Class Action Reformation

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SCOTUS: CLASS ACTIONS TRANSFORMED

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SUPREME COURT'S TRANSFORMATION OF CLASS ACTIONS

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WAL-MART STORES, INC. V. DUKES,
131 S. CT. 2541 (2011) (5-4);

COMCAST CORP. V. BEHREND,
133 S. CT. 1426 (2013) (5-4)*;*

AT&T MOBILITY LLC V. CONCEPCION,
131 S. CT. 1740 (2011) (5-4);

AM. EXPRESS CO. V. ITALIAN COLORS REST.,
133 S. CT. 2304 (2013) (5-3);

SUPREME COURT'S TRANSFORMATION OF CLASS ACTIONS

Rule 23. Class Actions

(a) Prerequisites. One or more members of a class may sue or be sued as representative parties on behalf of all members only if:

- **(1) the class is so numerous that joinder of all members is impracticable;**
- **(2) there are questions of law or fact common to the class;**
- **(3) the claims or defenses of the representative parties are typical of the claims or defenses of the class; and**
- **(4) the representative parties will fairly and adequately protect the interests of the class.**

WAL-MART STORES, INC. V. DUKES, 131 S. CT. 2541 (2011)

23(a)- "RIGOROUS STANDARD"

The Rule's four requirements — numerosity, [*7] commonality, typicality, and adequate representation — "effectively `limit the class claims to those fairly encompassed by the named plaintiff's claims.'" *General Telephone Co. of Southwest* v. *Falcon*, 457 U. S. 147, 156 (1982) (quoting *General Telephone Co. of Northwest* v. *EEOC*, 446 U. S. 318, 330 (1980)).**

WAL-MART STORES, INC. V. DUKES, 131 S. CT. 2541 (2011)

23(a)- "RIGOROUS STANDARD"

Rule 23 does not set forth a mere pleading standard. A party seeking class certification must affirmatively demonstrate his compliance with the Rule — that is, he must be prepared to prove that there are *in fact* sufficiently numerous parties, common questions of law or fact, etc. We recognized in *Falcon* that "sometimes it may be necessary for the court to probe behind the pleadings before coming to rest on the certification question," 457 U. S., at 160, and that certification is proper only if "the trial court is satisfied, after a rigorous analysis, that the prerequisites of Rule 23(a) have been satisfied," *id.*, at 161; see *id.*, at 160 ("[A]ctual, not presumed, conformance with Rule 23(a) remains . . . indispensable").

SUPREME COURT'S TRANSFORMATION OF CLASS ACTIONS

Rule 23. Class Actions

(b) Types of Class Actions. A class action may be maintained if:
(3) the court finds that the questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy. The matters pertinent to these findings include:
(A) the class members' interests in individually controlling the prosecution or defense of separate actions;
(B) the extent and nature of any litigation concerning the controversy already begun by or against class members;
(C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; and
(D) the likely difficulties in managing a class action.

COMCAST CORP. V. BEHREND, 133 S. CT. 1426 (2013)

23(b)– PREDOMINANCE

Repeatedly, we have emphasized that it "`may be necessary for the court to probe behind the pleadings before coming to rest on the certification question,' and that certification is proper only if `the trial court is satisfied, after a rigorous analysis, that the prerequisites of Rule 23(a) have been satisfied.'"

COMCAST CORP. V. BEHREND, 133 S. CT. 1426 (2013)

23(b)– PREDOMINANCE

The same analytical principles [*5] govern Rule 23(b). If anything, Rule 23(b)(3)'s predominance criterion is even more demanding than Rule 23(a). *Amchem Products, Inc.* v. *Windsor*, 521 U. S. 591, 623-624 (1997). Rule 23(b)(3), as an "`adventuresome innovation,'" is designed for situations "`in which "class-action treatment is not as clearly called for."`" *Wal-Mart*, supra, at ___ (slip op., at 22) (quoting *Amchem*, 521 U. S., at 614-615). That explains Congress's addition of procedural safeguards for (b)(3) class members beyond those provided for (b)(1) or (b)(2) class members (*e.g.*, an opportunity to opt out), and the court's duty to take a "`close look'" at whether common questions predominate over individual ones. Id., at 615**

AT&T MOBILITY LLC V. CONCEPCION, 131 S. CT. 1740 (2011);

CLASS ACTION WAIVERS ENFORCEABLE UNLESS UNCONSCIONABLE

When state law prohibits outright the arbitration of a particular type of claim, the analysis is straightforward: The conflicting rule is displaced by the FAA.

AM. EXPRESS CO. V. ITALIAN COLORS REST., 133 S. CT. 2304 (2013);

CLASS ACTION WAIVERS ENFORCEABLE EVEN WHEN OTHER RIGHTS IMPLICATED

Vindication of rights exception to FAA largely rejected. The fact that arbitration of individual claims might cost more than recovery is not a basis to set aside arbitration contract and class waiver.

Justice Kagan Dissent: "Too darn bad"

WHAT DOES IT MEAN?

CONTRACTS TO WAIVE CLASS ACTIONS WILL BE ENFORCED

CLASS ACTIONS WILL UNDERGO RIGOROUS ANALYSIS BEFORE CERTIFIED

Stirring muddy waters: siting securities transactions by the point of irrevocable liability
By George Skelly, Ashley Baynham, and Ernie Gao

Last week, the United States Court of Appeals for the Second Circuit announced its new test for deciding when and how a securities transaction not involving securities listed on a domestic exchange should nonetheless be considered "domestic" under Morrison v. National Australia Bank Ltd., 130 S. Ct. 2869 (2010) ("Morrison"). "Domestic" transactions are subject to the federal securities laws. In Absolute Activist Value Master Fund v. Ficeto, 2012 U.S. App. LEXIS 4258 (2d Cir., Mar. 1, 2012) ("Absolute Activist"), a panel comprised of Circuit Judges Katzmann, Newman, and Winter held that a plaintiff alleges the existence of domestic securities transactions when it pleads facts suggesting that either "the parties to [a securities transaction] incurred irrevocable liability within the United States," or "title [for the securities] was transferred within the United States." Id. at *20-21. While the United States Supreme Court in Morrison adopted a bright-line rule against the extra-territorial reach of the federal securities laws, Absolute Activist's interpretation of Morrison's transactional analysis could keep hopes alive for some foreign plaintiffs who try to bring federal securities suits within the Second Circuit.

By the time it reached the Second Circuit for review, *Absolute Activist* involved claims brought by nine Cayman Islands hedge funds under Section 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder. These nine Cayman Islands hedge funds (the "Plaintiffs-Appellants" or "Funds") alleged that they had been defrauded in a variation on the classic "pump-and-dump" scheme where interested parties sell out, then artificially inflate the price of a stock leaving behind customers now holding securities of little value.

The defendants in the alleged version of this scheme in *Absolute Activist* included the investment manager of the Funds, officers of the interested manager, various individuals and entities that sold shares of thinly capitalized companies ("U.S. Penny Stocks") to the Funds, and a broker-dealer based in the United States and created by the individual defendants. The Funds claimed that these defendants acted in concert to manipulate the prices of the U.S. Penny Stocks by engaging in a series of fraudulent transactions in which they, acting as placement agents for the Funds, caused the Funds to purchase U.S. Penny Stocks. The defendants then allegedly artificially inflated the stock price by repeatedly trading these U.S. Penny Stocks between and among the Funds to create the illusion of trading volume. The purpose of this purported scheme was to generate higher fees and commissions for the defendants, and to allow the defendants to earn a

windfall by unloading their U.S. Penny Stocks—which they had literally acquired for pennies or less—on the Funds.

The Funds filed their complaint in the Southern District of New York in October 2009, and amended their complaint a month later. Some of the defendants moved to dismiss the complaint for failure to state a claim, for lack of personal jurisdiction, and for improper venue. After the Supreme Court decided *Morrison,* on June 24, 2010, the District Court *sua sponte* dismissed the complaint pursuant to *Morrison* on the grounds that it lacked subject matter jurisdiction, or in the alternative that the complaint failed to state a cause of action.[1]

On appeal, the Second Circuit began by addressing the impact of *Morrison*, which had rejected the Second Circuit's former "conducts and effects test" in favor of a bright-line rule that Section 10(b) and Rule 10b-5 do not apply extraterritorially, but only to "transactions in securities listed on domestic exchanges and domestic transactions in other securities." *Absolute Activist*, at *15 (quoting *Morrison,* 130 S. Ct. at 2884, 2866). The Funds' complaint did not implicate "the first prong of Morrison—whether a transaction involves a security listed on a domestic exchange. Rather, we must interpret *Morrison*'s second prong and determine under what circumstances the purchase or sale of a security that is not listed on a domestic exchange should be considered 'domestic' within the meaning of *Morrison*."[2] *Id.* at *15-16.

Having framed the issue in this manner, the Second Circuit pointed out that *Morrison* "provides little guidance on what constitutes a domestic purchase or sale" of securities. *Id.* at 18. Thus, the court began by parsing the language of the Exchange Act, which defines "purchase" and "sale" to include contracts to buy or sell securities. *Id.* at 19. The Second Circuit also noted that a purchase or sale of securities is deemed to occur the moment the parties to the securities transaction "obligat[e] themselves to perform what they had agreed to perform even if the formal performance of their agreement" is to occur later. *Id.* After invoking the meeting of the minds in the "classic contractual sense," the court extended this principle to answer the "where" question presented here: "Given that the point at which the parties become irrevocably bound is used to determine the timing of a purchase and sale, we similarly hold that the point of irrevocable liability can be used to determine the locus of a securities purchase or sale." *Id.* at 20.

But that was not all. Because a "sale" is ordinarily defined as "the transfer of property or title for a price," the Second Circuit went on to hold as well that "a sale of securities can be understood to take place at the location in which title is transferred." *Id.* at 21. It therefore concluded that "to sufficiently allege a domestic securities transaction in securities not listed on a domestic exchange, . . . a plaintiff must allege facts suggesting that irrevocable liability was incurred or title was transferred within the United States." *Id*. at 22.

In arriving at this conclusion, the Second Circuit rejected several alternative analyses that the parties had proposed. Thus, the following factors are irrelevant to a determination of whether a securities transaction occurred domestically: (i) where the broker-dealer performs tasks that irrevocably bind the parties to a securities transaction, (ii) whether the securities were issued by domestic entities or entities registered with the SEC, (iii) the citizenship or residence of the purchaser or seller of securities, and (iv) whether each individual defendant or participant in the scheme personally engaged in the fraudulent conduct while in the United States. *Id.* at 22-25*.*

Having articulated its general holding, the Second Circuit then turned to the Funds' complaint and concluded that it did not allege sufficient facts to raise the inference that domestic securities transactions had occurred. While the Funds' allegations that the securities were marketed in the United States or that the fraudulent conduct harmed domestic investors might have met the "now-defunct conducts and effects test," those allegations did not satisfy *Morrison*. *Id.* at 27. And allegations about where subscribers to the Funds had wired money (to New York) were inapposite because the claims were based on the Funds' purchases, not their investors. *Id.* at 26-27. The Second Circuit nonetheless gave the Funds leave to amend their complaint because it had been drafted and filed prior to *Morrison*, and because the Funds had made factual representations during oral argument that suggested

1 Although the District Court had committed a threshold error under Morrison by dismissing the complaint for lack of subject matter jurisdiction rather than on the merits. the Second Circuit nonetheless considered whether the complaint alleged domestic securities transactions within the reach of Section 10(b) because the District Court's alternate ground for dismissal had been under Federal Rules of Civil Procedure 12(b)(6). See Absolute Activist, at *18.

2 Notably, the Second Circuit acknowledged that the SEC had successfully argued—in an enforcement action against several of the same defendants involving many of the same factual allegations as the Funds' complaint—that the first prong of Morrison had been met because the U.S. Penny Stocks were traded on the domestic over-the-counter market. Because the Funds had not argued that the first prong of Morrison had been satisfied, the Second Circuit did not consider this argument. Absolute Activist, at *15 n.4

that leave to amend would not be futile. *Id.* at 30.

So what does it mean to have incurred irrevocable liability in the United States in a securities transaction? In deciding *Absolute Activist*, the Second Circuit ventured the types of allegations that might support the inference that a purchase or sale of securities had occurred in the United States: "facts concerning the formation of the contracts, the placement of purchase orders, the passing of title, or the exchange of money." *Id.* at 26. Because a plaintiff could allege facts from which one could plausibly infer "that the purchaser incurred irrevocable liability within the United States to take and pay for a security, *or* that the seller incurred irrevocable liability within the United States to deliver a security,"[3] *Id.* at 20 (emphasis added), the door remains open to foreign plaintiffs so long as one party becomes irrevocably bound to the transaction within the United States.

The Second Circuit's new pronouncements have been made in the context of a pre-*Morrison* pleading that barely addressed the issue. The contours of what facts will adequately establish domestic "irrevocability" of either a purchase or sale therefore remain to be fleshed out.

In the meantime, a related question in the shadow of *Morrison* (and now *Absolute Activist*) that has yet to percolate through the courts is whether some similar "bright line" test will be articulated to forestall some enforcement actions based on non-U.S. "offers" under Section 17(a) of the Securities Act, 15 U.S.C. § 77q. As the U.S. Securities & Exchange Commission strives to bring defendants to task based on complex securities transactions in the aftermath of the economic downturn, it appears to be relying more on such negligence-based quasi-fraud claims that turn on there being an "offer" rather than a "purchase or sale" such as Rule 10b-5 entails. To the extent the transactions involved in those claims involve overseas funds, offshore entities and other largely foreign components, even U.S. resident defendants, will likely explore carefully whether some "transactional" test for locating where the "offer" occurred might be invoked. Here, of course, it is not clear whether or how a concept of "irrevocability" might come into play, and the landscape of where the situs of an offer should be located remains open for development.

Absolute Activist could have broad ramifications on the scope of government enforcement over domestic financial institutions that market and sell securities to investors or purchasers located abroad. Financial institutions, placement agents, and other issuers of securities to foreign investors hoping for additional predictability from the Second Circuit on how *Morrison* applies to securities not listed on domestic exchanges should pay close attention to how lower courts apply the teaching of *Absolute Activist*.

3 The Second Circuit noted that this test had already been adopted by district courts in this Circuit. See, e.g., SEC v. Goldman Sachs & Co., 790 F. Supp. 2d 147, 159 (S.D.N.Y. 2011).

Gabelli v. SEC

By Christopher M. Mason, Alex Lipman, Sean T. Haran, Carolyn G. Nussbaum, and Emily Sy

The Supreme Court of the United States has unanimously held that the general five-year statute of limitation set forth in 28 U.S.C. § 2462 applies to SEC actions seeking civil penalties and begins to run from the date of the occurrence of a violation, not from the date of its discovery by the government. The Court premised its decision on the "most natural reading of the statute." In doing so, the Court overturned the Second Circuit, which had held that a "discovery rule" applied to Section 2462 in this context, and therefore, that the statute of limitations only began to run when the "claim [was] discovered, or could have been discovered with reasonable diligence." The Second Circuit had reasoned that because fraud claims "by their very nature involve self-concealing conduct . . . the discovery rule applies." *SEC v. Gabelli*, 653 F.3d 49, 59 (2d Cir. 2011).

The defendants in *Gabelli* had allegedly allowed an investor in their fund to engage in time zone arbitrage, a variant of market timing which, while technically legal, could result in harm to the long-term investors in the same fund. Because the defendants were alleged to have hidden this conduct from other investors in the fund, the SEC sued them for, among other things, penalties for violating certain antifraud provisions of the federal securities laws. Interestingly, according to the transcript of the oral argument before the Court, when asked why the government was late in bringing its action, the government responded that "there was a lot of back and forth between the parties, document exchanges. . . . The government hoped there would

be a settlement." But when the ultimate settlement only encompassed the fund and not the individual petitioners, the government decided to bring its case. Oral Argument at 37:10-35, *Gabelli v. SEC*, 568 U.S. ___ (2013), available at http://www.supremecourt.gov/oral_arguments/argument_transcripts/11-1274.pdf.

