How Presumption Of Reliance May Violate Due Process

Law360, New York (September 10, 2013, 3:48 PM ET) -- For decades, courts in some fraud cases have certified class actions on the basis of a "presumption of reliance." This presumption acknowledges the usually individualized nature of reliance but holds that uniform reliance can be presumed when the alleged fraud reaches the entire class and is objectively material.

And on the basis of that presumption, the individualized reliance or causation issues that would ordinarily make class treatment impossible are deemed common — capable of resolution along with the question of materiality itself — and thus, no barrier to class certification.

This presumption has proven useful to plaintiffs seeking class certification in a range of cases, including consumer fraud cases. But as recent U.S. Supreme Court cases help to illustrate, the way this presumption has been applied — particularly in consumer fraud cases — violates defendants' due process rights by effectively preventing them from rebutting the presumption.

The presumption of reliance is well-known in securities fraud cases, a field in which it received approval from a four-justice majority of the U.S. Supreme Court 25 years ago in Basic v. Levinson, 485 U.S. 224 (1988).

As the Supreme Court explained just last term in Amgen Inc. v. Connecticut Retirement Plans And Trust Funds, 133 S.Ct. 1184 (2013), Basic's rationale was that "certain well developed markets are efficient processors of public information," and in those markets, "the market price of shares will reflect all publicly available information." 133 S. Ct. at 1192.

Based on this premise, the Basic court held that when "a market is shown to be efficient, courts may presume that investors who traded securities in that market relied on public, material misrepresentations regarding those securities." Id.

Although this rationale would appear to impose a limiting principle on the use of the presumption of reliance, other courts both before and after Basic have applied a presumption of reliance in other contexts — consumer fraud cases, for example — that are not "efficient" in the same sense that securities markets were presumed to be in Basic.

In Vasquez v. Superior Court, 484 P.2d 964 (Cal. 1971), for example, the California Supreme Court allowed an "inference" of reliance in a case in which the agents of the defendants — sellers of freezers and frozen foods — had "memorized a standard statement" that was "recited by rote to every member of the class." Id. at 971-73.

And recent cases applying federal class action rules continue to apply similar presumptions in consumer fraud cases, both in California and in other jurisdictions.[1]

This approach is not tenable because in the real world, consumers do not react uniformly to most representations, but the presumption as it has been applied makes no provision for the resolution of individualized reliance or causation defenses. In an individual consumer fraud case, there is no question that the plaintiff would bear the burden of proving reliance or causation.

The presumption applied in the class action context does not, and cannot, delete this reliance or causation element from the cause of action. Under the Rules Enabling Act, the class action rule as a rule of procedure cannot "abridge, enlarge or modify any substantive right." 28 U.S.C. § 2072(b); see also Shady Grove Orthopedic Assocs. PA v. Allstate Ins. Co., 130 S. Ct. 1431, 1443 (2010) (plurality opinion) (class action rule is procedural and thus "leaves the parties' legal rights and duties intact and the rules of decision unchanged").

Instead, a presumption merely shifts the burden of proof to the defendant, turning the questions of reliance and causation into defenses rather than affirmative burdens for the plaintiff to prove. This is what the Supreme Court meant when it said recently that the securities fraud presumption of reliance is "just that" — a presumption that can "be rebutted by appropriate evidence." Erica P. John Fund Inc. v. Halliburton Co., 131 S. Ct. 2179, 2185 (2011).

And because the presumption can be rebutted, shifting the burden of proving reliance or causation does not change the individualized nature of the issue. Courts certifying consumer fraud class actions on the basis of a presumption of reliance sometimes acknowledge as a theoretical matter that "defendants may introduce evidence to rebut the inference of reliance," e.g., Wiener v. Dannon Co. Inc., 255 F.R.D. 658 (C.D. Cal. 2009), but few, if any, have given serious attention to the question of how it could be manageable to do so in a class setting.

The failure or refusal to resolve this issue reflects an insufficiently rigorous class certification inquiry. As the Supreme Court has recently made clear, the mere fact that the individualized issues in a case are the defendant's burden to prove rather than the plaintiff's should not alter the certification analysis. "[A] class cannot be certified on the premise that [the defendant] will not be entitled to litigate its ... defenses to individual claims." Wal-Mart Stores Inc. v. Dukes, 131 S. Ct. 2541, 2561 (2011).

This holding has underpinnings in due process, which guarantees a defendant's right to present "every available defense." Lindsey v. Normet, 405 U.S. 56, 66 (1972); see also Philip Morris USA Inc. v. Scott, 131 S. Ct. 1, 4 (2010) (Scalia, Circuit J.) (citing Normet for a proposition similar to the one embraced in Wal-Mart Stores).

Thus, unless the proceeding envisioned by a class certification order can account for case-by-case defenses on the issues of reliance or causation, class treatment is improper as a matter of due process.

The reality is that courts certifying consumer fraud class actions have no plans of permitting real rebuttal of the presumption. Once a court certifies a case for class treatment, it rarely allows discovery of absent class members, which would likely prevent a defendant from putting on individualized reliance or causation defenses.[2]

The effect of this approach is to render the presumption of reliance irrebuttable, which likewise threatens due process rights. See, e.g., Vlandis v. Kline, 412 U.S. 441, 446 (1973) (noting that the Supreme Court has repeatedly held that rules that "creat[e] a presumption which operates to deny a fair opportunity to rebut it violates the due process

clause").

In short, the time has come for courts to start applying greater scrutiny to the presumption of reliance, particularly in the consumer fraud context and in other cases lacking the "efficient market" rationale advanced as a justification for the rule in Basic. The reality is that reliance is usually individualized, and courts are not entitled to pretend otherwise in order to facilitate class certification at the expense of defendants' due process rights.

--By Geoffrey Wyatt and Nina Rose, Skadden Arps Slate Meagher & Flom LLP

Geoffrey Wyatt is a counsel in the Washington, D.C., office of Skadden. Nina Rose is an associate in Skadden's Washington, D.C., office.

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[1] See, e.g., Jordan v. Paul Financial LLC, 285 F.R.D. 435, 465-67 (N.D. Cal. 2012) (applying presumption of reliance where "all class members received the same representations" in "nearly identical loan documents"); Stanich v. Travelers Indem. Co., 249 F.R.D. 506, 518 (N.D. Ohio 2008) ("Where there are uniform presentations of allegedly misleading information, or common omissions throughout the entire class, especially through form documents, courts have found that the element of reliance may be presumed class-wide, thereby obviating the need for an individualized inquiry of each class member's reliance.").

[2] See, e.g., Garden City Employees' Retirement Sys. v. Psychiatric Solutions Inc., No. 3:09-882, 2012 U.S. Dist. (M.D. Tenn. Oct. 10, 2012) (noting that absent class member discovery "is rarely permitted" and denying defendants leave to propound interrogatories on absent class members in order to determine whether they relied on allegedly material representations that were the basis of a presumption of reliance).