report problems internally before going to the agency, said Mr. LaCroix.

"It wouldn't surprise me if the SEC were to take some type of pre-emptive type of enforcement action on those types of policies," he said.

"My sense is that if the SEC continues to take a really broad view of what they deem to be not acceptable, then many employers' existing agreements need to be changed immediately," said Mr. Keating.

Experts recommend firms closely examine the language in their severance contracts, as well as their nondisclosure and confidentiality agreements and codes of conduct, and, if absent, insert carve-outs that allow for regulatory whistleblowing activity.

"The good news is, these are relatively easy to fix," said Mr. Keating. Firms need only put in additional language "that makes clear that nothing in the agreement precludes them in any way from communicating with a government agency including, the SEC."

"You just have to be wary that if you push the envelope too far that you're going to potentially suffer a regulatory action, and you have to watch the tea leaves and make sure" that any actionable language is changed, Mr. Clark said.

But there are no guarantees, warned Joseph C. Toris, of counsel with Jackson Lewis P.C. in Morristown, New Jersey. "Unless there's some sort of judicially-sanctioned language" there is always going to be a question of interpretation, he said.

"The trick is, there's no sort of SEC-sanctioned language," Mr. Toris said. "It's something employers have to give careful thought and consideration to when they're drafting the language to make sure it's as innocuous as possible from not dissuading employers from going to the Commission."

Rule 21F-17 was introduced in 2011 and here it is 2016, and "we're kind of having to piece together through these administrative orders" what is acceptable, said David Smyth, an attorney with law firm Brooks, Pierce, McLendon, Humphrey & Leonard L.L.P. in Raleigh, North Carolina. "It would be better if there were a clearer roadmap."

Mr. McKessey said, however, the SEC has jurisdiction over tens of thousands of companies, ranging from those with just two employees to others with thousands, and developing language applicable to all is infeasible.

Furthermore, similarly-situated companies have different track records and cultures with some more prone to using language that "skirts the line."

It is also undesirable for the SEC "to be handcuffed by a simple check-the-box" set up, which creates the danger of disclosures becoming routine and "doesn't lend itself to thinking about what (the SEC) is trying to accomplish," said Mr. McKessey.

While companies want a bright line test, regulators want flexibility, he said. That said, looking at the orders in the BlueLinx and Health Net cases, "you can glean certain themes about what the SEC is really interested in," which includes language about not reporting it, Mr. McKessey said.

He also said the SEC will not be "super aggressive" with firms with pre-Rule 21Ff-17 provisions that willingly modify their language.

"I don't think this is overly complicated," he said.

2016 RPLU+ & RPLU Designees

Congratulations to the following industry professionals who achieved their RPLU+ or RPLU Designation in 2016.

For purposes of publishing this list, only those candidates who have qualified for designation through October 10, 2016 are listed.

RPLU+

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Richard Carter, Jr.
Philadelphia Insurance Companies

Jason Crow
Philadelphia Insurance Companies

RIta K. Hale
Travelers Bond & Specialty Insurance

Dingchou Allan Han
Tokio Marine Insurance Singapore Ltd.

Kimberly Karol Kercheval-Lorenz
Scottsdale Insurance Company

Brianna Kohler
Philadelphia Insurance Companies

Natasha Richard
RLI

Nikki Wetzel
Philadelphia Insurance Companies

RPLU

Matthew Anania
Endurance

Jessica Anderson
Medical Protective

Nicole Barna
Markel Global Insurance

Mary E. Beck
McGriff, Seibels & Williams, Inc.

Kimberly Becker
ACE

Stephen D. Bedosky
York International Agency, LLC

Christal Bennett-Govia
Markel

Angie Biancalana
Great American Insurance Company

Neal Bordenave
California State University - Chico

Carissa Bowser
Apogee

Joseph Brizuela
Liberty International Underwriters

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Axis Reinsurance

Christine Callas
RLI Insurance Company

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Starr Companies

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AmWINS Access Insurance Services

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Healthcare Providers Insurance Company

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Ryan Cervasio
McGowan Risk Specialists

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ENCON Group, Inc.

Victoria Chevalier
Professional Risk Management Services, Inc.

