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Commercial Litigation

January 2015

2014 SCOTUS Term: Important Developments in the Class-Action Arena

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In a break with the past few years' precedent of focusing on when a class action can be brought, with one exception, the 2014 Supreme Court now narrowed in on whether a plaintiff's class action claims can be tried in state or federal court and under state or federal law. And while the Court made it easier for defendants to remove class actions to federal court, it held that in two instances class actions and mass actions can remain in state court or seek damages solely for violations of state law.

Understanding the circumstances under which these cases arose and the reasons behind the Court's decisions will be important to general counsel and stakeholders at companies in a variety of industries, including insurance, banking, manufacturing, energy, and many other areas where the validity of class actions is being ascertained. The decisions will also impact legal strategy employed when companies respond to class actions. Takeaways from the term's decisions include:

- Affirmation that individuals and entities providing advice on investing in unsecured securities are subject to class actions under state securities law;

- Clarification on the qualifications for mass action under the Class Action Fairness Act ("CAFA"), and limitations on a company's opportunity to remove an action to federal court;

- Class action defendants now only need to make a plausible allegation that the amount in controversy exceeds CAFA's $5 million threshold to remove actions from state to federal courts, which simplifies and lessens costs for the removal process; and

- Expansion in when defendants may offer evidence that alleged public misrepresentations did not affect stock prices, which can be used to defeat class certification in securities fraud class actions.

Those Who Provide Investment Advice on Unsecured Securities Are Subject to Class Actions

In *Chadbourne & Parke LLP v. Troice et al.,* four groups of plaintiffs filed state law class-action securities suits alleging that the defendants helped Stanford International Bank and its founder, Allen Stanford, perpetrate a multibillion dollar Ponzi scheme. The plaintiffs were private investors who bought the Bank's certificates of deposit, and filed suit in two separate states alleging that investment advisers violated state securities law when they helped the Bank perpetuate the fraud.

The United States District Court for the Northern District of Texas held that the Securities Litigation Uniform Standards Act of 1998 ("Securities Litigation Act") required the cases be dismissed. The Securities Litigation Act forbids the bringing of large securities class actions "based upon the statutory or common law of any State" in which the plaintiffs allege "a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security." The Act defines "covered security" to include only securities traded on a national exchange. Although the certificates of deposit were not covered securities, the District Court concluded that the defendants' alleged misrepresentations that the Bank's ownership of other covered securities made investments in the uncovered certificates more secure provided the requisite connection between the state law claims and transactions in covered securities.

The Fifth Circuit reversed. It agreed that the plaintiffs' complaints described misrepresentations about the Bank's investments in covered securities. But it found that the falsehoods about the Bank's holdings in covered securities were too tangentially related to the crux of the fraud—that the uncovered certificates were safe investments—to trigger the Securities Litigation Act.

The Supreme Court affirmed the Fifth Circuit's decision. It held that under the Securities Litigation Act "a fraudulent misrepresentation or omission is not made 'in connection with' such a 'purchase or sale of a covered security' unless it is material to a decision" to buy or sell an actual covered security. Because the plaintiffs had only purchased uncovered securities, their state-law class actions were not barred.

Take Away from *Chadbourne & Parke LLP v. Troice*. This decision clarifies that individuals and entities that advise about investing in unsecured securities (i.e., securities not traded on a national exchange) are subject to class actions alleging violations of state securities laws. The decision runs counter to two trends in recent Supreme Court class action decisions: (1) a pro-business trend; and (2) seeking to move more class action litigation to the federal courts.

A "Mass Action" Under the Class Action Fairness Act Requires at Least 100 Individual Plaintiffs

In *Mississippi ex rel. Hood v. AU Optronics Corp.*, Mississippi sued LCD manufacturers in state court, alleging that the manufacturers violated state law and seeking restitution for LCD purchases made by itself and its citizens. The defendant LCD manufacturers sought to remove the case to federal court, arguing that the suit qualified as a "mass action" under CAFA. Besides allowing for the removal of class actions, CAFA allows for the removal of a "mass action." CAFA defines a mass action as any civil action "in which monetary relief claims of 100 or more persons are proposed to be tried jointly on the ground that the

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plaintiffs' claims involve common questions of law or fact." The District Court held that the suit qualified as a mass action because 100 or more unidentified Mississippi consumers had purchased LCD screens and were therefore real parties in interest to the State's restitution claim. Despite this, the District Court remanded the suit to state court on the ground it fell within CAFA's "general public" exception. On appeal, the Fifth Circuit agreed with the District Court that the suit was a mass action because the real parties in interest were over 100 individual citizens who purchased LCD products in Mississippi. But the Firth Circuit held the general public exception was inapplicable, allowing the case to be removed to federal court.

The Supreme Court unanimously reversed. It stated that the question is whether CAFA's definition of a mass action "includes suits brought by fewer than 100 named plaintiffs on the theory that there may be 100 or more unnamed persons who are real parties in interest as beneficiaries of the plaintiffs' claims." The Court held that it did not, based on the statutory text. As the court pointed out, CAFA states that a mass action is a civil action in which claims of "100 or more persons" are proposed to be joined, not "100 or more named or unnamed real parties in interest." Further, the Court found that the"100 or more persons" referred to in the statute are not unspecified individuals who have no actual participation, but instead the plaintiffs referred to later in the sentence ("mass action means any civil action . . . in which monetary relief claims of 100 or more persons are proposed to be tried jointly on the ground that the plaintiffs' claims involve common questions of law or fact . . . .").

