ALERT MEMORANDUM

In Best Buy, Eighth Circuit Finds That Defendants Successfully Rebutted Presumption of Reliance By Showing A Lack of Price Impact

April 14, 2016

On April 12, 2016, the Eighth Circuit ruled in IBEW Local 98 Pension Fund v. Best Buy Co.[1] ("Best Buy") that the defendants had successfully rebutted the fraud-on-the-market presumption at the class certification stage by demonstrating that Best Buy's allegedly misleading statements did not impact the price of the company's stock at the time of the alleged misstatements. Cleary Gottlieb represented the U.S. Chamber of Commerce as an amicus curiae in support of Best Buy on this appeal. The Best Buy ruling represents the first time an appellate court has applied the price impact analysis set out in the Supreme Court's 2014 decision in Halliburton Co. v. Erica P. John Fund, Inc.[2] ("Halliburton II") and provides useful guidance to parties seeking to rebut the fraud-on-the-market presumption in other cases.

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Background

On September 14, 2010, Best Buy issued a press release before the stock market opened, summarizing its reported financial performance for the quarter and making projections about its earnings for the full year. Hours later, Best Buy executives held a conference call, during which they allegedly assured securities analysts that earnings were

[1] 2016 WL 1425807, No. 14-3178 (8th Cir. Apr. 12, 2016).

[2] 134 S. Ct. 2398 (2014).

"in line with . . . original expectations for the year" and that the company was "on track" to meet its increased earnings per share ("EPS") guidance.[3] Best Buy's stock price increased on September 14 from its closing price on the prior trading day.

On December 14, however, Best Buy issued a press release reporting a decline in sales and disclosing that it had reduced the company's EPS guidance. Best Buy's common stock price declined 14.8% on the day this news was released.[4]

Subsequently, plaintiffs filed suit alleging that Best Buy violated Rule 10b-5 by making false and misleading statements relating to its fiscal year projections in the September 14 press release and conference call. Plaintiffs argued that Best Buy had artificially inflated and maintained its stock price until its December 14 press release corrected these alleged misstatements.

In a prior ruling, the U.S. District Court for the District of Minnesota dismissed the claims relating to the September 14 press release, holding that the challenged statements in that press release were not actionable under the Private Securities Litigation Reform Act's safe harbor for forward-looking statements. However, the court denied Best Buy's motion to dismiss the claims based on the statements made during the conference call held later that day, concluding that those statements were not forward-looking.[5]

Plaintiffs subsequently moved to certify a class with respect to the alleged misstatements made during the September 14 conference call. Plaintiffs invoked the fraud-on-the-market presumption of reliance to satisfy the predominance requirement under Rule 23(b)(3) of the Federal Rules of Civil Procedure. As supporting evidence, Plaintiffs submitted an expert report concluding that Best Buy's stock price rose in response to the September 14 press release and conference call (without differentiating between the impact of the press release and the conference call).[6] Best Buy submitted its own expert report in response, which found that the price increase on September 14 occurred <u>after</u> the press release but <u>before</u> the call and that the challenged statements made during the conference call "had no discernible impact" on the price."[7] In response, Plaintiffs' expert argued that while the conference call statements did not immediately increase the share price, those statements <u>maintained</u> the previously inflated price.[8]

The district court stayed the class certification motion until after the Supreme Court's decision in <u>Halliburton II</u>, which clarified that defendants can rebut the fraud-on-the-market presumption of reliance at the class certification stage by showing that the challenged statements had no impact on the stock's price.[9]

Following <u>Halliburton II</u>, the district court in <u>Best Buy</u> granted Plaintiffs' motion for class certification, concluding that Best Buy had failed to rebut the fraud-on-the-market presumption. The court found that although the stock price may have been inflated prior to the conference call, the alleged misstatements made during the call "could have further inflated the price, prolonged the inflation of the price, or slowed the rate of fall."[10] The court further held that price impact can be proven by a decrease in price following disclosure of the fraud and that Best Buy had not

3 <u>Best Buy</u>, 2016 WL 1425807 at *1 (emphasis omitted).

4 <u>Id.</u> at *2.

5 <u>Id.</u>

6 <u>Id.</u> at *3.

7 <u>Id.</u>

8 <u>Id.</u>

9 134 S. Ct. at 2414.

10 <u>Best Buy</u>, 2016 WL 1425807 at *5, citing lower court opinion 2014 WL 4746195, No. 11–429 (DWF/FLN), at *6 (D. Minn. Aug. 6, 2014).

provided any evidence that its stock price did not fall after the December 14 disclosure.[11]

Analysis

The Eighth Circuit's majority decision concluded that the district court misapplied the price impact analysis under Halliburton II. The majority found that while the district court properly acknowledged Best Buy's burden of presenting evidence showing absence of price impact, it ignored that Best Buy had adequately done so through the opinions of its expert, as well as Plaintiffs' own expert.

Specifically, the court concluded that the analysis performed by Plaintiffs' expert demonstrated that the statements made during the September 14 conference call were not what inflated the stock price: in contrast to the statements contained in the press release released earlier that day, which had "an immediate impact" on the stock price, the subsequent "confirming statements" in the conference call had "no additional price impact" and "added nothing to what was already public."[12] The Eighth Circuit also noted that the investors' heavy reliance on the initial press release and the absence of any further impact following the call was evidence that the investors did not rely on the conference call statements.[13] The court thus concluded that Best Buy "rebutted the Basic presumption" by presenting "overwhelming evidence of no 'front-end' price impact."[14]

The Eighth Circuit further found that Plaintiffs' theory that the statements made during the conference call gradually increased the stock price between September and December "was contrary to the efficient market hypothesis on which the Basic presumption of reliance is based" because that hypothesis assumes that the market responds rapidly to publicly available information.[15]

Finally, the court declined to credit the "price maintenance theory" advanced by Plaintiffs and the dissenting judge, who argued that the challenged statements during the conference call impacted the company's share price by maintaining it at an inflated level until the December 14 "corrective disclosure" revealed that Best Buy had not met its target EPS. Instead, the majority found that Plaintiffs had provided "no contrary evidence" disproving Best Buy's "overwhelming" evidence of no price impact.[16]

Implications

Best Buy represents the first application by an appellate court of Halliburton II's price impact analysis. The decision holds that one possible way of rebutting the fraud-on-the-market presumption of reliance is by demonstrating that the challenged statements had "no 'front-end' price impact,"[17] meaning that there was no price movement at the time of the alleged misstatements (even if there was a subsequent decline after a purported corrective disclosure). The Best Buy decision's focus on "front-end" price impact also may cast doubt on the "price maintenance theory," which certain other courts have previously accepted.

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[11] Id.

[12] Id. at *6.

[13] Id.

[14] Id.

[15] Id.

[16] Id.

[17] Id.