David Chuang
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Anthony Vellutato
Gateway Specialty Insurance

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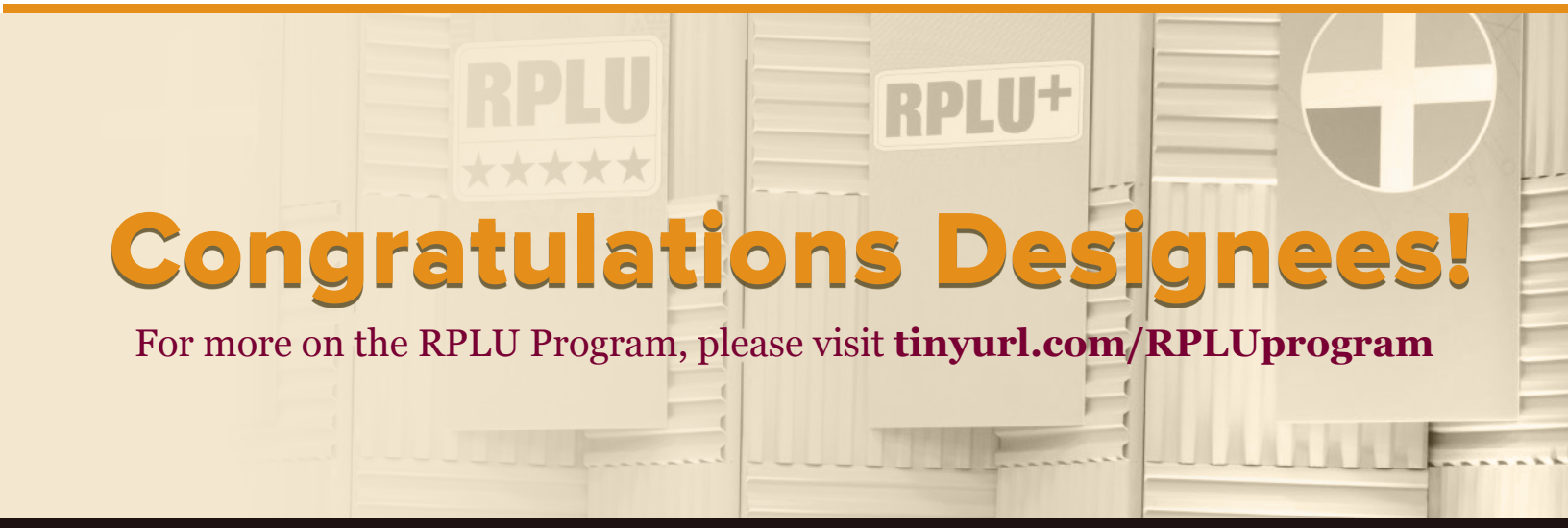
Lloyd's Insurance Company China Limited

Brent Wyse
Intact Insurance Company

Laura R. Zaroski
Socius Insurance

Danny J. Zimmerman
NCMIC

Jeffrey Zomorrodian



Congratulations Designees!

For more on the RPLU Program, please visit **tinyurl.com/RPLUprogram**

the Basic Presumption of Reliance continued from cover

security traded in an efficient market reflects all public, material information, including the alleged misstatements of the defendants. Buyers and sellers of the security rely on the price as an indicator of all of that information.

The Supreme Court adopted this economic theory in *Basic Inc. v. Levinson*[3] and held that securities plaintiffs may invoke a presumption that the entire class relied on the defendant's misrepresentation because that misrepresentation was reflected in the price of the stock. However, the Supreme Court made the presumption rebuttable, allowing defendants to put forth "[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."[4] In securities law shorthand, this is "price impact" evidence—evidence relating to the impact the misrepresentation did or did not have on the price of the security.

The Supreme Court recently reaffirmed the *Basic* rebuttable presumption of reliance in *Halliburton II*, and courts since *Halliburton II* have continued to grapple with how exactly the rebuttable presumption operates. Several cases that are currently on appeal—before the Second and Fifth Circuits—and one just decided by the Second Circuit–highlight some of the key issues that have emerged. We are watching these cases closely because they are likely to provide additional guidance on the viability of the price maintenance theory, the necessary links between corrective disclosures and earlier misrepresentations, and the burdens of proof and persuasion in challenging the *Basic* presumption of reliance on an efficient market. In this article, we identify the issues to be addressed in these upcoming appellate decisions.