In its opinion, the Court emphasized that the discovery rule applies to claims by fraud victims—including even the government when it had been defrauded—because the discovery rule is meant to aid recompensing those victims. The Court noted that the purpose of an action seeking a civil penalty by the SEC is to punish and label wrongdoers, not to provide compensation to the injured, and for that reason, the SEC is in a very different position. Given that the SEC has at its disposal "many legal tools at hand to aid" rooting out fraud, it made little sense to the Court to allow the SEC to take advantage of a discovery rule. The Court further observed that, as a pragmatic matter, determining when the government discovers a violation could be very difficult given the "hundreds of employees, dozens of offices and several levels of leadership" that characterize a typical agency. Applying a discovery rule to Section 2462 would, the Court worried, create an environment of uncertainty and leave defendants indefinitely exposed to government action for penalties.

The decision in *Gabelli* is a win for the defense bar. However, even when the SEC is barred from bringing an enforcement action within the five-year statute of limitations, the SEC may still seek equitable relief, such as an injunction or disgorgement. (The issue of application of Section 2462 to suits seeking equitable remedies was not before the Court.) In addition, it will be interesting to see if the SEC or other government agencies will ask Congress to Section 2462 in response to the Court's opinion in *Gabelli*.

Keeping things Basic: The Supreme Court rules in Halliburton

By Carolyn G. Nussbaum, Christopher M. Mason and Leah Threatte Bojnowski

As Jean-Baptiste Alphonse Karr said in the January 1849 issue of *The Wasps*, "plus ça change, plus c'est la même chose." Given the signals from several Justices in recent rulings, securities lawyers and academics speculated that the Supreme Court might use its second review of *Halliburton Co. v. Erica P. John Fund, Inc.* either to overrule, or to materially modify, the "fraud-on-the-market" presumption of reliance that the Court had first announced in *Basic Inc. v. Levinson*, 485 U. S. 224 (1988). (That presumption allows a plaintiff to establish reliance as a common issue for purposes of class certification in federal securities fraud cases.)

Instead, the unanimous decision of the Court yesterday (albeit with an opinion by three Justices concurring in the result to remand, but urging the reversal of *Basic*) emphasized that the presumption of reliance is rebuttable rather than conclusive and clarified the timing and burdens of proof required to establish and overcome the doctrine. In the view of six Justices, there simply was not an adequate "special justification" to overturn the existing precedent of *Basic. Halliburton Co. v. Erica P. John Fund, Inc.,* No. 13-317, slip op. at 4 (June 23, 2014) (*Halliburton II*). Only future cases will reveal whether defendants can, as a practical matter, take full advantage of the holding, announced by Chief Justice Roberts, "that defendants should at least be allowed to defeat the presumption [of reliance] at the class certification stage through evidence that the misrepresentation did not in fact affect the stock price. *Id*. at 18.

Background

To state a claim for securities fraud under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq*., and Rule 10b-5, one of the six key elements is proof that the plaintiff relied on the claimed misstatement or omission. *See, e.g., Halliburton II,* slip op. at 5. In damages class actions, this could present significant problems for plaintiffs, because Federal Rule of Civil Procedure 23(b)(3) prohibits certification of a class unless questions of law or fact common to the class predominate over individual questions. In *Basic Inc. v. Levinson*, the Supreme Court recognized this problem, *see* 485 U.S. at 245, but resolved it by endorsing a presumption of reliance "based on the hypothesis that, in an open and developed securities market, the price of a company's stock is determined by the available material information regarding the company and its business. . . . Misleading statements will therefore defraud purchasers of stock even if the purchasers do not directly rely on the misstatements. . . ." *Id.* at 241. Under this theory, "an investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price. Because most publicly available information is reflected in market price, an investor's reliance on any public material

misrepresentations, therefore, may be presumed for purposes of a Rule 10b-5 action." *Id.* at 247. The Court reasoned that this presumption of reliance would be consistent with and support congressional policy because it would "facilitate[] Rule 10b-5 litigation." *Id.* at 246. While the presumption was intended to be rebuttable, some believe, as the concurrence by Justice Thomas yesterday noted, that "*Basic's* presumption that investors rely on the integrity of the market price is virtually irrebuttable in practice . . . ." *Halliburton II*, concurrence in judgment, at 5.

The Supreme Court hinted in a footnote last year that the "fraud-on-the-market" theory might be ready for reexamination given the increasing debates among economists over some of its underlying assumptions.[1] The possibility of a change in the law was underscored by blunt statements from Justice Alito in a concurring opinion in *Amgen*, and a detailed criticism of the doctrine in a dissent by Justice Thomas in which Justices Kennedy and Scalia joined. The *Halliburton II* case appeared to create an ideal opportunity to revisit the issue.

The Halliburton Case

This is the second trip to the Supreme Court for the *Halliburton* case. Stockholders sued Halliburton in 2002, alleging that it misrepresented its liability in asbestos litigation, revenue from certain contracts and the benefits of a recent merger, purportedly to inflate its stock price. The plaintiffs sought certification of a class of all investors who purchased Halliburton common stock between 1999 and 2001. The District Court denied certification, and the Fifth Circuit affirmed, holding that the plaintiffs had not proved "loss causation" (that the alleged misrepresentations caused the economic loss) at the class certification stage and therefore could not invoke the presumption of fraud-on-the-market.[2] In a unanimous, but narrowly worded opinion, the Supreme Court vacated the Fifth Circuit's affirmance of this decision, clarifying that loss causation and reliance are distinct elements of a securities fraud claim, and only reliance need be proven to obtain certification.[3] In its opinion, the Court specifically declined to address "*Basic*, its presumption, or how and when it may be rebutted."[4]

The fraud-on-the-market issues left unresolved in *Amgen* and *Halliburton I* were framed on remand, where Halliburton argued that it should be entitled to present proof of the absence of price impact—that the alleged misrepresentations did not actually affect the price of the stock—at the class certification stage to rebut the presumption of fraud-on-the market. The District Court rejected that argument without discussion, and certified a class. The Fifth Circuit affirmed the lower court's decision, including its refusal to consider evidence of an absence of price impact. The Supreme Court then granted certiorari to consider whether *Basic*'s fraud-on-the-market theory should be upheld, rejected or modified, and whether the presumption of reliance may be rebutted at the class certification stage of a case with evidence that the misrepresentations did not impact the market price of the stock. *Halliburton II,* slip op. at 4.

In its briefing and at oral argument, Halliburton asserted that the two premises on which *Basic* rests are no longer valid: capital markets are not fundamentally efficient and investors do not always invest in reliance on the integrity of [the market] price. *See Halliburton II,* slip op. at 8-9. As an alternative to overruling *Basic*, Halliburton also asked the Court to require plaintiffs to provide affirmative proof of price impact, or expressly recognize the right of the defendant to demonstrate a lack of price impact, to defeat class certification.

In the end, however, the Court focused on *stare decisis* and its historical deference to precedent. At most, Chief Justice Roberts concluded, Halliburton was arguing that *Basic* was simply wrongly decided, which was insufficient to establish the "special justification" required to overrule the precedent of *Basic*. *Halliburton II,* slip op. at 4. In his opinion for the Court, the Chief Justice reviewed economists' debates over the efficient market hypothesis that some believe to be necessary for the fraud-on-the-market doctrine, but found that Halliburton had "not identified the kind of fundamental shift in economic theory that could justify overruling a precedent on the ground that it misunderstood, or has since been overtaken by, economic realities." *Halliburton II,* slip op. at 11.

Consistent with this result, the Chief Justice's opinion also rejected Halliburton's argument that plaintiffs should bear the burden of proving the existence of price impact as part of establishing the elements of fraud-on-the-market. *Id.*, slip. Op. at 20-21. The Court did agree with Halliburton, however, that "defendants should be allowed to defeat the presumption at the

1 See Amgen Inc. v. Conn. Retirement Plans and Trust Funds, 133 S. Ct. 1184 n.2 (2013).
2 Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co., No. 3:02-CV-1152, 2008 U.S. Dist. LEXIS 89598 (N.D. Tex. Nov. 4, 2008), aff'd, 597 F.3d 330 (5th Cir. 2010).
3 Erica P. John Fund, Inc. v. Halliburton Co., 131 S. Ct. 2179, 2186 (2011) (Halliburton I).
4 131 S. Ct. at 2187.

class certification stage through evidence that the misrepresentation did not in fact affect the stock price." *Halliburton II,* slip op. at 18. Some courts had already accepted such proof when submitted to challenge a plaintiffs' showing that the stock at issue traded in an efficient market. The opinion by Chief Justice Roberts clarified that a lack of price impact may also be presented by a defendant at the class certification stage as a direct attack on the fraud-on-the-market doctrine and the presumption of reliance it permits. *Halliburton II,* slip op. at 20-21. On this basis, six members of the Court agreed, the refusal to consider such evidence below required reversal.

The divergence of views of the Justices portend further debate, however. Indeed, the concurrence by Justice Thomas, joined by Justices Alito and Scalia, does not mince words: in their view, "*Basic* should be overruled." *Halliburton II*, concurrence in judgment, at 14. Additionally, both that concurrence and the opinion by the Chief Justice agree that application of the presumption of reliance at the class certification stage does not mean that all class members will necessarily have relied in fact upon the information in question. Individual instances of lack of reliance can and will still exist. *See Halliburton II,* slip op. at 15. But while the Chief Justice's opinion suggests "[t]hat the defendant might attempt to pick off the occasional class member here or there through individualized rebuttal," *id.,* the concurrence notes that "the realities of class-action procedure make rebuttal based on an individual plaintiff 's lack of reliance virtually impossible." *Halliburton II,* concurrence in judgment, at 13.

One problem is the unsupported presumption by Chief Justice Roberts that the number of non-relying class members will only be "occasional." In an environment where trading is increasingly driven by automated data analysis, without any direct human perception or evaluation of information, the number of potential class members who do not really rely on the integrity of the markets may be more than "occasional." (And even the "occasional" class member that does not rely on the integrity of the markets for its trades may constitute a large portion of any claimed damages.) Some cases may have a sufficient number of non-relying class members such that the requirement of Federal Rule of Civil Procedure 23(b)(3)(D)—manageability—would come into play if only a defendant could demonstrate the existence of such class members. Technically, the three Justices concurring only in the result are not correct that "at the class-certification stage, rebuttal is only directed at the class representatives, which means that counsel only needs to find one class member who can withstand the challenge." *Halliburton II,* concurrence in judgment, at 13. A defendant could be permitted to show, for example, that class members actually exist who did not rely on a supposed misstatement (or would have traded even had omitted information been public somewhere), and that their existence predicts the existence of others in sufficient numbers to make the litigation of the case on a class basis unmanageable. But the *Halliburton* opinions simply do not (among other things) deal with the manageability element of class certification at all.

Conclusion

The certification stage will remain the battleground that it has become, as virtually all commentators agree that once a class is certified, the cost of resolution increases dramatically. While the majority opinion suggests that that argument is best addressed to Congress, the reality is that the complexities of these issues, requiring expert analysis and testimony, will confound some courts, and inevitably lead to further conflicting opinions. The lower courts are likely to struggle with a number of issues, including the extent and degree of proof sufficient to rebut the presumption and the scope of allowable discovery relevant to these issues. Meanwhile, at least three of the Justices have remained steadfast in their belief that *Basic* should be overruled. The next opportunity may yet arise as the contours of the fraud-on-the-market doctrine remain a matter of debate.

Ninth Circuit applies Concepcion to invalidate California's "public injunction" exception to arbitration and further upholds KeyBank's "opt-out" clause title

By W. Scott O'Connell and W. Daniel Deane (Counsel to KeyBank in action)

The Supreme Court's pro arbitration message from *Concepcion* has once again reached the Ninth Circuit U.S. Court of Appeals with a direct impact on California's Unfair Competition Law. In its March 7, 2012, decision in the putative class action captioned *Kilgore, et al. v. KeyBank, National Association*, No. 09-16703, a three-judge panel of the Ninth Circuit[1] scuttled a line of California cases[2] mandating that

1 Circuit Judges Stephen S. Trott and Carlos T. Bea, and District Judge Rebecca R. Pallmeyer, sitting by designation.

2 Broughton v. Cigna Health-plans of California, 988 P.2d 67 (Cal. 1999); Cruz v. Pacificare Health Systems, Inc., 66 P.3d 1157 (Cal. 2003). See

arbitration agreements in California are not enforced where the plaintiff is "functioning as a private attorney general" in that the only relief sought is an injunction "enjoining future deceptive practices on behalf of the general public." *Id*. at 2645 (quoting *Broughton v. Cigna Health-plans of California*, 988 P.2d 67, 76 (Cal. 1999)). Despite misgivings that the ruling might reduce the effectiveness of California's robust consumer protection laws, the Ninth Circuit concluded that, following the Supreme Court's recent decision in *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011), there could be no doubt that the Federal Arbitration Act ("FAA") preempts the California law. The Ninth Circuit also ruled that the plaintiffs could not prevail on their alternative argument that the arbitration clause was unconscionable because KeyBank provided its borrowers with a meaningful opportunity to "opt-out" of arbitration.

The *Kilgore* lawsuit was brought by two disgruntled students of Silver State Helicopters, LLC ("SSH"), a national aviation school that closed operations and declared bankruptcy in February 2008. KeyBank had been one of the lenders to SSH students. The plaintiffs, seeking to represent a class of former California-based SSH students, claimed that SSH did not deliver on the education it promised, and that under California's Unfair Competition Law ("UCL"), KeyBank, as a preferred lender, should be held liable for SSH's failures. Seeking a judicial forum for their class action, the plaintiffs filed four different complaints, the last one of which contained carefully crafted allegations to trigger California's public injunction exception. Rather than seeking damages from KeyBank, the plaintiffs asked for an order enjoining KeyBank from enforcing its SSH promissory notes and from reporting delinquencies to the credit reporting agencies. Each of those promissory notes contained an arbitration clause providing that either party could elect binding arbitration of any disputes.

KeyBank elected to arbitrate the dispute and filed a motion asking the U.S. District Court for the Northern District of California to stay the *Kilgore* lawsuit and compel arbitration. Judge Thelton E. Henderson denied KeyBank's motion based on California's policy against arbitrating cases seeking a public injunction. KeyBank preserved the arbitration issue by immediately filing for interlocutory appeal pursuant to the FAA, but the district court retained jurisdiction and ruled on KeyBank's alternative motion to dismiss.[3] Ironically, the district court granted KeyBank's motion to dismiss, ruling that the National Bank Act and the regulations of the Office of the Comptroller of the Currency preempt plaintiffs' UCL claims. Plaintiffs appealed the district court's dismissal order to the Ninth Circuit and that appeal was consolidated with KeyBank's appeal of the arbitration decision.

The Ninth Circuit panel viewed the arbitration appeal as a threshold issue. Analyzing the text of the FAA, the panel recognized that where the parties to a contract have agreed to arbitration, the FAA "leaves no place for the exercise of discretion by a district court, but instead mandates that district courts *shall* direct the parties to proceed to arbitration." *Id*. at 2640 (quoting *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 218 (1985)). The limited exception to this mandate is where the arbitration clause would be unenforceable "upon such grounds as exist at law or in equity for the revocation of *any* contract." *Id*. at 2641 (emphasis added) (quoting 9 U.S.C. § 2). Thus, "a state statute or judicial rule that applies only to arbitration agreements, and not to contracts generally, is preempted by the FAA." *Id*.

As the Ninth Circuit acknowledged, the recent ruling in *Concepcion* is just the latest in a line of Supreme Court cases that have vigorously applied FAA preemption against state laws that are hostile to arbitration. In *Concepcion*, the Supreme Court threw out California's *Discover Bank* rule, which had prohibited as unconscionable all arbitration clauses that require a consumer to arbitrate all disputes in an individual bilateral arbitration and never as part of a plaintiff or class member in a class action proceeding.[4] The Court ruled that the FAA preempted California's anti-class action waiver rule because "[r]equiring the availability of classwide arbitration interferes with fundamental attributes of arbitration and thus creates a scheme inconsistent with the FAA." *Id*. at 2644 (quoting *Concepcion*, 131 S. Ct. at 1748). Notably, the Court stated that states "cannot require a procedure that is inconsistent with the FAA, even if it is desirable for unrelated reasons." *Id*. (quoting *Concepcion*, 131 S. Ct. at 1753).

