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# Presumptions of Reliance: What They Really Mean and How to Defeat Them

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When Henry Stanley posed the famous query, ''Dr. Livingstone, I presume?,'' he made a deduction based on common sense and probability. His question was amusing not only by virtue of its formality, but also because of the strength of the circumstantial evidence before him: In the Tanzanian village of Ujiji, David Livingstone was probably the only other Caucasian man for a thousand miles in any direction. Despite the strength of the circumstantial evidence, however, Stanley posed the words in the form of a question, not as a statement of fact. He allowed his addressee to verify the presumed fact.

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In fraud-based class action litigation, plaintiffs often characterize presumptions of reliance as statements of fact, punctuated with an exclamation point rather than a question mark. Presumptions of reliance, they argue, arise whenever the defendant has misrepresented or omitted a ''material fact.'' This permits them to dispense with individualized proof that the defendant's conduct actually duped class members to their detriment.

Too often, this argument is, in a word, presumptuous. Presumptions cannot arise unless they rest on facts which make actual reliance a reasonable probability, and even then, the presumptions may be rebutted. Unopposed, a presumption of reliance might eliminate individualized issues, but in the presence of contrary evidence, individual issues return and should defeat class certification. This article examines how plaintiffs use presumptions of reliance, and evaluates ways in which defendants may thwart such presumptions at the certification stage.

## Judicial Recognition of Presumptions of Reliance

Even at the inception of Rule 23(b)(3), its drafters recognized that certification of fraud cases presents difficulty ''where there was material variation in the representations made or in the kinds or degrees of reliance by the persons to whom they were addressed.'' Advisory Committee Notes, 1966 Amendment, Subdivision (b)(3). The drafters recognized that liability for fraud cannot arise unless the plaintiff has relied on the defendant's statement or omission. Whether a plaintiff can prove reliance, in fact, depends on what information the plaintiff had about the true set of facts and what he believed. Determining such reliance often requires highly individualized inquiries into the Plaintiff's state of

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mind, objectives, knowledge, prior conduct, alternative choices and many other factors.

To mitigate the difficulty in proving ''reliance,'' or ''justifiable reliance,'' state and federal courts have recognized that a presumption, or inference, of classwide reliance should arise where circumstantial evidence supports a probability that the plaintiffs did, in fact, rely. For example, in *Vasquez v. Superior Court*, 4 Cal. 3d 800 (1971), the California Supreme Court noted that California law does not require proof of reliance through direct evidence. Rather, it may either be inferred or presumed from the fact of a *material* false representation:

> [I]f the trial court finds material misrepresentations were made to the class members, at least an inference of reliance would arise as to the whole class.
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> *Id.* at 814. *See also Massachusetts Mutual Life Insurance Co. v. Superior Court*, 97 Cal. App. 4th 1282 (2002).

The U.S. Supreme Court has recognized presumptions of reliance in several contexts. For example, in *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128 (1972), the Court determined that native American claimants could pursue claims under Rule 10b-5 of the Securities Exchange Act of 1934 without direct evidence of reliance on fraudulent statements and omissions connected with their sale of securities:

> Under the circumstances of this case, involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery. All 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.
>
> *Id.* at 153-154.

As in *Vasquez*, the probability of reliance derived from the ''materiality'' of the information, and its effect on a ''reasonable'' investor.

The Supreme Court has also recognized a presumption of reliance in the context of ''fraud on the market.'' In *Basic v. Levinson*, 485 U.S. 224 (1988), the Court evaluated the manner in which plaintiffs in a 10b-5 securities class action could prove reliance, which it termed the ''requisite causal connection between the defendant's misrepresentation and a plaintiff's injury.'' *Id.*at 243. The Court noted that the market, itself, acts as the investor's agent, factoring all available relevant information into the price of the stock. The Court then explained that ''presumptions typically serve to assist courts in managing circumstances in which direct proof, for one reason or another, is rendered difficult.'' *Id.* at 245. Presumptions arise ''out of considerations of fairness, public policy and probability, as well as judicial economy. Presumptions are also useful devices for allocating the burdens of proof between the parties.'' *Id.*

Measured against these objectives, the Court concluded that reliance on a defendant's material misrepresentation or omission could be presumed from an investor's purchase of stock at its market price. Requiring a plaintiff to prove a speculative set of facts—how he would have invested had the information been known—would place an unrealistic evidentiary burden on the plaintiff. The presumption furthers congressional objectives in fostering the investor's reliance on the integrity of the market. Finally, the presumption is supported by ''common sense and probability.'' *Id.* at 246. An investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price. *Id.* at 247.