Rebutting the Basic Presumption on the Front End: What About a Price Maintenance Theory?

One piece of the puzzle for defendants attempting to rebut the *Basic* presumption with evidence that there was no price impact is a front-end question: Did the defendants' misrepresentation create artificial inflation in the price of the stock? The recent Eighth Circuit decision in *IBEW Local 98 Pension Fund v. Best Buy Co.*,[5] the first appellate case to examine the rebuttable presumption post-*Halliburton II*, illuminates this issue. In *Best Buy*, the plaintiffs alleged that statements in press releases and on a conference call at the start of the class period artificially inflated and maintained Best Buy's publicly traded stock price until the misstatements were disclosed a few months later in conjunction with the disclosure of quarterly earnings. The Eighth Circuit, in a 2-1 decision, held that a class should not have been certified because the defendants, through expert testimony, had demonstrated that the plaintiffs could not link the alleged misstatements to any increase or inflation in the stock price.

The dissent argued that the majority improperly rejected the plaintiffs' "price maintenance" theory, which stands for the proposition that the company had disclosed "confirmatory information…[w]hich fraudulently maintained its stock at a constant price and counteracted expected price declines."[6] Under the price maintenance theory, alleged misstatements can cause loss by maintaining existing price inflation, even if the misstatements did not cause the price inflation in the first place. That is, if the stock price remains steady when it otherwise would have declined, there is inflation present. The dissent also noted that the Seventh and Eleventh Circuits have recognized price maintenance theories to be cognizable under the Exchange Act.[7]

The Second Circuit also recently considered a case that raised the viability of the price maintenance theory. In *In re Vivendi Universal, S.A. Securities Litigation*,[8] the defendants argued that the plaintiffs' expert failed to demonstrate loss causation because he failed to show that any particular alleged misstatement by the defendants was tied to the inflation of the price of Vivendi's stock. The district court in *Vivendi*, like the dissent in *Best Buy*, embraced the plaintiffs' "maintenance" theory of price impact: "The Court … holds that a statement can cause inflation by causing the stock price to be artificially maintained at a level that does not reflect its true value."[9]

The defendants in *Vivendi* argued to the Second Circuit that this price maintenance theory contravenes the Supreme Court's requirement that there must be a direct causal connection between the misrepresentation and the loss, citing *Dura Pharmaceuticals, Inc. v. Broudo*.[10] They also noted that the Supreme Court in *Halliburton II* made clear that an alleged misstatement must "actually affect" stock price.[11] In their opening Second Circuit brief, the defendants argued that "adopting the district court's approach here would make a mockery of *Dura*'s loss-causation requirement. A plaintiff would need only identify an ordinary public statement, point to a subsequent price drop, and declare that the statement had 'maintained' inflation until the drop."[12]

In its opinion affirming the district court,[13] the Second Circuit rejected these objections to the price maintenance theory. Quoting the Eleventh Circuit in *FindWhat*, the court stated that "[i]t is far more coherent to conclude that such a misstatement does not simply maintain the inflation, but indeed 'prevents the preexisting inflation in a stock price from dissipating.'" According to the court, "Were this not the case, companies could eschew securities-fraud liability whenever they actively perpetuate (i.e., through affirmative misstatements) inflation that is already extant in their stock price, as long as they cannot be found liable for whatever originally introduced the inflation."[14]

The court's acceptance of "price maintenance" as a valid theory likely will now afford plaintiffs in that circuit with more latitude in pleading price inflation. From a defendant and insurance carrier perspective, the viability of the price maintenance theory is significant. The number of securities cases will almost certainly rise, since plaintiffs will no longer need to tie their cases to particular announcements that caused a price increase on the front end.

Rebutting the Basic Presumption on the Back End: Is It Price Impact or Loss Causation?

