SULLIVAN & CROMWELL LLP

S&C memo

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PRGE&J Ret. Sys. Admin. v. *Volkswagen*– Ninth Circuit Clarifies Limited Availability of *Affiliated Ute* Presumption in Securities-Fraud Cases

In Ninth Circuit, Reliance Cannot Be Presumed Under *Affiliated Ute* Where a Securities-Fraud Plaintiff Alleges Both Misstatements and Omissions, Making Certification of Securities Class Actions More Difficult

SUMMARY

Sullivan & Cromwell won an important victory in the U.S. Court of Appeals for the Ninth Circuit in a putative securities-fraud class action brought by a purchaser of 144A bonds against S&C client Volkswagen AG, a U.S. subsidiary and employees. The plaintiff accused Volkswagen of violating Section 10(b) of the Securities Exchange Act of 1934 because the Offering Memoranda for $8.3 billion in unregistered Rule 144A bonds issued by the U.S. subsidiary stated that Volkswagen was researching emissions-control technologies, and that its vehicles were subject to emissions-control laws, while omitting to disclose the existence of emissions-control "defeat devices" in certain diesel vehicles.

On June 25, 2021, the Ninth Circuit held that plaintiff could not rely on the *Affiliated Ute* presumption of reliance, clarifying that "the *Affiliated Ute* presumption is limited to cases that primarily allege omissions and present plaintiffs with the difficult task of proving a speculative negative." The Court found that the *Affiliated Ute* presumption did not apply in this case, because it would be possible for plaintiff to prove actual reliance on Volkswagen's allegedly false or misleadingly incomplete statements. The Court's holding clarifying the availability of the *Affiliated Ute* presumption of reliance will make it more difficult for putative securities fraud

class actions to be certified, since absent a presumption of reliance individual issues of direct reliance prevent certification.

BACKGROUND

The U.S. District Court for the Northern District of California declined to dismiss the case at the pleading stage, holding in a series of rulings that although the "fraud on the market" presumption of reliance announced in *Basic* v. *Levinson* did not apply to the plaintiff's purchase of newly issued 144A bonds, the plaintiff had adequately pled actual reliance.[1] S&C took targeted discovery on the issue of reliance and moved for summary judgment, arguing that there was no evidence that plaintiff or its investment advisor actually read or relied upon the Offering Memorandum, and that no presumption of reliance applied.

In September 2019, the District Court denied Volkswagen's motion for summary judgment, holding that the plaintiff was entitled to a presumption of reliance under *Affiliated Ute Citizens of Utah* v. *United States*.[2] The District Court reasoned that plaintiff's case could be characterized as primarily alleging omissions rather than misstatements, and that Ninth Circuit precedent governing cases of "mixed" misrepresentations and omissions was unclear.[3] Upon Volkswagen's motion, the District Court certified its summary-judgment decision for immediate interlocutory appeal, which was then taken up by the Ninth Circuit.

THE COURT'S REASONING

In *PRGE&J Ret. Sys. Admin*., the Ninth Circuit reversed the District Court in a 2-1 decision.[4] The majority held that plaintiff is not entitled to the *Affiliated Ute* presumption because its complaint alleges and primarily relies on many pages of allegedly false or misleading affirmative misstatements attributed to Volkswagen.[5]

Citing with approval the Second Circuit's decision in *Waggoner* v. *Barclays PLC*, the Ninth Circuit majority emphasized that the purpose of the *Affiliated Ute* presumption is to excuse the difficult or impossible burden of proving reliance in cases primarily alleging omissions, but that it would not be impossible for plaintiff to prove its direct reliance on the false or misleading statements alleged in the complaint.[6] The Ninth Circuit remanded the case to the District Court to further consider whether any triable issue of material fact remains.[7]

IMPLICATIONS

The Ninth Circuit's decision prevents plaintiffs from invoking the *Affiliated Ute* presumption—and thus avoiding the need to prove the elements of the *Basic* presumption such as market efficiency—by artfully framing their claims as primarily involving "omissions." As the majority opinion stressed, if the plaintiff and dissent's position were adopted, the *Affiliated Ute* presumption would become available for all securities fraud claims.[8]

The decision thus makes it more difficult to certify securities class actions, particularly those involving newly issued or illiquid securities such as 144A bonds.

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ENDNOTES

1 *See, e.g., In re Volkswagen "Clean Diesel" Mktg., Sales Practices, and Prods. Liab. Litig.*, 328 F. Supp. 3d 963, 968 (N.D. Cal. 2018) (plaintiff "cannot rely on *Basic*'s fraud-on-the-market theory to prove reliance," but plaintiff has pled "direct reliance"); *In re Volkswagen "Clean Diesel" Mktg., Sales Practices, and Prods. Liab. Litig.*, 2018 WL 1142884 (N.D. Cal. Mar. 2, 2018)

2 *In re Volkswagen "Clean Diesel" Mktg., Sales Practices, and Prods. Liab. Litig.*, 2019 WL 4727338 (N.D. Cal. Sept. 26, 2018)

3 *Id*. at *1.

4 *In re Volkswagen "Clean Diesel" Mktg., Sales Practices, and Prods. Liab. Litig.*, 2021 WL 2621171 (9th Cir. June 25, 2021).

5 *Id*. at *8.

6 *Id*. at *7-8 (citing *Waggoner* v. *Barclays PLC*, 875 F.3d 79, 96 (2d Cir. 2017).

7 *Id*. at *8.

8 *Id*.

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