## Rationale for Presumptions

As the cases above suggest, presumptions have a number of justifications. These include solving issues of proof, reconciling the parties' differing access to evidence, and the policies advanced by the underlying substantive law. *McCormick* notes that presumptions may often have more than one goal, but ''probability'' is the most important:

> Generally, . . . the most important consideration in the creation of presumptions is probability. Most presumptions have come into existence because the judges have believed that proof of fact B renders the inference of the existence of fact A so probable that it is sensible and time saving to assume the truth of fact A until the adversary disproves it.
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> *McCormick on Evidence* (7th Ed.), § 343 at p. 682 (Thompson Reuters 2013).

## Legal Effect of a Presumption of Reliance

What is the evidentiary effect of a presumption of reliance? Ordinarily the presumption will be rebuttable, but the exact effect of the presumption depends on which evidence code applies to the case.

For cases in federal court, Fed. Rule of Ev. 301 provides a general rule that governs most presumptions based on federal substantive law: The party against whom a presumption applies has the burden of producing evidence to rebut the presumption. However, the burden of proof remains on the party which originally had it. As explained by the Advisory Committee:

> a presumption is sufficient to get a party past an adversary's motion to dismiss made at the end of his case in chief. If the adverse party offers no evidence contradicting the presumed fact, the court will instruct the jury that if it finds the basic facts, it may presume the existence of the presumed fact. If the adverse party does offer evidence contradicting the presumed fact, the court cannot instruct the jury that it may *presume* the existence of the fact from the basic facts. The court may, however, instruct the jury that it may infer the existence of the presumed fact from proof of the basic facts.
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> Advisory Committee Notes, 1974 Amendment. (Emphasis in original).

For cases in federal court where state substantive law applies (usually diversity cases), Fed. R. of Ev. 302 adopts state law regarding the effect of a presumption.

California, the Golden State for class action litigation, differentiates between ''inferences,'' ''presumptions affecting the burden of producing evidence'' and ''presumptions affecting the burden of proof.'' An inference is a deduction of fact that may logically and reasonably be drawn from other facts. Ev. Code § 600(b). A presumption affecting the burden of producing evidence is one ''to implement no public policy other than to facilitate the determination of the particular action in which the presumption is applied.'' Ev. Code § 603. A presumption affecting the burden of proof, by contrast, is one established to implement a public policy *other than* resolving the dispute in question. Ev. Code § 605. Each type of presumption has a different effect. For presumptions affecting the burden of producing evidence, Cal. Ev. Code § 604 provides that once the party opposing the presumption has introduced evidence to negate the

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presumed fact, the trier of fact must resolve the issue on the evidence submitted, without regard to the presumption. An ''inference,'' however, may remain, even if the presumption is negated. For presumptions affecting the burden of proof, Cal. Ev. Code § 606 imposes on the party against whom the presumption applies the burden of proving the non-existence of the presumed fact.

Applying these rules to the cases above, the presumptions of *Affiliated Ute* and *Basic* are rebuttable under F.R.E. 301: unrebutted, they would establish reliance, but if rebutted, the burden of proof would remain on the plaintiff. The presumption/inference in *Vasquez* should be analyzed as a presumption affecting the burden of producing evidence. *Vasquez* and similar other California decisions do not describe any public policy favoring the creation of the presumption other than the objective of solving an issue of proof in the case at issue. Consequently, under Cal. Ev. Code § 604, introduction of contrary evidence would require the trier of fact to ignore the presumption, and resolve the issue based on the evidence, although it could continue to draw an ''inference'' based on materiality.