The Ninth Circuit recognized that the rationale of *Concepcion* also mandates the end of California's public injunction rule. That rule prohibits arbitration of claims that seek an injunction for the benefit of the public. Because the California rule "prohibits outright

also Davis v. O'Melveny & Myers, 485 F.3d 1066, 1082 (9th Cir. 2007) (applying California rule against arbitrating actions seeking public injunctions).

3 Unlike the majority of other circuits, in the Ninth Circuit the district court is not divested of jurisdiction upon a timely filed interlocutory appeal. That situation resulted in further proceedings before the district court while the appeal was pending.

4 Discover Bank v. Superior Court, 113 P.3d 1100 (Cal. 2005).

the arbitration of a particular type of claim, the analysis is straightforward: The conflicting rule is displaced by the FAA." *Id*. at 2643 (quoting *Concepcion*, 131 S. Ct. at 1747); *see also Id*. at 2650 (citing *In Marmet Health Care Center, Inc. v. Brown*, Nos. 11-391 and 11-394, 2012 U.S. LEXIS 1076 (Feb. 21, 2012) (per curiam) (preempting West Virginia law that prohibited arbitration of personal injury and wrongful death claims). In other words, Congresses' judgment, embodied in the text of the FAA, that all valid agreements to arbitrate should be enforced trumps any state legislature's conclusion that arbitration is not suitable in some cases.

The Ninth Circuit recognized, however, that *Concepcion* did not overthrow general common law contract defenses like unconscionability. The Court ruled that KeyBank's arbitration clause was not procedurally unconscionable because it was conspicuously displayed in the promissory note and was written in plain language. *Id*. at 2655. More importantly, the promissory note provided a meaningful opportunity for the borrower to opt-out of the arbitration agreement by submitting an opt-out notice to KeyBank in writing within 60 days. The promissory note set forth in plain language, in multiple locations in the document, the rights that plaintiff would waive by failing to opt-out. *Id*. The panel rejected plaintiffs' arguments that KeyBank did not go far enough. The opt-out instructions were clear and easy to follow, and, even to the extent that "Plaintiffs claim that they were so 'intoxicated by helicopters' that they never saw the arbitration clause, [the Court] refer[s] them to the end of the Note. Immediately above each Plaintiff's signature line is a warning that the student should read the contract carefully before signing, as well as a promise from the student that he would do so 'even if otherwise advised.'" *Id*. at 2656. Finding that the arbitration clause was not procedurally unconscionable, the Court did not address whether the terms of the clause were substantively unconscionable. *Id*.

Having concluded that the motion to compel arbitration should have been granted, the Ninth Circuit found that the district court's dismissal order was a nullity. The Ninth Circuit vacated the judgment in favor of KeyBank and remanded to the district court with instructions to enter an order staying the case and compelling arbitration. Thus, by winning its arbitration argument, KeyBank's favorable judgment on the merits based also on preemption was vacated. But given the broad repercussions of this ruling, including the expansion of *Concepcion* and the Ninth Circuit's explicit validation of KeyBank's arbitration clause and opt-out provision, it was a worthwhile exchange. Additionally, while the two *Kilgore* plaintiffs may continue to pursue their claims, they must do so as individuals as the arbitration agreement has a class waiver.

For consumer-facing companies with arbitration agreements, the *Kilgore* opinion is an important read to assess whether your provision would pass the unconscionability filter applied by this Court. Also, if you are managing cases in which efforts to compel arbitration have been defeated because injunctive relief is involved, this authority gives new vitality to your argument.

Nixon Peabody was counsel to KeyBank in this proceeding.

U.S. Supreme Court will hear landmark class action waiver case: American Express Co. v. Italian Colors Restaurant

By Paige L. Berges and Christopher M. Mason

This past week, the United States Supreme Court granted a writ of certiorari to review the most recent decision of the United States Court of Appeals for the Second Circuit in *American Express Travel Related Services Co. v. Italian Colors Restaurant ("In re Amex Merchants' Litigation")*. *See* No. 12-133, 2012 US LEXIS 8697(Nov. 9, 2012). The Second Circuit has addressed the arbitration clause and class action waiver in this case three times since 2009, and it has been to the Supreme Court once before already. It is back at the Supreme Court because, following remand to the Second Circuit in 2010, the Court of Appeals—as it had done twice before—reversed the trial court's decision in favor of individual arbitration, once again determining that the relevant arbitration and class action waiver clauses at issue were unenforceable.

The Supreme Court has not yet squarely addressed the question of whether or under what conditions a class action waiver might not comport with the Federal Arbitration Act (the "FAA," 9 U.S.C. §§ 1-16). The Supreme Court's upcoming decision could determine whether plaintiffs can relatively easily avoid such clauses in the future.

Background

The enforcement of contractual arbitration and class

action waiver clauses has been the subject of significant litigation in the past few years. (See, for example, our prior alert here.) The Supreme Court has been strongly supportive of arbitration, and has indicated some support for class action waivers. Not all lower courts have demonstrated the same deference, however.

Plaintiffs in the *In re Amex Merchants' Litigation* case are merchants (not consumers) who accept Amex cards for customer purchases. Amex and its chief competitors, Visa and Mastercard, earn revenue by withholding a "merchant discount fee" from each charged transaction. Plaintiffs allege that Amex charges a supra-competitive fee that exceeds the fee charged by Visa and Mastercard under circumstances that constitute a violation of federal antitrust law.

The contract that permits the American Express Company ("Amex") to charge a fee is its Card Acceptance Agreement (the "Agreement") with merchants. The Agreement is a form contract. Merchants do not negotiate its terms with Amex. It contains an "Honor All Cards" provision, which requires that merchants accept both Amex's charge cards (where the customer pays in full at the end of the month) and Amex's credit cards (where the customer can pay over time, like a typical credit card). According to the plaintiffs, legitimate reasons permit Amex to charge a higher fee with respect to its charge cards. But when Amex charges a higher fee for its credit card, plaintiffs allege that it does so by improperly using the "Honor All Cards" provision of the Agreement to create an illegal "tying arrangement" between the two different card products all in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1; *see e.g.*, *Northern Pacific Railway Co. v. United States*, 356 U.S. 1, 5-6 (1958) (defining a tying arrangement as "an agreement by a party to sell one product but only on the condition that the buyer also purchases a different (or tied) product . . . .").

In addition to its "Honor All Cards" provisions, the Amex Agreement contains a mandatory arbitration clause and class action waiver clause. These clauses preclude merchants from suing in court or commencing any arbitration other than on an individual (non-class) basis. Plaintiffs challenged this clause by filing suit in the United States District Court for the Southern District of New York rather than commencing an arbitration.

Amex I

On March 16, 2006, the District Court determined that the enforceability of the class action (or class arbitration) waiver was a matter to be decided by arbitrators and granted Amex's motion to compel arbitration under the FAA. *In re Amex Merchants' Litig.*, No. 06-1871, 2006 U.S. Dist. LEXIS 11742 (S.D.N.Y. March 16, 2006). The plaintiffs promptly appealed. In a January 30, 2009, opinion the Second Circuit reversed, concluding that the plaintiffs had properly raised a question of the enforceability of the class waiver provision, and, by extension, the arbitrability of the dispute, and that the issues were therefore for decision by a court, not any arbitrator. It further determined that the class waiver provision was unenforceable under the FAA because its enforcement would effectively preclude any action by plaintiffs. *See In re Amex Merchants' Litig.*, 554 F.3d 300 (2d Cir. 2009) ("*Amex I*").

In reaching these conclusions, the Second Circuit noted both the strong federal policy in favor of arbitration and recent debates surrounding class waivers in mandatory arbitration clauses. *Id.* at 302-03. But it also cited the Supreme Court's decision in *Green Tree Fin. Corp.-Alabama v. Randolph*, 531 U.S. 79, 82 (2000), for the proposition that a party may seek to invalidate an arbitration agreement on the grounds that arbitration would be prohibitively expensive if the plaintiff can show the likelihood of incurring such costs. *Amex I,* 554 F.3d at 315 (also citing *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc*., 473 U.S. 614 (1985), and *Gilmer v. Interstate/Johnson Lane Corp*., 500 U.S. 20 (1991)).

Although the Second Circuit recognized that, in the Supreme Court decisions it cited, the Supreme Court had enforced the underlying arbitration clauses, the Second Circuit claimed that a collective remedy was available in those cases, unlike in *Amex I.* It then concluded that the plaintiffs' evidence showed that they could not pursue their claims as individual arbitrations. The plaintiffs' expert had, for example, opined that an average single merchant might need to spend hundreds of thousands of dollars in order to claim only several thousand dollars in damages. The Second Circuit rejected the analysis (offered both by Amex and the District Court) that trebling of damages under the Clayton Act and the availability of attorneys' fees for a prevailing party would make an individual claim economically feasible. Instead, the Second Circuit held that to enforce the Agreement would "grant Amex *de facto* immunity from antitrust liability by removing the plaintiffs' only reasonably feasible means of recovery." *Id.* at 320. Amex responded with a petition for a writ of certiorari. *See American Express Co. v. Italian Colors Restaurant*, 130 S. Ct. 4201 (2010).

Amex II

The Supreme Court granted Amex's petition for certiorari and remanded the case for further consideration following its decision in *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 130 S. Ct. 1758 (2010). In that case, the Supreme Court held that a party cannot be forced to submit to class arbitration without evidence that it had agreed to such a collective procedure (and that silence is not sufficient evidence of such consent). (See our prior alert here).

On remand, however, the Second Circuit determined that *Stolt-Nielsen* had no real effect on the issues before it. It concluded that *Stolt-Nielsen* stands for the proposition that one party cannot initiate class arbitration against another party absent a contractual agreement to do so, but that *Stolt-Nielsen* did not mean that a contractual clause barring class arbitration is per se enforceable. *In re Am. Express Merchants' Litig.*, 634 F.3d 187, 193 (2d Cir. 2011) (*Amex II*).

In reaching this conclusion in *Amex II,* the Second Circuit once again found that plaintiffs had demonstrated that the class waiver in the arbitration clause at issue would preclude plaintiffs from bringing Sherman Act claims against Amex. *Id*. at 196. This time, the Second Circuit panel also seemed especially convinced that, as a matter of public policy, plaintiffs must never be deprived (even indirectly) of the protections of the federal antitrust laws. *See id.* at 197-98. It flatly rejected Amex's argument that *Stolt-Nielsen* disallowed the use of public policy as a basis to void contractual language. Instead, the panel held that *Stolt-Nielsen* only forbids using public policy to interpret the parties' intent in a contract to find that they had agreed to a class arbitration procedure. *Id.* at 199-200.

Amex III

On April 11, 2011, the Second Circuit placed a hold on its mandate in *Amex II* to allow Amex to file another petition for a writ of certiorari. While the mandate was on hold, the Supreme Court decided *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011). The parties then submitted supplemental briefing to the Second Circuit on the potential impact of *Concepcion.*

The Second Circuit held, however, that *Concepcion* did not alter its prior analysis. *See In re Am. Express Merchants' Litig.*, 667 F.3d 204 (2d Cir. Feb. 1, 2012) (*Amex III*). In its view, the decision in *Concepcion*, like the decision in *Stolt-Nielsen*, did not render class waivers per se enforceable. Instead, the Second Circuit held that both cases are simply applications of the principle that parties cannot be forced into a class wide arbitration unless they have agreed to that procedure. *Id.* at 213. The panel therefore described the Supreme Court's decision in *Concepcion* as offering "a path for analyzing whether a state contract law is preempted by the FAA," *id.*, not whether a class waiver is necessarily enforceable if plaintiffs demonstrate that enforcement would preclude their ability to vindicate federal statutory rights, *id.* at 214.

The Second Circuit denied rehearing *en banc* on May 29, 2012. In the concurring opinion to the order denying rehearing, Justice Pooler reiterated that the holding in Amex III "rests squarely on the vindication of statutory rights analysis—an issue untouched in *Concepcion*." *In re Am. Express Merchants' Litig.*, 681 F.3d 139 (2d Cir. 2012).

Looking Ahead

Having granted certiorari, the Supreme Court is expected to hear oral argument on *Amex III* early next year. The question on which it granted review is "[w]hether the Federal Arbitration Act permits courts, invoking the 'federal substantive law of arbitrability,' to invalidate arbitration agreements on the ground that they do not permit class arbitration of a federal-law claim." *See* Question Presented and Grant of Cert., *American Express Co. v. Italian Colors Restaurant*, No. 12-133, *available at* http://www.supremecourt.gov/qp/12-00133qp.pdf (last visited Nov. 14, 2012). A decision would most likely be announced in June 2013 and could be meaningful not only in the commercial context, but perhaps in shedding light on how the Supreme Court might address issues such as the National Labor Relations Board's recent decision in *D.R. Horton Inc.,* 357 NLRB No. 184 (2012) (deeming the "right" to file a class action or class arbitration a concerted protected activity and on that basis invalidating an arbitration agreement that allegedly violated federal labor law by requiring individual arbitration).

The dissent to the order denying rehearing *en banc* in the Second Circuit argued that *Concepcion* "teaches that the FAA does not allow courts to invalidate class-action waivers even if 'class proceedings are necessary to prosecute small-dollar claims that might otherwise slip through the legal system.'" 681 F.3d at 143, quoting *Concepcion*, 131 S. Ct. at 1753. This argument will likely carry weight with the majority of the Supreme Court that has in the past strictly upheld party choice in arbitration clauses. Whether it will be powerful enough for a reversal is yet unknown, but there is one other factor favoring Amex: Justice Sotomayor, who

originally sat on the Second Circuit panel in *Amex I*, is recused from the case. She was in the minority in *Concepcion* and thus might have been a voice against reversal in *Amex III.*

U.S. Supreme Court tells Oklahoma state court that state law does not trump the Federal Arbitration Act: Nitro-Lift Technologies, L.L.C. v. Howard

By Christopher M. Mason, Carolyn G. Nussbaum, and Paige L. Berges

For several years now, some lower federal courts have clearly been uncomfortable with the United States Supreme Court's decisions strongly favoring arbitration under the Federal Arbitration Act, 9 U.S.C. §§ 1-16 (the "FAA"), particularly when those decisions have limited procedural opportunities such as class-wide litigation and arbitration, or when they have favored arbitrators' powers in a way that reduces the usual role of courts in shaping the law. As we noted in our recent alert on *American Express Travel Related Servs. Co. v. Italian Colors Restaurant*, No. 12-133, 2012 US LEXIS 8697 (Nov. 9, 2012) (click here to view alert), and in prior alerts (click here to view prior alert), a majority of the current Supreme Court consistently interprets arbitration clauses to favor arbitration in its most traditional form unless the parties specify otherwise, and reserves as much as possible to arbitrators the power to make any outcome-influencing decisions about parties' disputes. Now, in its second *per curiam* decision of this calendar year with the same tone, the Court has emphasized to state courts that its views on arbitration are certainly not limited to the federal courts. Three days ago, in *Nitro-Lift Technologies, L.L.C. v. Howard*, No. 11-1377, 2012 U.S. LEXIS 8897 (Nov. 26, 2012) (*per curiam*), the Court told the Oklahoma Supreme Court in no uncertain terms that Oklahoma jurists cannot tread on an arbitrator's right to decide whether a special Oklahoma statute invalidates a non-competition agreement in a contract that also contains an arbitration clause. The tone of the decision is, for the Court, fairly blunt, much like the Court's tone in its February decision in *Marmet Health Care Center, Inc. v. Brown*, No. 11-391, 132 S. Ct. 1201 (Feb. 21, 2012) (*per curiam*), in which it rebuked the Supreme Court of Appeals of West Virginia for upholding a supposed West Virginia common law rule that as a "matter of public policy" personal injury and wrongful death claims cannot be subject to pre-dispute arbitration clauses.