Take Away from *Mississippi ex rel. Hood v. AU Optronics Corp*. The Supreme Court's decision clarifies that to qualify as a mass action under CAFA an action must have at least 100 named plaintiffs, and resolves a circuit split that arose after the Fifth Circuit's decision conflicted with decisions reached by the Fourth Circuit, Seventh Circuit, and Ninth Circuit. For businesses, the decision eliminates the potential to remove an action to federal court even if a large number of other individuals or entities may have an interest in or benefit from the litigation.

Removal to Federal Court Pursuant to the Class Action Fairness Act Gets Easier

In *Dart Cherokee Basin Operating Co., v. Owens*, the plaintiff filed a class action in Kansas state court alleging that the defendants underpaid royalties due under oil and gas leases. The defendants then removed the case to federal court, using the Class Action Fairness Act of 2005 ("CAFA") which gives federal courts jurisdiction over class actions if the amount in controversy exceeds $5 million. The plaintiff then moved to remand the case back to the Kansas state court. Although the defendants' notice of removal alleged that the purported underpayments totaled $8.2 million, the plaintiff argued that the removal notice was deficient as a matter of law because it included no evidence proving that the amount in controversy exceeded $5 million. In response to the motion to remand, the defendants submitted a detailed declaration supporting an amount in controversy over $11 million. Despite this, the Federal District Court granted the motion to remand, finding that Tenth Circuit precedent required proof of the amount in controversy in the notice of removal itself. The defendants petitioned the Tenth Circuit for permission to appeal, but the court denied review and rehearing en banc.

In a 5-4 ruling, the Supreme Court held that the Tenth Circuit abused its discretion in denying the appeal because the Tenth Circuit based its ruling on the erroneous view that the District Court had correctly applied the law for CAFA removals. As the Supreme Court explained, a defendant's notice of removal must include only a plausible allegation that the amount in controversy exceeds the jurisdiction threshold. Evidence establishing the amount is required only

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when the plaintiff contests, or the court questions, the defendant's allegation. Further, contrary to the District Court's finding, the Supreme Court explained there is no anti-removal presumption for cases invoking CAFA. The District Court erred in in remanding the case because the plaintiff did not contest the alleged amount in controversy in the defendants' notice of removal, and the Tenth Circuit abused its discretion in denying the appeal of the District Court's decision.

Take Away from *Dart Cherokee*. This decision is helpful for businesses seeking to use CAFA to remove class actions from state courts to federal court. As long as the notice of removal includes a plausible allegation that the amount in controversy exceeds CAFA's $5 million threshold, *Dart Cherokee* relieves defendants of the initial burden of gathering and providing evidence to establish that amount. This decision simplifies the removal process and makes it far more efficient and less costly.

Defeating Class Certification via Evidence on Alleged Public Misrepresentation

In *Halliburton Co. v. Erica John Fund, Inc.*, the plaintiff filed a putative 10b-5 securities fraud class action against Halliburton and one of its executives, alleging they made misrepresentations designed to inflate Halliburton's stock price. Investors can recover damages in a private securities fraud action only if they prove that they relied on the defendant's misrepresentations in deciding to buy or sell a company's stock. In *Basic Inc. v. Levinson*, 485 U.S. 224, the Supreme Court held that investors could satisfy this reliance requirement by invoking a presumption that the price of stock traded in an efficient market reflects all public, material information—including material misrepresentations. Here, the District Court initially denied the plaintiff's class certification motion on the ground it did not demonstrate it could prove a causal connection between the alleged misrepresentations and the alleged losses. The Fifth Circuit affirmed. But the Supreme Court vacated that judgment, concluding that securities fraud plaintiffs need not prove loss causation at the class certification stage to invoke *Basic's* presumption of reliance.

On remand, Halliburton argued that class certification was inappropriate because the evidence it offered to disprove loss causation also showed that its alleged misrepresentations had not affected its stock price. Halliburton contended this evidence had rebutted the *Basic* presumption and, without the benefit of the presumption, investors must prove reliance individually. Halliburton argued individual issues would predominate over common ones and the class could not be certified under Federal Rule of Civil Procedure 23(b)(3). The District Court rejected Halliburton's argument and certified the class. The Fifth Circuit affirmed, finding that Halliburton could only use its price impact evidence not at the class certification stage.

In a unanimous decision, the Supreme Court again vacated the Fifth Circuit's judgment. Although it disagreed with Halliburton's argument that *Basic* should be overruled, the Supreme Court held that securities fraud defendants must be afforded an opportunity to rebut the *Basic* presumption of reliance before class certification with evidence of a lack of price impact. The Court justified this decision by observing that defendants may already introduce evidence of a lack of price impact at the merits stage to rebut the *Basic* presumption, and at the class certification stage to counter a plaintiff's showing of market efficiency. According to the Court, "[f]orbidding defendants to rely on the same evidence prior to class certification for the particular purpose of rebutting the presumption altogether makes no sense, and can readily lead to results that are inconsistent with *Basic's* own logic." As the Court noted, *Basic* allows plaintiffs to establish price impact indirectly by showing that a stock traded in an efficient market and that a defendants' misrepresentations were public and material. But, "an indirect proxy should not prelude consideration of a defendant's direct" evidence showing that an alleged misrepresentation did not affect the stock's price and that the *Basic* presumption does not apply.

Take Away from *Halliburton Co. v. Erica John Fund, Inc.* This decision is a win for businesses facing 10b-5 securities fraud class actions. Although the *Basic* presumption that a public misrepresentation affected the price of a stock remains intact, *Halliburton* allows a defendant to overcome that presumption at the class certification stage by offering evidence that the misrepresentation did not affect the stock's price. Allowing defendants to offer this evidence at the class certification stage makes it easier for defendants to defeat certification of securities fraud class actions.

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* Law360, March 2014
** The American Lawyer 2013 and 2014 reports

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