## Deconstructing the House of Cards

In fraud-based class litigation, Plaintiffs' argument for class certification goes like this: ''The defendant misrepresented a fact affirmatively or by omission. The fact was material, in that a reasonable person could have wanted to know of it in making a decision. Because the fact was material, reliance can be presumed for all class members without proof of actual reliance. This disposes of individualized liability determinations, and permits class certification.'' *See, e.g., Ries v. Arizona Beverages U.S.A.*, 287 F.R.D. 523, 537-538 (N.D. Cal. 2012). In support of class certification, plaintiffs will often provide no proof of materiality and reliance other than their own self-serving declarations that they regarded the information as material. Had they only know the ''truth,'' they would not have purchased the product, or paid the same price. *Id.* at 539. (Evidence as to class representatives sufficient to establish presumption in favor of absent class members.)

This argument, in many circumstances, simply is not honest. It does not reflect the complexity of consumer decisionmaking, or the many factors that affect consumer choice. That some consumers might regard information as ''material'' does not mean that all, or even many, do. From the mere fact of materiality, however, plaintiffs construct a collective right whose economic significance far outweighs the true impact of the alleged misrepresentation. In this circumstance, the presumption of reliance lacks a basis in probability or common sense. Moreover, it serves no public policy. Payment of damages to un-damaged class members misallocates resources and raises serious due process and Article III considerations.

Defendants facing fraud class action cases must therefore carefully assess how to prevent a presumption of reliance from facilitating class certification.

## Goal #1: Prevent the Creation of a Presumption

A defendant will not need to rebut a presumption of reliance if it can prevent one from arising in the first place.

### Preventing Presumptions Based on Fraud on the Market

Where it appears that a plaintiff may pursue a ''fraud on the market'' theory, whereby the alleged misrepresentation caused all putative class members to pay inflated prices for something regardless of whether they heard or relied upon the misrepresentation directly, a defendant has several ways to prevent the creation of a presumption.

First, many courts have rejected the use of fraud on the market theories outside the securities context. See, e.g., *International Union of Operating Engineers Local No. 68 Welfare Fund v. Merck & Co.*, Inc., 192 N.J. 372, 391-392 (2007); *Oliveira v. Amoco Oil. Co.*, 201 Ill. 2d 134 (2002); *DeBouse v. Bayer*, 235 Ill. 2d 544 (2009). The market for the sale of products is far less efficient than that for the sale of securities, as consumers act for many different reasons, and prices do not reflect the total state of knowledge about a product. Moreover, state consumer fraud laws have been construed to require that the plaintiff actually see and be deceived by the alleged deceptive statement, such that paying an inflated price does not qualify as ''actual damage'' sufficient to confer statutory standing.

Second, even within the context of securities fraud, ''fraud on the market'' may have an uncertain future. This past spring, the Supreme Court affirmed class certification in *Amgen v. Connecticut Retirement Plans and Trust Funds*, 133 S. Ct. 1184 (2013), where plaintiff alleged that defendant made misrepresentations and omissions about two of its products, thereby artificially inflating the price of its stock. The Court held that a plaintiff need not prove ''materiality'' in order to win class certification, provided that it proves the prerequisites to fraud on the market: an efficient market, that the information or omission was public, and that the stocks were traded during the period of alleged misinformation.

Significantly, however, the defendant had conceded that these prerequisites were met. The majority, concurring and dissenting opinions, all noted that the court had not been asked to re-evaluate the fraud-on-the-market theory. The concurring opinion of Justice Alito, as well as the dissenting opinions of Scalia, Thomas and Kennedy expressed skepticism as to the validity of the fraud-on-the-market theory, raising the possibility that the Court may review it in another case.

That opportunity could be around the bend in *Erica P. John Fund, Inc. v Halliburton Co.* In that case, the Fifth Circuit recently affirmed the District Court's certification of a class of purchasers of Halliburton stock, based on allegations that the company misrepresented certain aspects of its operations. *Erica P. John Fund, Inc. v. Halliburton Co., et al.*, 718 F.3d 423 (5th Cir. Apr. 30, 2013).

Notably, the Fifth Circuit held that Halliburton's argument that the challenged statements had no impact on the price of the stock, which the Court acknowledged could doom individual plaintiffs' ability to establish materiality, was not relevant to common issue predominance and therefore not relevant at the class certification stage. *Id.* at 434-435. The U.S. Supreme Court recently granted Halliburton's Petition for Writ of Certiorari, and will soon have an opportunity to squarely address the continued role of classwide, fraud-on-the-market presumptions of reliance. Certiorari granted at

*Halliburton, Inc. v. Erica P. John Fund, Inc.*, 2013 BL 316759 (U.S. Nov. 15, 2013).