The Oklahoma state court decisions

The plaintiffs in *Nitro-Lift* were two former employees whose contracts with the company purported to preclude them from competing with Nitro-Lift for two years following their termination. The contract also provided for arbitration in Houston, Texas, under Louisiana law. When the former employees began to work for a competitor in Arkansas, Nitro-Lift commenced an arbitration. In response, the employees sought a declaration from an Oklahoma trial court that the contract's non-compete provision was null and void.

The Oklahoma trial court initially granted the employees a temporary injunction prohibiting the employer from proceeding with arbitration in Texas. But it later lifted the injunction and granted Nitro-Lift's motion to dismiss after finding the arbitration clause to be valid and reasonable. At the plaintiffs' urging, the Oklahoma Supreme Court then ordered the parties to show cause why the case should not be resolved by application of Okla. Stat., Tit. 15, § 219A (2011), which limits the enforceability of noncompetition agreements. On the basis of that statute, the Oklahoma Supreme Court eventually reversed the trial court's judgment.

The Oklahoma Supreme Court began its analysis by holding that the existence of an arbitration agreement in an employment contract does not prohibit judicial review of the underlying contract. *Howard v. Nitro-Lift Techs., L.L.C*, 273 P.3d 20 (Okla. 2011). To support this proposition, it noted without analysis that a forum selection clause (such as an arbitration clause) "may be so unreasonable that it will be gravely difficult and inconvenient resulting in a party being deprived of a day in court." *Id.* at 23. As a further basis for ignoring the arbitration clause in the parties' contracts, it then advanced the theory that "where two statutes address the same subject, one specific and one general, the specific will govern over the general." *Id.* at 26.

The "specific" statute cited by the Oklahoma Supreme Court provides that a covenant not to compete may only limit a former employee from "directly solicit[ing] the sale of goods, [and] services . . . from the established customers of the former employer." *Id.* at 28. The court reasoned that this specific Oklahoma law trumped the FAA, a "more general statute favoring arbitration." *Id.* at 26 n.21. Having trumped the FAA, the statute was then available for use by a court with respect to the non-compete provision at issue—which the Oklahoma Supreme Court promptly declared "void and unenforceable as against Oklahoma's public policy." *Id.* at 27.

The Supreme Court stands behind the FAA

After granting Nitro-Lift's petition for a writ of certiorari, the United States Supreme Court issued a *per curiam* decision reversing the Oklahoma Supreme Court and reinforcing its own jurisprudence that the FAA will displace any state law that purports to prohibit arbitration of a particular type of claim. The Court flatly rejected the argument that a state court may use a state statute to determine the substantive validity of an entire underlying contract when the contract otherwise contains a valid arbitration clause. 2012 U.S. LEXIS at *2. Instead, using unequivocal language, it reaffirmed that the FAA, applicable in both state and federal courts where a valid arbitration agreement exists, "declare[s] a national policy favoring arbitration." *Id.* at 5 (quoting *Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984)).

The Oklahoma Supreme Court should have applied this policy with full force in the *Nitro-Lift* case because, among other things, it had not found that the arbitration clause in the parties' contracts was invalid, merely that the non-compete clause in those contracts was null and void. Furthermore, because "it is a mainstay of the [FAA's] substantive law that attacks on the validity of the contract [are] distinct from attacks on the validity of the arbitration clause itself," the non-compete issue was one to be resolved by an arbitrator, not a court. *Id.* at 6. Consistent with its previous decisions, the Supreme Court therefore held that the question of the contract's substantive enforceability should have been decided by an arbitrator.

The Supreme Court also rejected the Oklahoma Supreme Court's theory that the "specific" provision of a state statute may "govern[] the general" provisions of the FAA, tersely stating that this rule of construction only "applies to a conflict between laws of equivalent dignity." *Id.* at 7. "There is no general-specific exception to the Supremacy Clause, U.S. Const. Art. VI, cl. 2." *Id.* at 8. Similarly, the Court found unavailing the Oklahoma Supreme Court's "declaration" that its decision rested on adequate and independent state grounds, because the Oklahoma court's reliance on state law "necessarily depended upon a rejection of the federal claim," and this rejection "is all the more reason for this Court to assert jurisdiction." *Id.* at 4.

The Supreme Court did not address arguments raised by the plaintiffs that the Oklahoma court could have held that the arbitration clause was unconscionable to arrive at the same result. *See Nitro-Lift Techs. v. Schneider*, 2012 U.S. S. Ct. Briefs LEXIS 3388 (Aug. 15, 2012). But given the Supreme Court's tone in its decision, it would take a very bold Oklahoma court to try to salvage the plaintiffs' position on remand. Proponents of arbitration should therefore find continued comfort in the United States Supreme Court's approach to the FAA.

Don't "put the cart before the horse": Supreme Court rejects Amgen's argument that securities fraud plaintiffs must prove materiality of alleged misrepresentations at the class certification stage title

By Carolyn G. Nussbaum, Christopher M. Mason, Leah Threatte Bojnowski, and Paige L. Berges

On February 27, 2013, the Supreme Court issued a split decision in *Amgen Inc. v. Conn. Retirement Plans and Trust Funds*, No. 11-1085, 2013 U.S. LEXIS 1862 (February 27, 2013) upholding the Ninth Circuit's decision that plaintiffs in securities fraud actions based on the fraud-on-the-market theory of reliance do not have to *prove* the materiality of alleged misrepresentations or omissions regarding the securities at issue to certify a class under Federal Rule of Civil Procedure 23(b)(3).[1] Acknowledging that materiality is essential to the fraud-on-the-market presumption itself, the Court nonetheless concluded that materiality need not be proven at the class certification stage because it is a question common to all class members: "failure of common proof on the issue of materiality ends the case for the class." *Id.* at *34.

Background

Connecticut Retirement Plans and Trust Funds ("Connecticut Plans") sued Amgen Inc. ("Amgen") alleging that Amgen made misrepresentations and misleading omissions regarding the safety, efficacy, and marketing of two of its flagship drugs. The Connecticut Plans sought to represent all investors who purchased Amgen stock between the date of the first alleged misrepresentation (April 22, 2004) and the date of the last alleged corrective disclosure (May 10, 2007). *Id.* at *16. The District Court granted Connecticut Plans' motion and certified the proposed class under Rule 23(b)(3). Amgen moved for interlocutory appeal from the District Court's class-certification order. Amgen argued that reliance cannot be proved on a class-wide basis unless materiality is also proved because, by definition, a class member could not rely on an

1 Rule 23(b)(3) requires that "questions of law or fact common to class members predominate over any questions affecting only individual members."

immaterial representation. The Court of Appeals did not accept this argument and affirmed the class certification.

The Supreme Court granted Amgen's petition for certiorari, 132 S. Ct. 2742 (2012), citing a split among the Courts of Appeals. While the Seventh Circuit had held that plaintiffs must "plausibly allege-but need not prove" materiality at the certification stage, *Schleicher v. Wendt*, 618 F.3d 679 (7th Cir. 2010), the Second and Fifth Circuits had required proof of materiality, or allowed defendants to rebut materiality on a certification motion. *See In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474 (2d Cir. 2008); *Oscar Private Equity Invs. v. Allegiance Telecom, Inc.*, 401 F.3d 316 (5th Cir. 2005).

"Fraud-on-the-market" theory

The fraud-on-the-market theory was created by the Supreme Court in its decision in *Basic Inc. v. Levinson*, 485 U.S. 224 (1998). There, the Court held that "if a market is shown to be efficient, courts may presume that investors who traded in that market relied on public, material misrepresentations regarding those securities." *Id*. at 245. This theory is important to securities fraud class actions because, as the Court notes in *Amgen*, requiring a showing of individual reliance for each class member would likely "overwhelm questions common to the class" and preclude certification of a class action. *Amgen* at *14. Materiality is both an element of a securities fraud claim under Rule 10b-5, and "an essential predicate of the fraud-on-the-market" theory. *Id.* at *20.

The Supreme Court last addressed the showing required by plaintiffs invoking fraud on the market at the class certification stage in *Erica P. John Fund, Inc. v. Halliburton Co.*, No. 09-1403, 2011 U.S. LEXIS 4181 (June 6, 2011). In *Halliburton*, the Court held unanimously that securities fraud plaintiffs do not need to prove loss causation to obtain class certification, noting however, that to invoke the fraud-on-the-market theory, plaintiffs did have to prove the elements of market efficiency and the public nature of an alleged misrepresentation.[2] The Court side-stepped the issue of whether plaintiffs must prove other elements of fraud-on-the-market theory—including reliance—or whether defendants may rebut these elements at the class certification stage, admonishing that, "we need not, and do not, address any other questions about *Basic*, its presumption, or how and when it must be rebutted." 2011 U.S. LEXIS at *19.

By contrast, in *Amgen,* the Court addressed these questions left open in *Halliburton*. Handing the defense a significant setback, the Court defined the issue on certification as whether "proof of materiality is needed to ensure that the questions of law or fact common to the class will 'predominate over any questions affecting only individual members.'" *Amgen* at *2. On the merits, the Court held the answer is "clearly 'no'" for two reasons. First, the question of materiality is an objective one, to be proven through evidence common to the class. Second, a failure of proof on materiality will not result in a predominance of individual questions; instead, such a failure will end the case for all class members. *Id.* at *3.

Responding to the dissents' suggestion that materiality must be assessed at the certification stage as an element of the fraud-on-the-market theory, the majority focused on the narrow question presented on certification—whether common questions predominate over questions affecting only individual class members, allowing certification of a class for monetary damages under Rule 23(b)(3). The majority of the Court reasoned that plaintiffs' ultimate inability to prove materiality on summary judgment or at trial, while fatal to the entire case, is not a "fatal dissimilarity" among class members that would render the use of the class-action device inefficient or unfair so as to defeat certification. *Id.* at *26-27. Thus, the Court held that materiality is not an issue relevant to the predominance analysis required to decide certification under Rule 23(b)(3).

The Court contrasted materiality from the other elements of the fraud-on-the-market theory required by *Halliburton* to be addressed at certification—market efficiency and publicity—noting that, although failure to prove these elements might defeat a finding of commonality and certification, such a failure would not by itself end the case on the merits. *Amgen* at *33. For example, if the defendant's alleged misrepresentations or omissions were not aired publicly, or if the market for its securities were not efficient, individual plaintiffs could not invoke the fraud-on-the-market presumption of reliance, but might still be able to establish individual reliance, along with all of the remaining requisite elements of a Rule 10b-5 claim. Conversely, a failure on materiality would end the case for all plaintiffs in the potential class.

The Court gave short shrift to *Amgen's* public policy argument that certification often leads to *in terrorem* settlements, warranting closer scrutiny before granting certification. The Court noted that Congress has addressed perceived litigation abuses with the

2 See our prior Alert here: http://www.nixonpeabody.com/files/Class_Action_Alert_06_08_2011.pdf.

enactment of the Private Securities Litigation Reform Act of 1995, 15 U.S.C. § 78u–4 (2006), imposing certain burdens on plaintiffs, and the Securities Litigation Uniform Standards Act of 1998, 15 U.S.C. §78bb(f)(1) (2006). Yet Congress has never opted to legislatively reject *Basic* or its presumption of classwide reliance. *See Amgen* at *38. Therefore, the Court did not think it "appropriate" for the judiciary to reinterpret the tenets of securities law where Congress has declined to do so. *Id.* at *39.

The Justices' comments at oral argument had revealed a philosophical split and gave rise to speculation that the Court might take the occasion to do what Congress has not: revisit *Basic* and the fraud-on-the-market theory's appropriateness as a whole. Indeed, Justice Alito's concurring opinion notes that although the petitioners did not ask the Court to revisit *Basic's* fraud-on-the-market presumption, reconsideration of *Basic* itself may be appropriate as "more recent evidence suggests that the presumption may rest on a faulty economic premise." *Amgen* at *49. Likewise, Justice Scalia's dissent leaves no doubt of his view of the fraud-on-the-market theory, suggesting that "some" consider the four-justice opinion in *Basic* "regrettable" and warning that the Court's opinion expands the consequences of *Basic* "from the arguably regrettable to the unquestionably disastrous." *Amgen* at *54-55.

In the end, the Justices agreed that materiality is an element of the fraud-on-the-market theory, but differed in their views of when materiality must be proven or may be rebutted. The majority held that adjudicating materiality at the certification stage would "have us put the cart before the horse." *Id.* at *9. The dissents challenged that characterization with Justice Thomas asserting that the majority, rather than Amgen, would put the cart before the horse. In his view, joined by Justice Kennedy, the plaintiff who cannot prove materiality should never get to the merits, because without materiality, fraud-on-the-market does not apply, individual questions of reliance predominate, and certification is not possible. *Id.* at *71. Similarly, Justice Scalia's dissent would have required a plaintiff to establish at the class certification stage all of the elements of the fraud-on-the-market theory, including materiality, if the presumption is relied upon to justify certification. *Id.* at *51-53.

Analysis

The majority position in *Amgen* includes justices all along the ideological spectrum, and seems at first glance to be an exception to the recent general trend of cases limiting the availability of class actions and favoring defendants. From a class-action plaintiffs' perspective, the *Amgen* decision also appears to be a win on two key fronts: the fraud-on-the-market presumption is preserved for the time being, and the battle over materiality is removed from the certification landscape. Whether *Amgen* actually marks an end point generally to decisions disfavoring class actions, however, may not be known until the outcome of *American Express v. Italian Colors Restaurant*, No. 12-133, 2012 US LEXIS 8697 (Nov. 9, 2012).[3] Further, on March 25, the Court is scheduled to hear arguments in *Oxford Health Plans LLC v. Sutter*, cert. granted, No. 12-135, 2012 U.S. LEXIS 9417 (December 7, 2012)[4] over whether an arbitrator correctly ruled that the parties had consented to authorize class arbitration of pay disputes under the broad language of their individual plans requiring arbitration. This case may finally test whether the Court will apply limits to an arbitrator's power under the Federal Arbitration Act. *See Question Presented and Grant of Cert.,* available at: http://www.supremecourt.gov/qp/12-00135qp.pdf

3 See our prior Alert here: http://www.nixonpeabody.com/landmark_class_action_waiver_case

4 Docket available at: http://www.supremecourt.gov/Search.aspx?FileName=/docketfiles/12-135.htm (accessed February 28, 2013)

The Supreme Court tightens up on CAFA—and on class plaintiffs

By Christopher M. Mason, Sara E. Farber, and Scott O'Connell

Yesterday, the United States Supreme Court decided a deceptively important question of class action law in *Standard Fire Insurance Co. v. Knowles*, No. 11-1450, 2013 U.S. LEXIS 2370 (March 19, 2013). While the Court's conclusion—that a named plaintiff in a putative state court class action cannot, simply by disclaiming damages above $5 million at the start of the case, avoid the effect of the jurisdictional provisions of the Class Action Fairness Act of 2005 ("CAFA"), 28 U.S.C. 1332(d)(2), (5), allowing removal to federal court of actions involving more than $5 million in collective damages—seems procedural, in fact, it is a significant statement about the powers of representative plaintiffs generally.

Overview

As we have noted for many years, CAFA is a complex statute, and has perhaps not always accomplished as much reduction in state court class action litigation as President George W. Bush and the defense bar expected when it was signed into law as the first legislation of President Bush's second term of office. *See* Christopher M. Mason and Philip M. Berkowitz, *Decisions Begin To Interpret the Class Action Fairness Act* (March 21, 2005), available here; Christopher M. Mason, *A Giant Step Forward for the Class Action Fairness Act* (Feb. 14, 2005), available here; *see also* White House Transcript, *President Signs Class-Action Fairness Act of 2005* (Feb. 18, 2005), available here. This new decision, however, advances those expectations as well as providing guidance about the power of representative plaintiffs generally.