Price maintenance cases raise a fundamental question about the ways in which the rebuttable *Basic* presumption can be rebutted. When a plaintiff argues that the defendants' misrepresentations did not increase the stock price but only maintained a now-artificially high price, there is no way to prove price impact or a lack thereof at the beginning of the class period. Rather, the only point at which the effect on the price is visible is at the back end, when the subsequent corrective disclosures cause the price to fall.

The back end is also the point at which loss causation is demonstrated. Loss causation and reliance (or transaction causation) are counterpart elements of causation that a plaintiff must establish in a Section 10(b) case. Reliance shows that the defendant's alleged misrepresentation caused the plaintiffs to buy or retain the company's stock. Loss causation shows that the defendant's alleged misrepresentation, once corrected, was the cause of the stock price's decline because it separates out losses that are attributable to other intervening market forces, such as fluctuations in the economy as a whole or in a particular industry. Together, loss causation and reliance show the required nexus between the defendant's alleged misrepresentation and the economic harm suffered by the plaintiff. Without one or the other, Section 10(b) would simply be "a scheme of investor's insurance."[15]

Loss causation thus answers the question, "Did the correction of the defendant's misrepresentation cause the price decline?", or its inverse, "Did something else cause the price decline?" A defendant attempting to show a lack of price impact at the back end might also put in evidence that the price decline was caused by other factors, or that the price decline was not caused by the misrepresentation. However, unlike reliance (which may be shown through the *Basic* rebuttable presumption), plaintiffs are not required to prove loss causation at the class certification stage.[16] Courts thus must consider whether defendants may put in evidence at the class certification stage that goes to the issue of loss causation because it can also be used to show lack of price impact to rebut the presumption of reliance. The extent to which courts allow this evidence at the earlier stage of litigation will impact the number of cases that plaintiffs are willing and able to bring.

This issue is now before the Fifth Circuit, which once again considers the Halliburton securities litigation.[17] On remand from *Halliburton II*, the district court addressed how defendants may actually go about rebutting the *Basic* presumption with evidence of no price impact.[18] Halliburton attempted to rebut the *Basic* presumption at the back end—by arguing that the particular disclosures at issue were not in fact corrective of misrepresentations at the start of the class period. In seeking to defeat class certification, the defendants argued that, while the company may have disclosed adverse news that resulted in stock drops, the plaintiffs could not connect those announcements to any misrepresentation that inflated the stock price in the first place. The district court held that these arguments were inappropriate at the class certification stage and, rather than showing evidence of lack of price impact, were a veiled attempted at a truth-on-the-market defense, which goes to materiality (not an issue for class certification).

In the appeal before the Fifth Circuit, the defendants argue that to assume that all disclosures are "corrective" deprives defendants of their right to rebut the *Basic* presumption with evidence that there is no link between the price decline and the earlier misrepresentation: "In effect, the district court *irrebuttably* presumed price impact, reneging on the Supreme Court's promise that *Basic* created a *rebuttable* presumption."[19] According to the defendants, the fundamental premise of *Basic* is that the *misrepresentation*—not the disclosure—is reflected in the stock's price, and so a price decline following a disclosure that is not actually corrective of the alleged misrepresentation would reveal nothing about that misrepresentation's earlier effect on the price. In their petition for interlocutory review, the defendants also argued that simply assuming that the disclosure is corrective, and therefore reflects the price impact of the alleged misrepresentation, "opens the floodgates to class certification based on any price decline caused by negative news."[20]

How Much Evidence Is Required to Rebut the Presumption of Reliance?

In two cases on appeal, *In re Goldman Sachs Group, Inc. Securities Litigation*[21] and *Strougo v. Barclays PLC*,[22] the Second Circuit will face the question of how much evidence defendants must put forward in order to rebut the presumption of reliance (and relatedly, how the burdens of proof and persuasion work in the context of the rebuttable *Basic* presumption). In *Basic*, the Supreme Court held: "Any showing that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff, or his decision to trade at a fair market price, will be sufficient to rebut the

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the Basic Presumption of Reliance continued from pg.9

presumption of reliance."[23] Defendants have argued that "any showing" means just that—once they put forward evidence in any amount indicating that there is no price impact, the burden of persuasion remains on the plaintiff to show that the underpinnings of the *Basic* presumption still apply.