## Preventing Presumptions Based on Alleged 'Materiality' to the Consumer

Although *Amgen* held that ''materiality'' need not be proven at the class certification stage in securities fraud cases, demonstrating lack of uniform materiality in other contexts may prevent a presumption from arising.

How do courts define ''material''? The California Supreme Court has stated: ''A misrepresentation is judged to be 'material' if 'a reasonable man would attach importance to its existence or nonexistence in determining his choice of action in the transaction in question' [citations], and as such materiality is generally a question of fact unless the 'fact misrepresented is so obviously unimportant that the jury could not reasonably find that a reasonable man would have been influenced by it.' '' *Engalla v. Permanente Medical Group*, 15 Cal. 4th 951, 976-977 (1975).

While this is an objective standard, there are several ways in which individualized proof can help defeat a finding of uniform ''materiality,'' thereby preventing a classwide presumption of reliance from arising.

First, and most obviously, a fact cannot be material to class members who were not exposed to it. This was the Ninth Circuit's holding in *Mazza v. American Honda*, 666 F. 3d 581 (9th Cir. 2012), where the defendant's alleged advertising statements were not broadly or prominently distributed to the class. *Id.* at 595 (''[W]e agree with Honda's contention that the misrepresentations at issue here do not justify a presumption of reliance. This is so primarily because it is likely that many class members were never exposed to the allegedly misleading advertisements, insofar as advertising of the challenged system was very limited.'')

If there is evidence to show that not all class members saw the material misrepresentation, a presumption of reliance lacks a basis in probability. *Id.* at 596. (''Here the limited scope of that advertising makes it unreasonable to assume that all class members viewed it.'') *See, also, Tucker v. Pacific Bell*, 208 Cal. App. 4th 201 (2012); *Fairbanks v. Farmer's New World Life Ins. Co.*, 197 Cal. App. 4th 544 (2011).

Second, a defendant may avoid a presumption by showing that the Plaintiff himself did not rely on the misrepresentation, and fails to offer evidence of materiality as to absent class members. For example, in *Faulk v. Sears Roebuck and Co.*, 2013 BL 106693 (N.D. Cal. Apr. 19, 2013), plaintiff argued the defendant failed to disclose in warranty contracts that warranty claims would not be honored unless the buyer could prove that certain tire maintenance procedures had been performed. Plaintiff alleged that this information was uniformly omitted as to the entire class.

Nevertheless, the defendant showed that plaintiff purchased additional tires and the exact same warranty after learning of the alleged deception, and also failed to produce any evidence that other tire purchasers would have regarded the information as material. *Id.* (''Faulk does not point to common proof that would establish the materiality element of his own claim and his conclusory arguments do not meet that burden.'') Of course, where the Plaintiff does not believe or rely on the misrepresentation, defendant should also be entitled to summary judgment. *See, e.g., In re Cheerios Marketing and Sales Practices Litigation*, 2012 BL 231037 (D.N.J. Sept. 10, 2012).

Third, a defendant may introduce evidence that the alleged deceptive statement is not susceptible to a standard interpretation: something cannot be ''material'' if class members do not attach the same meaning to it. For example, in *Thurston v. Bear Naked,* No. 3:11-cv-02890 (S.D. Cal. 2013), plaintiff alleged that defendant engaged in false advertising by marketing its food products as ''100% Pure & Natural'' and ''100% Natural'' when, in fact, the products contained processed and synthetic ingredients. Plaintiffs argued that this justified a presumption or an inference of reliance. *Id.* T

The defendant, however, produced evidence, including survey evidence, that consumers, food companies, and regulators do not share a common understanding of what ''natural'' means. The quantities of certain of the challenged ingredients were low and in several instances were specifically permitted by regulation to be in foods labeled ''organic.''

The Court concluded that plaintiffs had not made an adequate showing of materiality. *Id.* (''Plaintiffs fail to sufficiently show that 'natural' has any kind of uniform definition among class members, that a sufficient portion of class members would have relied to their detriment on the representation, or that Defendant's representations of natural in light of the presence of the challenged ingredients would be considered to be a material falsehood by class members.'') *Cf. Ries v. Arizona Beverages U.S.A*, 2013 BL 87038 (N.D. Cal. Mar. 28, 2013) (Summary judgment granted where plaintiffs produced no evidence to prove that representations of ''natural'' and ''all natural'' were likely to mislead the public.)