Background

The plaintiff in the *Standard Fire Insurance Co. v. Knowles* case, Greg Knowles ("Knowles"), filed a class action lawsuit in Arkansas state court against Standard Fire Insurance Company ("Standard Fire"). Knowles claimed that Standard Fire had breached the homeowners' insurance policy sold to him by underpaying claims for hail damage to Knowles' home. Knowles alleged that his policy, and the policies of those similarly situated, provided for full reimbursement for such loss or damage, including for reasonable charges associated with retaining a general contractor to repair or replace the damaged property. Standard Fire, however, had refused to reimburse "general contractors' overhead and profit," or about 20% of the costs of a contractor making repairs. According to Knowles, there were likely "hundreds, and possibly thousands" of individuals in Arkansas who suffered similar damages in the form of underpayments. 2013 U.S. LEXIS 2370, at * 4 (internal citation omitted).

When Knowles filed his complaint, he stipulated that the Circuit Court of Miller County, Arkansas, had jurisdiction over the action because his recovery and that of any class member individually would not exceed $75,000.00, and his total damages and those of all class members in aggregate would be less than $5,000,000.00. The point of this stipulation, of course, was to try to avoid removal on CAFA's minimal diversity grounds (*i.e.*, given that the insurer was not from Arkansas, if the collective amount in controversy exceeded $5 million, federal jurisdiction would exist, *see* 28 U.S.C. §§ 1332(d)(2), (5)(B), (6)).

The Lower Courts' Decisions

Standard Fire, however, was not dissuaded by Knowles' stipulation. It removed the action to federal court, arguing that, regardless of Knowles' effort to limit his and the purported class' damages, his counsel never agreed that they would not seek attorney's fees that would bring total recovery beyond that amount. Standard Fire also claimed that Knowles lacked authority to limit other class members' damages through a stipulation.

There was good support for Standard Fire's position—other courts that had considered the issue were split on it. *Compare, e.g., Bell v. Hershey Co.*, 557 F.3d 953, 958 (8th Cir. 2009) *with Lowdermilk v. United States Bank Nat'l Assoc.*, 479 F.3d 994, 998 (9th Cir. 2007). But this meant that Knowles also had authority for his prompt motion to remand the action. In doing so, Knowles simply claimed that his stipulation was effective to limit the total recovery to below federal jurisdictional limits, and that as a plaintiff he had the right to craft his complaint in a way that would enable him to bring his action in the court of his choosing.

The District Court agreed with Knowles. It held that, by means of a binding stipulation, Knowles had shown in good faith that the aggregate damages claimed on behalf of the class would not exceed $5 million. It also held that if class members felt constrained by Knowles' limitation on recoveries, they could opt out of the class and pursue other remedies. It, therefore, remanded the case to state court.

Standard Fire sought an interlocutory appeal to the United States Court of Appeals for the Eighth Circuit. The Court of Appeals, however, denied that request without explanation. Standard Fire then filed a petition for *certiorari* to the Supreme Court, which the Court granted on August 31, 2012.

The Supreme Court's Decision

The Supreme Court held that Knowles' stipulation could not avoid CAFA because the stipulation could not bind absent class members. The unanimous opinion by Justice Breyer asserts that the "reason is a simple one: Stipulations must be binding", 2013 U.S. LEXIS 2370, at * 7, but "a plaintiff who files a proposed class action cannot legally bind members of the proposed class before the class is certified", *id.* at * 7–8. At that point there would have been a decision as to whether, for example, Knowles was an adequate class representative, Fed. R. Civ. P. 23(a)(4), and exactly what the class contained, Fed. R. Civ. P. 23(c)(1)(B).

Interestingly, while the opinion states that one characteristic of a binding stipulation is that it is "not subject to subsequent variation" and is "conclusive[ ]", 2013 U.S. LEXIS 2370, at * 7 (quoting *Christian Legal Soc. v. Martinez,* 130 S. Ct. 2971, 2983 (2010), and 9 J. Wigmore, Evidence § 2590, at 822 (J. Chadbourn rev. 1981)), Federal Rule of Civil Procedure 23(c)(1)(C) expressly recognizes that class certification orders may be altered or amended, thus undermining the assumption that a class representative's stipulation after certification will necessarily be as binding as one by an individual plaintiff. Indeed, the Court's own opinion recognizes that a court could "permit the action to proceed with a new representative" other than Knowles in the future. 2013 U.S. LEXIS 2370, at * 10. Thus, the deep structure of the Court's decision in *Standard Fire Insurance Co. v. Knowles* is not one based on rules of evidence or procedure, but doubt about the ultimate power of a class representative absent the oversight of a court. In effect, a stipulation limiting damages before class certification is a sort of settlement, and settlements require express court approval. *See, e.g.,* Fed. R. Civ. P. 23(e).

Conclusion

The Supreme Court's decision was welcomed by traditional class action defense lawyers as a win. But it may have effects beyond even the rigor it places on CAFA procedure. In particular, it emphasizes that named plaintiffs *cannot* assume that their general power to define their own case will withstand scrutiny when they appear to leave substantial issues without potential resolution to avoid a problem of jurisdiction—prior pending action—or greater authority by a regulator. We have, for example, seen named plaintiffs attempt to include in proposed classes entities that cannot be sued or that must be represented by other counsel besides the proposed class counsel. The *Standard Fire Insurance Co. v. Knowles* opinion indicates that such attempts should receive closer scrutiny than they often have been given in the past.

U.S. Supreme Court rejects class certification based on the damages model: Comcast Corp. v. Behrend

By Christopher M. Mason, Todd R. Shinaman, Devon Haft Little, and Annica Sunner

Yesterday, the United States Supreme Court reversed the certification of a class of over two million present and former cable television customers seeking antitrust damages against their cable provider. *Comcast Corp. v. Behrend*, No. 11-864, 2013 U.S. LEXIS 2544 (2013). The 5-4 decision, authored by Justice Scalia, marks the second time in 3 years that the Court has evaluated and overturned a grant of class certification based on a "rigorous analysis" of the certification standards in Federal Rule of Civil Procedure 23. In doing so, the decision expressly extends the trend of *Wal-Mart Stores Inc. v. Dukes*, 131 S. Ct. 2541 (2011) to damages classes certified solely under Federal Rule of Civil Procedure 23(b)(3), and may open the door for arguments about commonality of damages in a way not previously pursued in many decisions.

Facts

Comcast Corporation and its subsidiaries ("Comcast") own and operate cable television systems, including in the Philadelphia metropolitan area. Between 1998 and 2007 (according to paragraph 35 of the plaintiffs' complaint), Comcast entered into nine "agreements to exchange or 'swap' [Comcast] cable customers in other areas of the country for the cable customers of competitors in [Comcast's] cluster in and around Philadelphia." These customer-swapping transactions supposedly not only substantially increased Comcast's market share in the Philadelphia "cluster," but violated Sections 1 and 2 of the Sherman Act. To remedy this, the plaintiffs sued Comcast in the United States District Court for the Eastern District of Pennsylvania.

The District Court's decision

In their lawsuit, the plaintiffs asserted four different ways in which they believed Comcast's swap transactions injured competition and damaged customers. One of these theories was that the customer swaps deterred competitors from "overbuilding," that is, from building a cable system alongside Comcast's existing operations in the Philadelphia cluster. The consequence of this deterrence was to reduce competition in the Philadelphia cluster, which in turn allowed Comcast to raise the price of cable services above competitive levels.

When the plaintiffs moved to certify a class, the District Court held that, of their four different theories of injury, only this overbuilder theory was capable of class-wide proof. *See Comcast Corp. v. Behrend*, 264 F.R.D. 150, 174 (E.D. Pa. 2010). It therefore certified a class only as to this theory. As to that theory, however, the

District Court held that the plaintiffs had met all the requirements of Federal Rule of Civil Procedure 23(a) (numerosity, commonality, typicality, and adequacy), as well as the predominance and superiority requirements of Rule 23(b)(3). As to the predominance requirement, it held in particular that the plaintiffs had shown that a "common methodology" was available "to measure and quantify damages on a class-wide basis." *Id*. at 191.

The basis for the District Court's finding that a "common methodology" for measuring the class' damages existed was an economic model offered by the plaintiffs' expert using regression analysis to compare the actual price of cable service in the Philadelphia "Designated Market Area" (or "DMA") to hypothetical prices that would have prevailed in that DMA in the absence of Comcast's anticompetitive behavior. *See id.* at 181-83. In what would prove to be an important detail, this model did not, however, isolate the damages only resulting from the deterrence of overbuilders. *See id*. at 190-91; *Comcast Corp. v. Behrend*, 655 F.3d. 182, 215, n.18 (3d. Cir. 2011). Instead, it calculated overall damages without distinguishing between the four theories originally offered by the plaintiffs. *See id*. at 190-91; *Comcast Corp. v. Behrend*, 655 F.3d. 182, 215, n.18 (3d. Cir. 2011).

The Third Circuit's affirmance

Now facing a class of over two million members, Comcast appealed this certification decision. A divided panel of the United States Court of Appeals for the Third Circuit affirmed the District Court. In doing so, the Third Circuit reiterated its holding in *In re Hydrogen Peroxide Antitrust Litig.,* 552 F.3d 305 (3d Cir. 2008), to the effect that "a district court may inquire into the merits only insofar as it is 'necessary' to determine whether a class certification requirement is met." *Comcast Corp. v. Behrend*, 655 F.3d at 199. It also rejected Comcast's argument that the plaintiffs' model was not adequate because it did not separately identify the damages for each of the plaintiffs' theories of harm, stating that "[a] t the class certification stage we do not require that [p] laintiffs tie each theory of antitrust impact to an exact calculation of damages, but instead that they assure us that if they can prove antitrust impact, the resulting damages are capable of measurement and will not require labyrinthine individual calculations." *Id.* at 206.

The Supreme Court's reversal

In his opinion for a 5-4 majority, Justice Scalia held that the Third Circuit had erred in affirming class certification, and in particular, erred in agreeing that the plaintiffs had satisfied Rule 23(b)(3)'s requirement that questions of law or fact common to class members predominate over questions affecting only individual members. On the record presented, plaintiffs were only entitled to seek damages on a class basis with respect to one type of antitrust impact: overbuilding. Yet, there was "no question" that the regression model offered by the plaintiffs' economic expert failed to measure damages resulting specifically from overbuilding as opposed to any other type of antitrust impact. And where a damages model offered to show commonality does not measure the damages actually attributable to the plaintiffs' particular theory of liability, "it cannot possibly establish that damages are susceptible of measurement across the entire class for purposes of Rule 23(b)(3)." *Comcast v. Behrend*, 2013 U.S. LEXIS 2544 at *15. (Indeed, according to Justice Scalia, even though the plaintiffs had claimed a geographic market consisting of a cluster of counties, "if the model had identified subscribers who paid more solely because of the deterrence of overbuilding, it still would not have established the requisite commonality of damages unless it plausibly showed that the extent of overbuilding (absent deterrence) would have been the same in all counties, or that the extent is irrelevant to effect upon ability to charge supra-competitive prices." *Id.* at *20-21 n.6). In short, the lower courts had failed to do a properly "rigorous analysis" of the expert witness' proposed method for calculating damages and how it would support the requirement that common questions predominate. *Id.* at *15.

In a lengthy dissent, Justices Ginsburg and Breyer, joined by Justices Sotomayor and Kagan, argued that the case was not properly before the Court for both procedural and substantive reasons. First, they noted that the Court, in granting *certiorari*, had changed the question presented from "from the District Court's Rule 23(b)(3) analysis to its attention (or lack thereof) to the admissibility of expert testimony." *Id.* at *22. Second, they argued that any issue of the admissibility of the expert's testimony had been waived by Comcast's failure to timely object to it. Thus, the Court should have dismissed its own writ of *certiorari* as improvidently granted. *Id.* at *23. (Justice Scalia, however, retorted that even if that were the case, "it does not make it impossible for them to argue that the evidence failed 'to show that the case is susceptible to awarding damages on a class-wide basis.'" *Id.* at *11 n.4.) Third, trying to limit the prospective effect of the majority's opinion, the dissenters argued that "[t]he Court's ruling is good for this day and case only", *id*. at *28, and that the majority's decision "should not be read to require, as a prerequisite to certification, that damages attributable

to a classwide injury be measurable 'on a class-wide basis.'" *Id*. at *25.

As to this last point, it is true that the parties did not challenge the District Court's holding that damages need to be provable on a class-wide basis. The majority opinion acknowledged this, and the dissenters read that acknowledgment as an indication that "the decision should not be read to require, as a prerequisite to certification, that damages attributable to a classwide injury be measureable 'on a class-wide basis.'" *Id.* The issue therefore appears to be open for debate.

Implications

In *Comcast*, just as he did in *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541 (2011), Justice Scalia wrote for a five-justice majority, joined by Chief Justice Roberts and Justices Thomas, Kennedy, and Alito. And just as in *Wal-mart*, Justice Scalia's opinion in *Comcast* raises the level of scrutiny for class action certifications. Supreme Court Raises the Bar for Class Certification in Landmark Sex Discrimination Decision (June 2011); Dukes redux: plaintiffs seek certification of smaller class sizes in two states (Nov. 2011).

In *Wal-Mart*, the Court applied a "rigorous analysis" requirement to the existence of a common issue of law or fact under Rule 23(a). *Wal-Mart*, 131 S. Ct. at 2551. In *Comcast*, the Court applied the same standard to plaintiffs' damages calculations as a matter of satisfying Rule 23(b)(3). In each instance, the Court found (without addressing whether the expert testimony requirements of *Daubert v. Merrell Dow Pharmaceuticals Inc.*, 509 U.S. 579 (1993), must apply) that the expert statistical and economic evidence offered was not sufficient to support class certification. This will necessarily make it more difficult for plaintiffs typically relying on such evidence—for example, plaintiffs alleging violations of employment or antitrust laws based on impacts on class members—to certify large classes.

In addition, Justice Scalia's footnote 6, rebuking the plaintiffs in Comcast for lacking "the requisite commonality of damages" would seem to support arguments that putative classes in many other cases should be limited to smaller groups (as occurred on remand in the Wal-Mart case, see Dukes redux: plaintiffs seek certification of smaller class sizes in two states (Nov. 2011)), with smaller differences in damages, despite boilerplate comments that have existed for years to the effect that differences in damages alone do not provide a basis for denying class certification if damages can be proved by a mathematical calculation or formula. See, e.g., Gunnells v. Healthplan Servs., 348 F.3d 417, 427-29 (4th Cir. 2003), cert. denied, 542 U.S. 915 (2004).

In short, *Comcast* is a further decision favoring defendants in class actions. And so long as the five Justice majority in it and the *Wal-Mart* case hold together, defendants have hopes that the heightened scrutiny proposed by Justice Scalia may be applied to other elements of class certification.

Seller beware: merchants with stores that request zip codes may face consumer class actions after recent Massachusetts Supreme Judicial Court ruling

By George J. Skelly and J. Christopher Allen, Jr.

Can requesting zip codes from consumers in connection with retail credit card transactions constitute "unfair or deceptive" conduct that gives rise to liability under Chapter 93A, the Massachusetts consumer protection statute? On March 11, 2013, in *Tyler v. Michaels Stores, Inc.*, 464 Mass. 492 (2013), the Massachusetts Supreme Judicial Court answered that question in the affirmative, and, in response, the plaintiff's bar has wasted little time in serving retailers who operate in Massachusetts with demand letters asserting similar claims.

The plaintiff's claims

In *Tyler*, the plaintiff alleges that she made several purchases with her credit card at a Michaels Stores location in the Greater Boston area. In the course of each purchase, the plaintiff was asked to supply her zip code, and she did so under the "mistaken impression" that her zip code was needed as part of the transactions. *Id.* at 493. In her complaint, the plaintiff contends that the zip code was not, in fact, necessary to process her credit card but rather that Michaels Stores used it to obtain her address from a third party database and send her "unsolicited and unwarranted" marketing materials. *Id.* at 494. On the basis of these allegations, the plaintiff asserts that Michaels Stores violated Mass. Gen. Laws c. 93 § 105(a), which regulates credit card transactions.[1] The plaintiff further asserts that the

1 No person, firm, partnership, corporation or other business entity that accepts a credit card for a business transaction shall write, cause to be written or require that a credit card holder write personal identification information, not

violation of Chapter 93, § 105(a), in turn, constitutes "unfair or deceptive acts or practices" and gives rise to liability under the Massachusetts consumer protection statute, Chapter 93A, §§ 2 and 9. *Id.* The complaint also asserts a cause of action for unjust enrichment and seeks a declaratory judgment with respect to Michaels Stores' alleged violation of Chapter 93, § 105(a).