However, several district courts, including the Southern District of New York in *Barclays* and *Goldman Sachs*, have imposed more rigorous evidentiary burdens on defendants. In *Barclays*, the court acknowledged that "defendants' arguments suggest that the post-disclosure price movement does not support a strong inference or provide compelling evidence of price impact," but found that Barclays did not sufficiently demonstrate lack of price impact because the defendants did not "foreclose plaintiffs' reliance on the price maintenance theory."[24] The court held that "[t]o succeed, defendants must prove by a *preponderance of the evidence* that the price drop on the corrective disclosure date was not due to the alleged fraud."[25]

In *Goldman Sachs*, the court likewise observed that "Defendants' attempt to demonstrate a lack of price impact merely marshals evidence which suggests a price decline for an alternate reason, but does not provide *conclusive evidence* that no link exists between the price decline and the misrepresentation."[26] The plaintiffs' claims in *Goldman Sachs* are based on statements Goldman Sachs made about its business practices and how it handled conflicts of interest. The plaintiffs assert that these statements were revealed as untrue when information regarding the company's conflicts in certain collateralized debt transactions reached the marketplace through SEC and DOJ announcements of investigations and enforcement actions. In considering the defendants' price impact evidence to rebut the *Basic* presumption, the district court concluded that they had "failed to demonstrate a complete lack of price impact" and could not "show that the total decline in the stock price on the corrective disclosure dates is attributable simply to the market reaction to the announcement of enforcement actions and not to the revelation to the market that Goldman had made material misstatements about its conflicts of interest policies and business practices."[27] The court also extended this rationale into its discussion of the plaintiffs' damages methodology: "The possibility that Defendants could prove that some amount of the price decline is not attributable to Plaintiffs' theory of liability does not preclude class certification. *Comcast* [*Corp. v. Behrend*][28] speaks to measuring damages stemming from the accepted theory of liability, and not the extent to which that liability can be proven."[29] The court also observed that any failure in the damages model to account for other causes of the stock price drop would affect the entire class uniformly.

The Fifth Circuit will also confront the issue of the burden of persuasion in *Halliburton*. The defendants in *Halliburton* argue that the district court erred in stating that they bore the burden of persuasion on price impact. Rather, according to the defendants, plaintiffs bear the burden of persuasion on all class certification requirements, including predominance. The *Basic* presumption allows plaintiffs to satisfy the predominance requirement with respect to the element of reliance only by showing that the entire market relied on the defendants' alleged misrepresentation because it was reflected in the stock price. In support, the defendants cite to *Halliburton II*: "The *Basic* presumption does not relieve plaintiffs of the burden of proving—before class certification—that [the predominance] requirement is met. *Basic* instead establishes that a plaintiff satisfies that burden by proving the prerequisites for invoking the presumption—namely, publicity, materiality, market efficiency, and market timing. The burden of proving those prerequisites still rests with plaintiffs and (with the exception of materiality) must be satisfied before class certification."[30]

Endnotes

1 134 S. Ct. 2398 (2014).

2 *See Amgen Inc. v. Conn. Ret. Plans & Trust Funds*, 133 S. Ct. 1184, 1192 (2013).

3 485 U.S. 224 (1988). **4** *Id.* at 248-49. **5** 818 F.3d 775 (8th Cir. 2016).

6 *Id.* at 784.

7 *See FindWhat Inv'r Grp. v. FindWhat.com*, 658 F.3d 1282, 1314-15 (11th Cir. 2011) ("[C]onfirmatory information that wrongfully *prolongs* a period of inflation—even without increasing the *level* of inflation—may be actionable under the securities laws. That is, defendants can be liable for knowingly and intentionally causing a stock price to *remain* inflated by preventing preexisting inflation from dissipating from the stock price." (emphasis in original)); *Schleicher v. Wendt*, 618 F.3d 679, 683 (7th Cir. 2010) ("when an unduly optimistic statement stops a price from declining (by adding some good news to the mix): once the truth comes out, the price drops to where it would have been had the statement not been made").

8 No. 15-180 (2d Cir.).

9 *In re Vivendi Universal, S.A. Secs. Litig.*, 765 F. Supp. 2d 512, 562 (S.D.N.Y. 2011).