## Goal #2: Restore Individual Issues Via Rebuttal Evidence

Even where plaintiffs do present evidence that, standing alone, would justify a presumption, this does not mean that class certification will necessarily follow. Presumptions are rebuttable, and the introduction of rebutting evidence should restore issues of individual reliance to the case and prevent certification. The key, however, is that the defendant must have evidence, not just speculation, to demonstrate that the class members did not uniformly rely.

Class actions involving smoking have offered prime examples of defendants defeating presumptions of reliance through rebuttal evidence. For example, in *In re Light Cigarettes Marketing Sales Practices Litigation*, 751 F. Supp. 2d 205 (D. Me. 2010), plaintiffs alleged that tobacco companies deceived smokers by using the designations ''light'' and ''low tar,'' even though ''light'' cigarettes can deliver as much tar and nicotine as full flavor cigarettes (through the phenomenon of ''compensation'') and present an equivalent health risk.

They argued that all putative class members saw these representations on packages and in marketing, and because the implication of a reduced health risk would be material to reasonable consumers, reliance and causation should be presumed under various state consumer fraud laws. Defendants, however, rebutted this presumption by introducing evidence of consumer knowledge of the lack of health benefits, and the different motivations that smokers have for smoking light cigarettes. They introduced evidence of media reports,

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company disclosures, and survey evidence. *Id.* at 417 (''[T]he record here indicates that many smokers did not believe the misrepresentations and bought light cigarettes without relying on them.'') The Court noted that inferences or presumptions of reliance are not automatic, and are inappropriate when class members receive other information that negates reliance. *Id. See also Lawrence v. Philip Morris*, 164 N.H. 93 (2012); *Wyatt v. Philip Morris*, 2013 BL 208833 (E.D. Wis. Aug. 08, 2013).

Cases involving medical products also provide good examples of rebuttal evidence. In *In re Vioxx Class Cases*, 180 Cal. App. 4th 116 (2009), plaintiffs argued that defendant had made material misrepresentations about the safety of Vioxx and had failed to disclose information about its cardiovascular risks. The trial court, however, found that Merck provided ''overwhelming evidence'' that reliance could not be determined on a classwide basis. *Id.* at 133.

The Court of Appeal agreed. *Id.* at 133-134. Defendant demonstrated that Vioxx did not present an increased risk of death to all putative class members, and that some class members did not regard defendant's statements as material: Certain doctors and certain patients would still prescribe and take Vioxx if it remained on the market. It also demonstrated that many doctors get their information from many sources besides the manufacturer, and often distrust pharmaceutical manufacturers. For many doctors, defendant's statements were not material. Moreover, certain patients simply could not tolerate medications other than Vioxx, and the risk-benefit analysis supported its use. The Court concluded: ''when all of these patient-specific factors are a part of the prescribing decision, the materiality of any statements made by Merck to any particular prescribing decision cannot be presumed.'' *Id.* at 134.

Similarly, in *In re St. Jude Medical Inc.*, 522 F. 3d 836 (8th Cir. 2008), plaintiffs argued that Minnesota law did not require proof of individual reliance for them to pursue their claims on a classwide basis. The 8th Circuit, however, noted that Minnesota law does not prohibit a defendant from introducing evidence to demonstrate that the plaintiffs did not rely on the misrepresentations: ''when such evidence is available, then it is highly relevant and probative on the question of whether there is any causal nexus between alleged misrepresentations and any injury.'' *Id.* at 840.

## Conclusion

Many, if not most, class actions involving consumer or life science products will offer opportunities for defendants to defeat presumptions of reliance by showing the lack of uniform consumer behavior.

Consumers buy cars, not fuel hoses, head gaskets or manifolds. It is not reasonable to expect the possibility of future repairs on specific vehicle components would have a uniform effect on purchase decisions. General Mills sold Cheerios for decades. It is not reasonable to believe that its claims about cholesterol reduction uniformly duped consumers into buying it, or paying inflated prices.

Defendants' challenge is to consider proactively how plaintiffs will use presumptions of reliance in their case, and be prepared to prevent its invocation or, through evidence, to demonstrate how it lacks a basis in common sense or probability.