Federal District Court Judge Young grants motion to dismiss but permits plaintiff to certify issues to the Supreme Judicial Court

The Plaintiff brought suit in the United States District Court for the District of Massachusetts on behalf of herself and a putative class of Massachusetts consumers. *Id.* at 492. Michaels Stores responded to the plaintiff's complaint by filing a motion to dismiss for failure to state a claim as to all causes of action asserted. On January 6, 2012, the Hon. William G. Young granted Michaels Stores' motion. Judge Young concluded that, while Michaels Stores' request for the plaintiff's zip code may not have complied with Chapter 93, § 105(a), the plaintiff's allegations did not demonstrate that she had sustained any cognizable injury under Chapter 93A, and thus, her claims were not viable. Despite granting dismissal, however, Judge Young invited the plaintiff to certify several questions to the Massachusetts Supreme Judicial Court. Chief among them: whether a plaintiff could establish injury under Chapter 93A without alleging that her zip code was obtained for purposes of identity fraud.

The Supreme Judicial Court rejects Judge Young's conclusion that the plaintiff had not been injured

Addressing this issue in *Tyler*, the Supreme Judicial Court concluded at the outset that Chapter 93, § 105(a) was not intended as a protection against identity fraud, but rather "to address invasion of consumer privacy by merchants." *Id.* at 501. Therefore, as to the certified question, the Court held that it was not necessary for a plaintiff to allege identity fraud in order for a claim to survive dismissal. *Id.* Having discarded identity fraud as a requirement, the Court then proceeded to describe what circumstances may give rise to injury.

Although Chapter 93A, § 2 explicitly provides that recovery is only available to a "person ... who has been injured by another person's [unfair or deceptive conduct]," Mass. Gen. Laws c. 93A, § 9(1) (emphasis supplied), what constitutes cognizable injury has been ill defined in the Supreme Judicial Court's jurisprudence for several decades. As the Court acknowledged in *Tyler*, "one source of confusion" has been *Leardi v. Brown*, 394 Mass. 151 (1985), on which the *Tyler* plaintiff heavily relied. In *Leardi*, the Court introduced the concept that injury under Chapter 93A can arise where there has been an "invasion of a legally protected interest," *id.* at 160, but Massachusetts courts, including the Supreme Judicial Court, appears to have shied away from accepting the full implications of that notion. Indeed, in recent years, the Court has held that a violation of a consumer statute, like Chapter 93, § 105(a), may establish "per se" unfair or deceptive conduct in violation of Chapter 93A, but that such a "per se" violation is not sufficient to establish "per se" injury. *See, e.g. Rhodes v. AIG Dom. Claims, Inc.*, 461 Mass. 486, 496 n.16 (2012); *Casavant v. Norwegian Cruise Line Ltd.*, 460 Mass. 500, 504-505 (2011); *Iannacchino v. Ford Motor Co.*, 451 Mass. 623, 632-633 (2008); *Hershenow v. Enterprise Rent-A-Car Co. of Boston*, 445 Mass. 790, 801-802 (2006). Instead, "the violation of a legal right" must be shown to cause a "separate, identifiable harm." *Tyler*, 464 Mass. at 503.

In *Tyler*, the Supreme Judicial Court was careful to state that it was not relying upon *Leardi*. Nevertheless, the Court concluded that "a distinct injury" may "in theory" arise "in at least" two circumstances where Chapter 93, § 105(a) is violated:

> [T]here appear to be at least two types of injury or harm that might in theory be caused by a merchant's violation of [Chapter 93, § 105(a)]: the actual receipt by a consumer of unwarranted marketing materials as a result of the consumer's personal identification information; and the merchant's sale of consumer's personal identification information or the data obtained from that information to a third party.

Id. at 503-504. The Court explained that, in both instances, a cognizable injury is established because the retailer has used the information in violation of the right of privacy protected by Chapter 93, § 105(a) "for its own business purposes" and/or to make a "profit." *Id.* at 504.

The Supreme Judicial Court also offered comment on the amount of a plaintiff's damages in circumstances in which injury has been established. *Id.* at 504 n.20. Where the plaintiff has received promotional materials as a result of supplying her zip code, the Court stated

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required by the credit card issuer, on the credit card transaction form. Personal identification information shall include, but shall not be limited to, a credit card holder's address or telephone number. The provisions of this section shall apply to all credit card transactions; provided, however, that the provisions of this section shall not be construed to prevent a person, firm, partnership, corporation or other business entity from requesting information is necessary for shipping, delivery or installation of purchased merchandise or services or for a warranty when such information is provided voluntarily by a credit card holder. Mass. Gen. Laws c. 93, § 105(a).

that, while difficult to quantify in monetary terms, the privacy invasion causes harm of "more than a penny," and therefore entitles the plaintiff to recover the minimum statutory award of $25. *Id.* Perhaps more troubling, where a retailer has sold zip codes to a third party, "[d]isgorgement of the merchant's profits may be an appropriate remedy." *Id.*

Tyler's impact on retailers

The incidence of putative class actions based on consumer protection act violations, like those in *Tyler*, have increased exponentially over the last decade. The plaintiff's bar has gravitated toward Chapter 93A in particular because, in addition to permitting the recovery of compensatory damages (where they are measurable), the statute permits a minimum statutory award of $25 to each member of the class, makes available double and treble damages for willful violations,[2] and automatically awards a plaintiff her reasonable attorneys' fees upon a finding of liability. Thus, the economic incentives for bringing suit are ample. Moreover, like many other consumer protection acts, Chapter 93A relaxes the plaintiff's burden of proof by eliminating the elements of intent and reliance which are otherwise necessary to establish common law fraud. In so doing, the statute not only affords an easier path for establishing liability, it removes at least two individualized issues that have traditionally served as impediments to class certification. Thus, it is not at all surprising that, within days of the *Tyler* decision, there was a cascade of demand letters to retailers, often enclosing a courtesy copy of the Supreme Judicial Court's opinion. More are sure to follow.

While *Tyler* certainly affords something of a road map to class counsel, the broad parameters of its framework do not presage inescapable liability in every circumstance, nor do they guarantee class certification. Indeed, despite its ultimate holding, in *Tyler*, the Supreme Judicial Court has taken another significant step in distancing itself from *Leardi* and, in so doing, reaffirms the need for a plaintiff to establish causation. Therefore, careful consideration not only must be given to what use the retailer made of its customers' zip codes, but also the specific purchasing behavior of the proposed class representative. In the right circumstances, an early dispositive motion may also be a viable strategy for the defense.

2 Minimum statutory damages cannot be multiplied. Leardi, 394 Mass. at 163. Thus, the availability of double or treble damages only arises where the plaintiff has established compensatory damages.

Update on the Kilgore Ninth Circuit appeal: California's public injunction exception escapes for another day, but the en banc court reads the exception to arbitration narrowly and rejects plaintiffs' attempt at artful pleading

By Scott O'Connell and Dan Deane (Counsel to KeyBank in the action)

In a prior Alert (see Ninth Circuit applies Concepcion to invalidate California's "public injunction" exception to arbitration and further upholds KeyBank's "opt-out" clause, March 12, 2012), we reported on a three-judge panel decision of the Ninth Circuit, which ruled in favor of KeyBank and held that the Federal Arbitration Act ("FAA") trumps California's court-made rule that actions seeking relief on behalf of the public may only be adjudicated in court and not in arbitration.[1] That panel had concluded that the Supreme Court's rulings in *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 179 L. Ed. 2d 742 (2011), and *Marmet Health Care Center, Inc. v. Brown*, 132 S. Ct. 1201, 182 L. Ed. 2d 42 (Feb. 21, 2012) (per curiam) made clear that any state law rules that "prohibit[] outright the arbitration of a particular type of claim" are displaced by the FAA. The en banc Ninth Circuit reconsidered that decision and, after further briefing and arguments before a ten-judge panel, issued a decision on April 11, 2013. *See Kilgore v. KeyBank, National Association*, No. 09-16703, 2013 U.S. App. LEXIS 7312 (9th Cir. en banc Apr. 11, 2013). While the en banc Court declined to go as far as the original panel to declare the outright demise of the public injunction rule, it applied a narrow definition of what it means to bring a public injunction action. Digging below the surface of plaintiffs' claims, the en banc Court rejected the plaintiffs' avowals that they sought relief on behalf of the general public, and concluded that arbitration is a proper forum for their claims.

The *Kilgore* lawsuit was brought by two aspiring helicopter pilots who had enrolled in Silver State Helicopters, LLC, a national aviation school, before it declared bankruptcy in February 2008. KeyBank had been one of Silver State's preferred lenders. Dissatisfied with the training they received from Silver State, the plaintiffs brought a preemptive class action

1 See Kilgore v. KeyBank, National Association 673 F.3d 947 (9th Cir. 2012), vacated and rehearing en banc granted by Kilgore v. KeyBank Nat'l Assoc., 697 F.3d 1191 (9th Cir. Sept. 21, 2012).

in May 2008 alleging that Silver State was a sham school for which the students should not be required to pay. Because the school was insolvent, the plaintiffs sought loan forgiveness from the lender. On behalf of themselves, and a putative class of about 120 other former California-based Silver State borrowers, plaintiffs filed suit in California state court. KeyBank removed the lawsuit to the U.S. District Court for the Northern District of California.

Plaintiffs claimed that KeyBank should be held derivatively liable for the flight schools' failures because KeyBank had allegedly violated California's Unfair Competition Law ("UCL"), Cal. Bus. & Prof. Code § 17200, by failing to include the "holder in due course" notice required by the Federal Trade Commission's "holder rule." Had the holder notice been included in the promissory notes, plaintiffs would have been entitled to assert any claims or defenses against KeyBank arising from Silver State's misconduct. The plaintiffs argued that pursuant to the UCL, the FTC's holder notice should be read into the promissory notes despite KeyBank's omission of it. For relief, the plaintiffs sought an order enjoining KeyBank from (1) enforcing collection under the promissory notes; (2) making adverse reports concerning class members to the credit reporting agencies; and (3) engaging in false and deceptive acts and practices with respect to consumer credit transactions (namely, disbursing loan proceeds to any seller without including the holder rule language in the consumer credit contract).

The promissory note for each Silver State student in the class contained an identical arbitration clause, which provided that any disputes between the lender and the borrower would be subject to binding bi-lateral arbitration upon election of either party, and that if arbitration is elected, the borrower waives any right to participate as a representative or member in a class action. But the clause also provided that any borrower could "opt out" of the arbitration provision (and the class action waiver) simply by providing written notice of such election to KeyBank within 60 days of signing the promissory note. The promissory note did not tie disbursement of the loan funds to the passage of this 60-day opt-out period, and therefore borrowers were not penalized for making that election.

Because neither of the *Kilgore* plaintiffs had elected to opt out of the arbitration clause, KeyBank sought to remove the case to arbitration. But the district court denied KeyBank's motion to compel arbitration based on California's policy against arbitrating public injunction claims. In California, this rule is commonly called the "*Broughton/Cruz*" rule, after the two California Supreme Court cases that established it.[2] KeyBank immediately filed for interlocutory appeal pursuant to the FAA. In the meantime, the district court retained jurisdiction and then granted KeyBank's motion to dismiss on all grounds, ruling that plaintiffs' various claims either failed to state a claim or were preempted by the National Bank Act. Plaintiffs appealed the district court's dismissal order and that appeal was consolidated with KeyBank's arbitration appeal.

In March 2012, a three-judge panel of the Ninth Circuit ruled in favor of KeyBank on its arbitration appeal and vacated the district court's dismissal order as moot. Applying *Concepcion* and the body of Supreme Court case law before and since, the Ninth Circuit panel ruled that California's public injunction rule must yield to the FAA. The panel ruled that the public injunction rule could not survive *Concepcion* because the FAA expressly displaces state rules that amount to a categorical ban against arbitration. Congresses' national policy that all valid agreements to arbitrate should be enforced, trumps any state law-making body's conclusion that arbitration is unsuitable in some cases. The panel remanded to the district court with instructions to compel arbitration.

The plaintiffs thereafter petitioned the en banc Ninth Circuit for rehearing. Underscoring the stakes involved, plaintiffs' petition was supported by several amicus briefs filed by organizations aligned with the plaintiffs' bar, including, among others, the National Association of Consumer Advocates, National Consumer Law Center, the National Employment Lawyers Association, and an alliance of law professors from across the country. KeyBank opposed the petition for rehearing and was joined by its own amicus ally, the United States Chamber of Commerce. The Ninth Circuit granted the plaintiffs' petition for rehearing and an argument before the ten-judge en banc panel was conducted on December 11, 2012.

Plaintiffs' focused their argument on the so-called "vindication of rights" exception to arbitration. In a number of cases, the Supreme Court has recognized an exception to the FAA in addition to the savings clause—namely, that the FAA cannot compel enforcement of an

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2 Broughton v. Cigna Health-plans of California, 988 P.2d 67 (Cal. 1999) (public injunction claims brought under the Consumer Legal Remedies Act not arbitrable); Cruz v. Pacificare Health Systems, Inc., 66 P.3d 1157 (Cal. 2003) (public injunction claims brought under the UCL not arbitrable). See also Davis v. O'Melveny & Myers, 485 F.3d 1066, 1082 (9th Cir. 2007) (applying California rule against arbitrating actions seeking public injunctions to federal case).

arbitration clause where enforcement would prevent a party from effectively vindicating its substantive statutory rights. *See*, *e.g*., *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc*., 473 U.S. 614 (1985). Plaintiffs argued that while a party may waive procedural rights by arbitration agreement, they cannot waive substantive rights, and the right to seek a public injunction is a substantive right that cannot be adequately vindicated in arbitration. KeyBank and the Chamber of Commerce responded by pointing out that all of the Supreme Court's "vindication of rights" cases concerned the vindication of *federal* statutory rights. Contrary to cases involving state law exceptions to arbitration, cases involving federal statutes do not implicate the Supremacy Clause. The Supremacy Clause prevents state courts and state legislatures from carving their own exceptions out of federal law, however well intentioned; that prerogative is left solely to Congress. KeyBank also argued that plaintiffs were seeking a public injunction in name only, not in substance, and thus the vindication of rights argument was inapplicable.

Judge Andrew D. Hurwitz, writing for the nine-judge majority, seized the latter argument as a vehicle for resolving the case without reaching the broader question of the vitality of California's public injunction rule. The majority opinion analyzed the definition of a "public injunction": "Whatever the subjective motivation behind a party's purported public injunction suit, the *Broughton* rule applies only when 'the benefits of granting injunctive relief by and large do not accrue to that party, but to the general public in danger of being victimized by the same deceptive practices as the plaintiff suffered.'" *Kilgore*, 2013 U.S. App. LEXIS 7312, at *18-19 (quoting *Broughton*, 988 P.2d at 76). Breaking down the *Kilgore* plaintiffs' individual claims for relief, the majority concluded that they do not fall within the "narrow exception to the rule that the FAA requires state courts to honor arbitration agreements." *Id*. at *19 (quoting *Cruz*, 66 P.3d at 1162). The first two claims for relief—seeking to enjoin KeyBank from enforcing the promissory notes and from reporting defaults to the credit agencies—would only benefit the 120 putative class members. While the third requested injunction—barring future loan disbursements to sellers without the holder rule language—could potentially amount to a claim for public relief, it was not such a claim on the undisputed facts of this case. As the plaintiffs' third amended complaint conceded, KeyBank had completely withdrawn from the private school lending business and there was no allegation that KeyBank was still making similar loans. The majority rejected the notion that arbitration of plaintiffs' claims would be inadequate in this case, "where Defendants' alleged statutory violations have, by Plaintiffs' own admission, already ceased, where the class affected by the alleged practices is small, and where there is no real prospective benefit to the public at large from the relief sought." In other words, the Ninth Circuit looked past plaintiffs' conclusory assertion of a claim for public injunctive relief, and found that plaintiffs merely sought run-of-the mill individual debt relief—exactly the type of claim well suited to arbitration.