10 544 U.S. 336, 341-42 (2005). **11** 134 S. Ct. at 2405.

12 Final Principal Br. for Vivendi at 75, No. 15-180 (filed Aug. 19, 2015).

13 *In re Vivendi Universal, S.A. Securities Litigation*, No. 15-180, 2016 WL 5389288 (2d Cir. Sept. 27, 2016).

14 Id. at 73. **15** *Dura,* 544 U.S. at 345.

16 *See Erica P. John Fund, Inc. v. Halliburton Co.,* 563 U.S. 804, 812 (2011) *(Halliburton I).*

17 *Erica P. John Fund, Inc. v. Halliburton Co.,* No. 15-11096 (5th Cir.).

18 *Erica P. John Fund, Inc. v. Halliburton Co.,* 309 F.R.D. 251 (N.D. Tex. 2015), *leave to appeal granted,* No. 15-90038, 2015 WL 10714013 (5th Cir. Nov. 4, 2015).

19 Br. of Appellants at 21-22, No. 15-11096 (filed Feb. 8, 2016) (emphasis in original).

20 Defs.' Pet. at 2, No. 15-11096 (filed Aug. 12, 2015). **21** No. 16-250 (2d Cir.).

22 No. 16-1912 (2d Cir.). **23** 485 U.S. at 248.

24 *Strougo v. Barclays PLC*, 312 F.R.D. 307, 325 (S.D.N.Y. 2016).

25 *Id.* at 326 (emphasis added).

26 *In re Goldman Sachs Grp., Inc. Secs. Litig.*, No. 10-cv-3461, 2015 WL 5613150, at *7 (S.D.N.Y. Sept. 24, 2015) (emphasis added).

27 *Id.* at *6.

28 133 S. Ct. 1426 (2013). **29** 2015 WL 5613150 at *8.

30 134 S. Ct. at 2412.

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propriety of this data, leaving attorneys scrambling.

While we can all agree that the information gathered by wearable technology is clearly valuable, an attorney must pause to consider ethical and professional responsibilities before pursuing this data. Take a moment to consider privacy concerns. A device which stores personal health information is obviously different than, say, a file kept in a treating physician's office. Yesterday's attorney would subpoena medical records to evaluate the extent of a plaintiff's treatment, whereas today's attorney may collect nearly identical data from the plaintiff's FitBit— while also learning of the plaintiff's physical health, habits, and other data unrelated to the litigation. Some personal fitness trackers store the information on the device itself, while others use a "cloud" storage system where the data is actually maintained on a central server owned by a third-party company. In these instances, attorneys must be careful to consider the proper manner by which the information is requested.

Moreover, and perhaps most importantly, any attorney seeking to obtain and utilize the data from a personal fitness tracker must necessarily take caution to exercise the proper ethical considerations. Is it fair to assume that users of wearable technology consider the data too personal and private? Is the collected information more akin to that of a medical record or a personal diary or notebook? Does the simple fact that information is stored and maintained by a third party invalidate any claim to privacy? These are the kinds of novel questions that lack a definitive answer because this is a new and developing area of inquiry. Attorneys must exercise their best discretion in working out these issues.

Fortunately, the courts have provided some (but not much) guidance. In a recent decision, the Fourth Circuit Court of Appeals considered whether the acquisition of certain cellular phone data constituted an invasion of privacy in United States v. Graham, 824 F.3d 421 (4th Cir. 2016). In doing so, the court evaluated whether such data is "voluntarily provided" by the user. The court was concerned with cell-site location information (CSLI), which is data transmitted to cell phone towers from individual mobile phones in the process of making a call or sending a text message. In Graham, the federal government used CSLI to pinpoint the location of the defendants in order to place them in the vicinity of an armed robbery. The Fourth Circuit relied in part on Supreme Court precedent holding that no Fourth Amendment protection exists for "information [a party] voluntarily turns over to a third party."[6]

Ultimately, the Fourth Circuit held that CSLI, among other data which is automatically transmitted in the normal course of the use of a cell phone, cannot be considered private. Essentially, the transmission of the data from the user's cell phone, even though it happens automatically each and every time the user operated the phone, amounted to that person turning over their data to a third party.

A takeaway from this decision could be that the GPS functions of personal fitness trackers —i.e., any function which relies on cell towers, satellites, or a web server to which the personal device transmits data—preclude any legitimate expectation of privacy and therefore should be open and discoverable in a civil matter. This would seemingly also extend to data such as heart rate, blood pressure, or other fitness data transmitted to a central server by a fitness tracker.

FitBit's own privacy policy makes clear that this type of data transfer occurs. "When you sync your Device through an App or the Software, data recorded on your Device about your activity is transferred from your Device to our servers. This data is stored and used to provide the FitBit Service and is associated with your account."[7] Additionally, FitBit's privacy policy states that stored information may be shared with third-parties independent of FitBit:

> Fitbit may share or sell aggregated, de-identified data that does not identify you, with partners and the public in a variety of ways, such as by providing research or reports about health and fitness or as part of our Premium membership. When we provide this information, we perform appropriate procedures so that the data does not identify you and we contractually prohibit recipients of the data from re-identifying it back to you.[8]

Therefore, from a practical standpoint, it may prove difficult to argue that fitness data is protected in any meaningful sense, particularly when the user agreement discloses that information is shared with third parties of whose identities they are completely unaware.

Of course, the law is far from settled. Even the majority opinion in Graham concedes that the traditional rules by which we evaluate what information is considered private, protected, and privileged may need to be rewritten in the digital age. In a compelling dissent, Judge James A. Wynn, Jr., considered the impact of an ever-changing digital age on privacy considerations:

> The majority "fails to see how a phone user could have a reasonable expectation of privacy in something he does not know." I wonder: does the majority imagine that Danny Kyllo knew what levels of infrared radiation emanated from his home and were recorded with precision by the government's thermal imaging device? The rule that one must 'know' what one can reasonably expect to keep private is new to me, and I believe to Fourth Amendment doctrine as well. It is also yet another aspect of this Court's present decision with troubling future

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implications. I suppose we can also expect no privacy in data transmitted by networked devices such as the 'Fitbit' bracelet, which 'can track the steps you take in a day, calories burned, and minutes asleep'; the 'Scanadu Scout,' which can 'measure your temperature, heart rate, and hemoglobin levels'; or the 'Mimo Baby Monitor 'onesie' shirt,' which can 'monitor your baby's sleep habits, temperature, and breathing patterns."[9]

With this statement, Judge Wynn lays bare the central point of dispute: may a user have a reasonable expectation of privacy for any information transmitted through a "networked device"? This differs from, say, an e-mail, which is sent directly from one party to another, and merely uses the electronic interface as a delivery method. But with respect to devices, such as fitness trackers, which constantly deliver a stream of information directly to a third-party, the argument must be made that the very nature of that delivery renders any privacy concerns inoperable.

Wearable fitness trackers represent another fascinating example of the intersection between technology and the law. As is true in all professions, attorneys must adapt to these developments in order to provide the highest level of client service. Given the very real possibility that fitness trackers may open doors to a litigation advantage, we can expect to see more discovery directed toward collecting this information. Time will tell how the courts define the permissible and ethical limits as attorneys target data stored by fitness tracking technology.

Endnotes

1 *How Social Media Are Transforming Litigation*, American Bar Association, Journal of the Section of Litigation, Vol. 39, No. 2., Andy Radhakrant and Matthew Diskin

2 www.Gallup.Com; Well-Being, July 29, 2015. http://www.gallup.com/poll/184403/far-2015-americans-exercising-frequently.aspx

3 *Study: MobiHealthNews* Aditi Pai, May 5, 2016. http://mobihealthnews.com/content/study-12-percent-us-consumers-own-fitness-band-or-smartwatch

4 *FitBit Still Tops in Wearables* Lance Whitney, February 23, 2016. http://www.cnet.com/news/fitbit-still-tops-in-wearables-market/

5 *Id.*

6 Smith v. Maryland, 442 U.S. 735, 743-44 (1979).

7 https://www.fitbit.com/legal/privacy-policy.

8 *Id.*

9 *United States v. Graham*, 824 F.3d 421, 445 n.7 (4th Cir. 2016).

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