The majority also ruled that the arbitration agreement was not unconscionable. Under California law, a contractual provision is unenforceable only if it is both procedurally and substantively unconscionable. The majority found that KeyBank's arbitration provision was neither. The arguments that the class waiver provision or the costs of arbitration could make the arbitration clause substantively unconscionable are both foreclosed by Supreme Court precedent. *See id*. at *13 (citing *Concepcion*, 131 S. Ct. at 1753, and G*reen Tree Fin. Corp.-Ala. v. Randolph*, 531 U.S. 79, 90-91 (2000)). Moreover, the majority had little trouble finding that the arbitration provision was not procedurally unconscionable inasmuch as the arbitration clause was not buried in fine print, was clearly labeled in bold and set forth in its own section of the promissory note, and provided all borrowers with an opportunity to opt out of arbitration within 60 days of signing the note. *See id*. at *14. Accordingly, the Court reversed the denial of the motion to compel arbitration and remanded to the district court with instructions to compel arbitration.

Judge Pregerson wrote the lonely dissent. The dissent did not engage the public injunction argument, but instead rested on Judge Pregerson's belief that the arbitration clause is unconscionable.

The end result of the en banc rehearing is a modest ratcheting back of the initial panel's opinion, which had relegated California's public injunction exception to the scrap heap of California rules preempted by the FAA. While the en banc decision preserves that question for another day (and the public injunction rule survives on life support), the decision significantly limits the exception by defining it narrowly.

The Ninth Circuit's ruling sends a strong signal to the plaintiffs' bar that they will not be successful in circumventing the preemptive effect of the FAA through artful pleading. The ruling should discourage tactical pleading of "public injunction" claims solely

for the purpose of gaining settlement leverage. Additionally, the majority opinion's unconscionability analysis provides a roadmap for businesses seeking to craft arbitration clauses that will withstand judicial scrutiny. And it is not just consumer-facing businesses that should take note, as the impact of the decision is likely to reverberate in other areas. For example, many employers now require their employees to sign agreements mandating arbitration of any disputes. The *Kilgore* decision further affirms the national policy that arbitration is a preferred method of dispute resolution and that unsubstantiated unconscionability challenges will not be given credence.

U.S. Supreme Court allows class arbitration under Section 10(a)(4) of the Federal Arbitration Act: Oxford Health Plans LLC v. Sutter

By Christopher M. Mason, W. Daniel Deane, Paige L. Berges, and Devon Haft Little

While not all members of the United States Supreme Court may be comfortable with the idea of class arbitration, (*see, e.g.*, Christopher M. Mason, Devon Haft Little & Sherli Yeroushalmi, *Supreme Court Addresses Problems of Size*, N.Y.L.J., June 10, 2013, at S2), yesterday, all of them agreed that if an arbitrator finds that the parties have actually agreed to such a procedure, that finding is entitled to substantial deference under Section 10 of the Federal Arbitration Act ("FAA"), 9 U.S.C. § 10(a)(4) (2013). *Oxford Health Plans LLC v. Sutter*, No. 12-135, 2013 U.S. LEXIS 4358 (2013). In reaching its conclusion, the Court distinguished *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 559 U.S. 662 (2010), on the grounds that the parties in *Oxford* had expressly submitted the issue of class arbitration to the arbitrator, and the arbitrator had decided (although perhaps wrongly, in the view of some of the Court) that they had agreed to it.

Facts

In 1998, Oxford Health Plans, LLC ("Oxford") and Dr. John Sutter entered into an agreement for Sutter to treat Oxford's plan members at set rates. The agreement included an arbitration clause stating that all disputes arising under it would be resolved through binding arbitration. It seemed, however, to be silent on the issue of class arbitration.

In 2002, Dr. Sutter sued Oxford for breach of contract and violations of state law. He did so not only on behalf of himself, but also on behalf of a proposed class of other health care providers under contract with the company. Pursuant to the terms of the parties' agreement, the court referred the dispute to an arbitrator. Examining the text of the agreement, the arbitrator found that "on its face, the arbitration clause . . . express[d] the parties' intent that class arbitration can be maintained." *Oxford Health Plans LLC*, 2013 U.S. LEXIS 4358, at *5.

Oxford promptly moved to vacate this decision on the theory that the arbitrator had exceeded his powers under Section 10(a)(4) of the FAA. A federal district court denied that motion, and on appeal, the United States Court of Appeals for the Third Circuit affirmed that denial.

The arbitration then proceeded on a class-wide basis until the Supreme Court rendered its decision in *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 559 U.S. 662 (2010). In *Stolt-Nielsen*, the Court held that "a party may not be compelled under the FAA to submit to class arbitration unless there is a contractual basis for concluding that the party *agreed* to do so." 559 U.S. at 684 (emphasis in original).[1]

Given this language, Oxford filed a motion for reconsideration before the arbitrator of his earlier decision on class arbitration. The arbitrator, however, concluded that "*Stolt-Nielsen* had no effect on the case because [the] agreement authorized class arbitration." *Oxford Health Plans LLC*, 2013 U.S. LEXIS 4358, at *6. He reasoned that, unlike *Stolt-Nielsen*, the parties in *Oxford* had agreed to submit the entirety of the interpretation of the arbitration clause to an arbitrator; the arbitrator interpreted that clause as "vest[ing] in the arbitration process everything that is prohibited from the court process," *id.* at *5; and concluded on that basis that the parties "unambiguously evinced an intention to allow class arbitration." *Id.* at *7 (citations omitted).

Oxford once again sought review of the arbitrator's decision in federal court, and once again both the district court and the Third Circuit denied Oxford's motion. The Court of Appeals, in particular, rested its decision on the limited scope of judicial review permitted under Section 10(a)(4) of the FAA. As it concluded, where an arbitrator "makes a good faith attempt to [interpret and enforce a contract], even serious errors of law or fact will not subject his award to vacatur." *Sutter v. Oxford Health Plan LLC*, 675 F.3d 215, 220 (2012). While the

arbitrator may not have been right in his conclusion, he had "endeavored to interpret the parties' agreement within the bounds of the law," and had articulated "a contractual basis for his decision to order class arbitration. . . ." *Id.* at 223-24. Oxford promptly sought and obtained a petition for certiorari to the Supreme Court.

The Supreme Court affirms

In a unanimous opinion written by Justice Kagan, the Supreme Court affirmed the decision of the Court of Appeals, agreeing as to the enormous deference afforded to an arbitrator's decision under the FAA. As it emphasized, "[s]o long as the arbitrator was 'arguably construing' the contract . . . a court may not correct his mistakes under § 10(a)(4)." *Oxford Health Plans LLC*, 2013 U.S. LEXIS 4358, at *15 (citing *Eastern Assoc. Coal Corp. v. Mine Workers*, 531 U.S. 57, 62 (2000)). Indeed, "[i]t is not enough . . . to show that the [arbitrator] committed an error—or even a serious error. Because the parties bargained for the arbitrator's construction of their agreement, an arbitral decision even arguably construing or applying the contract must stand, regardless of a court's view of its (de)merits. Only if the arbitrator act[s] outside the scope of his contractually delegated authority—issuing an award that simply reflect[s] [his] own notions of [economic] justice rather than draw[ing] its essence from the contract—may a court overturn his determination." *Oxford Health Plans LLC*, 2013 U.S. LEXIS 4358, at *9 (quoting *Stolt-Nielsen*, 559 U.S. at 671, and *Eastern Assoc. Coal Corp.*, 531 U.S. at 62) (internal quotation marks omitted).

The Court took care to distinguish its decision in *Stolt-Nielsen*, describing the contrast between the cases as "stark." *Oxford Health Plans LLC*, 2013 U.S. LEXIS 4358, at *13. In *Stolt-Nielsen*, unlike in *Oxford*, "the arbitrators did not construe the parties' contract, and did not identify any agreement authorizing class proceedings." *Id.* The Court had thus overturned the arbitral decision in *Stolt-Nielsen* "because it lacked any contractual basis for ordering class procedures, not because it lacked . . . a 'sufficient' one." *Id.* at *12. Thus the two cases "fall on opposite sides of the line that § 10(a)(4) [of the FAA] draws to delimit judicial review of arbitral decisions." *Id.* at *14.

All of this was a normal effort by the Court to use a standard of review to avoid a more substantive decision. And all members of the Court agreed on that course. But in a concurrence, Justices Alito and Thomas made clear that, if they had reviewed the arbitrator's interpretation of the parties' agreement *de novo*, "we would have little trouble concluding that [the arbitrator] improperly inferred an implicit agreement to authorize class-action arbitration . . . from the fact of the parties' agreement to arbitrate." *Id.* at *17 (Alito, J., concurring) (quoting *Stolt-Nielsen*, 559 U. S. at 685) (internal quotation marks omitted). More significantly, Justice Alito also argued that the arbitrators' decision and the arbitration clause itself gave "no reason to think that the absent class members ever agreed to class arbitration." *Oxford Health Plans LLC*, 2013 U.S. LEXIS 4358, at *18. It is therefore "far from clear that [the absent class members] will be bound by the arbitrator's ultimate resolution of [the] dispute." *Id.* In effect, he was alerting the parties that issues of class procedures and *res judicata* may yet allow Oxford to try to avoid much of any substantive decision by the arbitrator.

Implications

Overall, *Oxford* is a narrow decision as to class arbitration issues and a conventional decision as to standard of review under Section 10(a)(4) of the FAA. In *Stolt-Nielsen* the Court left open the question of whether the availability of class arbitration is a gateway "question of arbitrability" (*i.e.* whether specific classes of disputes are barred from arbitration) that can only be decided by a court. The Court briefly mentioned the issue in *Oxford*, but declined to address it because the parties had conceded that they had agreed the arbitrator was empowered to decide the question of arbitrability. It thus remains unclear how the Court would rule in different circumstances. It also remains unclear whether the majority that has favored class waivers and disfavored class arbitration in other cases,[2] will find good use in later cases for Justice Alito's argument that an arbitrator's decision based on an otherwise silent arbitration clause, or without opt-in procedures, might not bind absent class members.

As with many prior decisions from the Court, the *Oxford* decision should remind drafters of arbitration clauses that clarity matters. If the parties do not want class or representative arbitrations, the better course may be to say so expressly. Particularly in the consumer or small business context, of course, such waivers may raise additional issues—issues that the Court may address in its upcoming *American Express Travel Related Services Co. v. Italian Colors Restaurant (In re AmEx Merchants' Litigation)* decision. *See, e.g.*, Christopher M. Mason, Carolyn G. Nussbaum & Paige L. Berges, *Landmark Class Action Case To Be Heard In Supreme Court,* Law360 (Dec. 13, 2012), *available at* http://www.

law360.com/classaction/articles/398852/landmark-class-action-case-to-be-heard-in-supreme-court

(Endnotes)

1 See e.g. our prior alert here: http://www.nixonpeabody.com/Supreme_Court_speaks_loudly_in_Stolt_Nielsen.

2 See e.g. our prior alerts here: http://www.nixonpeabody.com/landmark_class_action_waiver_case; http://www.nixonpeabody.com/Supreme_Court_speaks_loudly_in_Stolt_Nielsen; http://www.nixonpeabody.com/Supreme_Court_upholds_class_action_waivers_in_consumer_contracts; http://www.nixonpeabody.com/Supreme_Court_rejects_class_certification_based_on_damages_model_Comcast_v_Behrend.

SCOTUS upholds class action waiver again: Amex III significantly limits the "effective vindication" of statutory rights doctrine

By W. Scott O'Connell, Christopher M. Mason, W. Daniel Deane, Morgan C. Nighan, and Paige L. Berges

Last year, we noted that when the United States Court of Appeals for the Second Circuit denied rehearing *en banc* of its decision rejecting a class action waiver in *In re Am. Express Merchants' Litig.*, 681 F.3d 139 (2d Cir. 2012), the dissent to that denial argued that the Supreme Court's decision in *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011), "teaches that the FAA does not allow courts to invalidate class-action waivers even if 'class proceedings are necessary to prosecute small-dollar claims that might otherwise slip through the legal system.'" 681 F.3d at 143. *See "*U.S. Supreme Court will hear landmark class action waiver case: *American Express Co. v. Italian Colors Restaurant*," November 19, 2012, *available here*. We predicted this argument might carry weight with the Supreme Court when it finally resolved the issue—and it clearly did. In a 5 to 3 decision,[1] with the majority opinion authored by Justice Scalia, the Supreme Court forcefully held that agreements to waive class procedures in otherwise valid agreements *will* be enforced according to their terms, even if one consequence may be to render the pursuit of a particular claim uneconomic. The decision is particularly important for businesses that use arbitration agreements with class waivers (and should encourage other businesses that have avoided arbitration clauses in recent years to reconsider their decision). Such agreements may no longer need to include the kinds of devices found in the arbitration clauses in *Concepcion,* such as bounties, premiums, or multiplier cost shifting mechanisms to ensure enforcement of the waiver. At this point, the cumulative effect of recent decisions by the Supreme Court under the Federal Arbitration Act, 9 U.S.C.A. §§ 9-16 (West 2013) (the "FAA"), has reached a level where we would recommend to many clients that they take a new, close look at arbitration and dispute resolution clauses generally in their businesses.

In *Am. Express Co. v. Italian Colors Restaurant*, the majority held that the FAA, does not allow the invalidation of class waivers merely because the costs of arbitrating claims individually may outweigh the potential recovery. No. 12-133, 2013 U.S. LEXIS 4700 at *16-17 (2013) (*Amex III*). Justice Scalia's opinion also makes clear to state and lower federal courts that the "effective vindication" of statutory rights doctrine—the idea that the law does not recognize agreements to prospectively waive congressionally created entitlements—must be construed narrowly in the context of agreements to arbitrate. In doing so, the Court sent a strong message that its earlier arbitration-friendly decision in *Concepcion* should be read expansively when courts are considering arguments that an agreement to bilateral arbitration should be set aside. Echoing the Second Circuit dissent to the denial of *en banc* review, Justice Scalia noted that the decision in *Concepcion* "all but resolves this case." *Id.* at *16.

The resolution of the issues in *Amex III* became necessary because, despite the Supreme Court's views of the primacy of party agreement in earlier decisions, lower courts had continued to show hostility toward arbitration agreements and class waiver provisions. Those decisions usually invoked the FAA's "Savings Clause," 9 U.S.C.A. § 2, to hold an arbitration agreement unenforceable under a particular state law definition of unconscionability.[2]

In its 2011 decision in *Concepcion*, the Supreme Court had limited application of the Savings Clause, holding that defenses which, in theory can be generally applied to all contracts (like unconscionability), were still preempted by the FAA if they were applied disproportionately to invalidate arbitration agreements. As recently as last week, however, state courts were still using the vindication of statutory rights doctrine to invalidate arbitration clauses and class waivers, and citing pre-*Concepcion* Supreme Court holdings to do so. *See*, *e.g.*, *Feeney v. Dell, Inc.*, 465 Mass. 470, 2013 WL 2479603 (June 12, 2013) ("*Feeney II*") (citing, e.g., *Green Tree Fin. Corp.-Ala. v. Randolph*,

1 Justice Sotomayor recused herself because she had participated in the case while on the Second Circuit.

2 The Savings Clause provides that "such grounds as exist at law or in equity for the revocation of any contract" will still apply to any purported agreement to arbitrate.

531 U.S. 79 (2000), and *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985). *See* "Massachusetts SJC rules on class waivers days before United States Supreme Court issues *Amex* decision," June 19, 2013, *available at* http://www.nixonpeabody.com/MA_SJC_rules_on_class_waivers. Such efforts to avoid the Supreme Court's views will be very difficult now.

Background to ***Amex III***

Merchants who accept American Express cards have an agreement that requires the arbitration of any disputes and waives the merchants' right to arbitrate as a class. A few years ago, some of these merchants filed a lawsuit alleging that American Express had used its monopoly power in the market for charge cards to force merchants to accept credit cards at rates approximately 30% higher than the fees for competing credit cards.

American Express moved to compel individual arbitration of these antitrust claims pursuant to its agreements with the merchants. In resisting the motion, the merchants argued that the cost of an expert economic analysis necessary to prove the individual antitrust claims would amount to hundreds of thousands of dollars (and possibly over $1 million) for each claimant. Yet the expected recovery for each individual plaintiff would likely be less than $40,000.
The District Court granted American Express's motion to dismiss, but the United States Court of Appeals for the Second Circuit reversed and remanded for further proceedings on the ground that that the class action waiver was unenforceable in the face of the merchants' supposedly "prohibitive costs if compelled to arbitrate under the class action waiver." 2013 U.S. LEXIS 4700 at *6 (quoting *In re Am. Express Merchants' Litig.*, 554 F.3d 300, 315-316 (2d Cir. 2009)).

The Supreme Court granted *certiorari* and vacated this decision, remanding for further consideration in light of *Stolt-Nielsen, S.A. v. Animal Feeds Int'l Corp.*, 559 U.S. 662 (2010), which held that a party may not be compelled to submit to class arbitration absent an agreement to do so. *Am. Express Co. v. Italian Colors Restaurant*, 559 U.S. 1103 (2010). The Court of Appeals stood by its reversal, but later *sua sponte* reconsidered its ruling in light of *Concepcion*, in which the Supreme Court had held that the FAA pre-empted a *state* law barring enforcement of a class-arbitration waiver. *See* 131 S. Ct. at 761-62. Yet despite the holding in Concepcion, the Second Circuit sided with the merchants for a third time by distinguishing Concepcion, which was premised on FAA preemption of a state law policy that conflicted with the FAA, from the case at bar, which involved the competing policies of two federal statutes (the FAA and the Sherman Act). After the Second Circuit denied rehearing *en banc*, the Supreme Court granted *certiorari* to consider "whether the Federal Arbitration Act permits courts . . . to invalidate arbitration agreements on the ground that they do not permit class arbitration of a federal-law claim." *Amex III*, 2013 U.S. LEXIS 4700 at *7.

The decision

In answering this question, Justice Scalia, writing for the same conservative majority that decided *Concepcion*, reiterated the common refrain from earlier decisions that "arbitration is a matter of contract." *Id*. at *8. In addition, however, he pointedly noted that "the antitrust laws do not guarantee an affordable procedural path to the vindication of every claim." *Id*. Contrary to the views of the Second Circuit, any vindication of statutory rights doctrine arose only as "dicta" in *Mitsubishi Motors* (a decision that in fact upheld the enforceability of an arbitration clause). *Id*. at *11. The true nature of that doctrine is a "desire to prevent 'prospective waiver of a party's *right to pursue* statutory remedies.'" *Id*. (quoting *Mitsubishi Motors*, 473 U.S. at 637) (emphasis in original). As Justice Scalia explained, "the fact that it is not worth the expense involved in *proving* a statutory remedy does not constitute the elimination of the *right to pursue* that remedy." *Id*. at *13 (emphasis in original). As long as an agreement provides *some* method to pursue a remedy, an arbitration clause containing a class action waiver provision will therefore be upheld under the FAA even though it may not be cost effective for the claimant to actually pursue the remedy in arbitration. According to Justice Scalia, the Court in *Concepcion* had already "specifically reject[ed] the argument that class arbitration was necessary to prosecute claims 'that might otherwise slip through the legal system.'" *Id*. at *17 (quoting *Concepcion*, 131 S. Ct. at 1752). That principal "all but resolves this case." *Id.*

The "nutshell" dissent

Justice Scalia's majority opinion is clear and forceful. Justice Kagan's dissent is also quite clear. As she put it, "here is the nutshell version of today's opinion, admirably flaunted rather than camouflaged: too darn bad." *Id.* at *20 (Kagan, J., dissenting).

Justice Kagan sided with the merchants and accused the majority of rendering a decision that "operates to confer immunity from potentially meritorious federal claims," an outcome that the FAA was never meant to

produce. *Id.* at *21. (Kagan, J., dissenting). According to her, the effect of the majority's decision is that "[t]he monopolist gets to use its monopoly power to insist on a contract effectively depriving its victims of all legal recourse." *Id*. at *20. (Kagan, J., dissenting).

Regarding prospective waivers of federal rights, the dissent insists this rule can only work if it applies not just to a contract clause explicitly barring a claim, but to others, such as the one in this case, that have the practical effect of barring claims.[3] In *Mitsubishi Motors*, for example, the Court held that an arbitration clause "should be 'set[] aside' if 'proceedings in the contractual forum will be so gravely difficult' that the claimant 'will for all practical purposes be deprived of his day in court.'" *Id.* at *24-25 (Kagan, J., dissenting). (quoting *Mitsubishi Motors*, 437 U.S., at 632). The FAA itself also supposedly supports a vindication of rights doctrine by reflecting a federal policy favoring arbitration as a "'method of resolving disputes,' not as a foolproof way of killing off valid claims." *Id*. at *26 (Kagan, J., dissenting) (quoting *Rodriguez de Quijas v. Shearson/ Am. Express, Inc*., 490 U.S. 477, 481 (1989)).

3 Notably, the dissent explicitly argues that the vindication of statutory rights doctrine does not apply to state law, meaning any possible application of it in the future can only be used for federal claims. This statement by the dissent further undermines the decisions of several federal and state courts that have extended "effective vindication" of statutory rights doctrine to state law claims.

Effects of ***Amex III***:

The *Amex III* decision puts an exclamation point on the Supreme Court's series of significant arbitration decisions over the last few terms. In itself, it makes class waivers in arbitration clauses very difficult to defeat. Any effort to use a vindication of statutory rights doctrine for that purpose, for example, will be limited to instances when a party prospectively waives rights to *pursue* federal statutory claims. The fact that pursuit of those claims is difficult, expensive, or burdensome will not itself constitute a "waiver." As we noted earlier, it may be time for clients to spend some time reviewing their arbitration and dispute resolution clauses and strategies anew. While *Amex III* will not stop some courts and parties from trying to find ways around otherwise appropriate clauses favoring individualized resolution of disputes, the Supreme Court has now indicated a very clear preference for party choice and traditional, bilateral, dispute resolution. *See also, e.g.*, Christopher M. Mason, Devon Haft Little, and Sherli Yeroushalmi, *Supreme Court Addresses Problems of Size: 'Too big' and 'too small' cases pose a* struggle, N.Y.L.J., June 10, 2013, at S2.

UPDATE: Massachusetts SJC clarifies rule on class waivers in light of Amex II

By Scott O'Connell, Daniel Deane, and Morgan Nighan

As we reported in a prior alert, the Massachusetts SJC attempted to avoid the Supreme Court's decision in *AT&T Mobility LLC v. Concepcion*[1] that prohibits courts from invalidating class waivers.[2] Notwithstanding *Concepcion*, the SJC in *Feeney v. Dell, Inc.* ("*Feeney II*")[3] held that a consumer-facing arbitration clause is unenforceable because its class waiver provision prevents customers from effectively vindicating their rights under Massachusetts's consumer protection statute.[4]

That decision was abrogated just a few days later by the Supreme Court's decision in *Am. Express Co. v. Italian Colors Restaurant* (*Amex III*),[5] where the majority of the Court specifically held that the FAA does not allow the invalidation of class waivers merely because the costs of arbitrating claims individually may outweigh the potential recovery.[6]

On petition for rehearing in *Feeney II*, the SJC concluded that its analysis "no longer comports with the Supreme Court's interpretation of the FAA."[7] The SJC's decision makes clear its disagreement with the Supreme Court's analysis of *Concepcion*, characterizing as "untenable" the Supreme Court's view that the FAA trumps any interest in ensuring the prosecution of low-value claims, but concedes that "we are bound to accept that view as a controlling statement of Federal law."

This decision further affirms our prior advice that clients should review their arbitration and dispute resolution

1 131 S. Ct. 1740 (2011)

2 For a summary of *Concepcion*, see our prior alert, "U.S. Supreme Court upholds class action waivers in consumer contracts: *AT&T Mobility v. Concepcion*," April 27, 2011, available here.

3 465 Mass. 470, 2013 WL 2479603 (June 12, 2013)

4 See "Massachusetts SJC rules on class waivers days before United States Supreme Court issues *Amex* decision," June 19, 2013, available here.

5 No. 12-133, 2013 U.S. LEXIS 4700 at *16-17 (2013)

6 See "SCOTUS upholds class action waiver again: *Amex III* significantly limits the 'effective vindication' of statutory rights doctrine," June 24, 2013, available here.

7 See *Feeney, et al v. Dell, Inc.,* et al, Lawyers Weekly No. 10-142-13 (August 1, 2013).

clauses and strategies. Although parties and courts may continue to find ways to invalidate arbitration provisions, the Supreme Court has reiterated a clear preference favoring parties' preferences for arbitration and traditional bilateral dispute resolution.

The Second Circuit turns over a new leaf: class action waivers work after Amex III

By Paige Berges and Christopher M. Mason

The Second Circuit has just applied the Supreme Court's recent decision in *American Express v. Italian Colors Restaurant* to compel an individual employee to pursue a claim through individual rather than class arbitration in *Sutherland v. Ernst & Young*.[1] This represents an important change in the tenor of the Circuit's approach to these issues, and clients should be mindful of this change and review their arbitration and dispute resolution clauses and strategies.

Amex I, II, and III

By the time it decided *In re Am. Express Merchants' Litig.* ("*Amex III*"),[2] the Court of Appeals for the Second Circuit had already twice rejected class action waivers when such waivers seemed to the Court to preclude a plaintiff's ability to vindicate federal statutory rights. The Supreme Court had once granted *certiorari* and vacated the Second Circuit's decision to that effect in *In re Am. Express Merchants' Litig.* ("*Amex I*"),[3] remanding the case for reconsideration in light of *Stolt-Nielsen, S.A. v. Animal Feeds Int'l Corp*.[4] The Second Circuit itself then *sua sponte* reconsidered its similar decision in *In re Am. Express Merchants' Litig.* ("*Amex II*")[5] in light of *AT&T Mobility LLC v. Concepcion*.[6] Finally, the Second Circuit had denied rehearing *en banc* in *In re Am. Express Merchants' Litig.*[7]

In November 2012, the Supreme Court granted a writ of *certiorari* to review the Second Circuit's *Amex III* decision.[8] The question presented was "whether the Federal Arbitration Act permits courts . . . to invalidate arbitration agreements on the ground that they do not permit class arbitration of a federal-law claim."[9]

The Supreme Court decided the case on June 20, 2013, holding in a 5 to 3 decision that agreements to waive class proceedings will be enforced even if enforcement of the waiver would appear in the abstract to render a plaintiff's claim economically infeasible.[10]

The Second Circuit has now for the first time applied this holding, doing so in *Sutherland v. Ernst & Young*.[11] Its opinion reverses the decision of the United States District Court for the Southern District of New York and holds (consistent with the Supreme Court's analysis) that an employee cannot invalidate a class-action waiver provision in an arbitration agreement even when such waiver removes the "financial incentive" to pursue a claim under the Fair Labor Standards Act of 1938 ("FLSA").

The issues in ***Sutherland***

In *Sutherland*, a former employee of Ernst & Young ("E&Y") sued on behalf of herself and similarly situated plaintiffs to recover "overtime" wages pursuant to the FLSA and New York minimum wage laws. The plaintiff had signed an agreement calling for mediation and arbitration which expressly barred "any class or collective proceedings in the arbitration."[12] Nonetheless, the plaintiff filed a class action in New York federal court. E&Y promptly moved to dismiss and to compel arbitration. The plaintiff argued that requiring individual arbitration would dwarf her potential recovery of less than $2,000. On this basis, the district court denied E&Y's motion, holding the class action waiver unenforceable under the then binding precedent of *Amex I*.[13]

On appeal, the Second Circuit recognized that "*Amex I* and the subsequent decisions that followed in [this]

1 See *Sutherland v. Ernst & Young*, 12-304-CV, 2013 U.S. App. LEXIS 16513 (2d Cir. Aug. 9, 2013).
2 667 F.3d 204 (2d Cir. Feb. 1, 2012).
3 554 F.3d 300, 315-316 (2d Cir. 2009).
4 559 U.S. 662 (2010).
5 634 F.3d 187, 193 (2d Cir. 2011).
6 131 S. Ct. 1740 (2011).
7 681 F.3d 139 (2d Cir. May 29, 2012). See our prior alert, U.S. Supreme Court will hear landmark class action waiver case: *American Express Co. v. Italian Colors Restaurant*.
8 See *American Express Travel Related Services Co. v. Italian Colors Restaurant* ("*In re Amex Merchants' Litigation*"), No. 12-133, 2012 U.S. LEXIS 8697(Nov. 9, 2012).
9 *Am. Express Co. v. Italian Colors Restaurant*, No. 12-133, 2013 U.S. LEXIS 4700 at *7 (2013) ("*Amex III*") See our prior alert, U.S. Supreme Court will hear landmark class action waiver case: *American Express Co. v. Italian Colors Restaurant*.
10 *Amex III*, 2013 U.S. LEXIS 4700 at **16-17. See our prior alert, SCOTUS upholds class action waiver again: *Amex III* significantly limits the "effective vindication" of statutory rights doctrine.
11 2013 U.S. App. LEXIS 16513 at *4 (2d Cir. Aug. 9, 2013).
12 *Id.* at *11.
13 See *Sutherland v. Ernst & Young LLP*, 847 F. Supp. 2d 528, 535 (S.D.N.Y. 2012).

Circuit are no longer good law in light of the Supreme Court's recent decision in *American Express Co. v. Italian Colors Restaurant*, 133 S. Ct. 2304, 186 L. Ed. 2d 417 (2013)." In particular, the Second Circuit described the Supreme Court's ruling as holding "that plaintiffs could not invalidate a waiver of class arbitration under the so-called 'effective vindication doctrine' by showing that 'they ha[d] no economic incentive to pursue their antitrust claims individually in arbitration.'"[14]

The Second Circuit analysis of SCOTUS's ***Amex III*** decision

The Second Circuit first remarked that the Supreme Court establishes a "liberal federal policy favoring arbitration agreements… unless the FAA's [Federal Arbitration Act] mandate has been 'overridden by a contrary congressional command.'"[15] The plaintiff claimed that the FLSA contained such a command in its provision that an employee may maintain an action "by any one or more employees for and in behalf of himself or themselves or other employees similarly situated."[16] The Second Circuit rejected this statutory analysis and, citing *Concepcion*, stated that "Supreme Court precedents inexorably lead to the conclusion that the waiver of collective action is permissible in the FLSA context."[17]

The plaintiff had also claimed that E&Y's class waiver prevented her from "effectively vindicating her rights" because individual arbitration was "prohibitively expensive." She did so because the Supreme Court had left open, in *Green Tree Fin. Corp.-Ala v. Randolph*,[18] the argument that an arbitration agreement could be invalidated because of prohibitive costs. The Supreme Court had also held, however, that a party bears the burden of showing the likelihood of such costs.

Responding to this issue on appeal, the Second Circuit unequivocally states in its opinion that an argument that an arbitration that is "prohibitively expensive" is insufficient to invalidate a class-action waiver provision in light of *Amex III*. Although the Second Circuit claimed that the "'effective vindication doctrine' could be used to invalidate 'a provision in an arbitration agreement forbidding the assertion of certain statutory rights,'"[19] it also held that the Supreme Court's decision in *Amex III* "compels the conclusion that Sutherland's class-action waiver is not rendered invalid by virtue of the fact that her claim is not economically worth pursuing individually."[20] There did not seem to be any question in *Sutherland* that the plaintiff had demonstrated she would face substantial costs if forced to arbitrate individually. Nonetheless, the Second Circuit ultimately found that the "'effective vindication doctrine' cannot be used to invalidate class-action waiver provisions in circumstances where the recovery sought is exceeded by the costs of individual arbitration."[21]

Clients should be aware that courts all over the country will no doubt reexamine their own precedent in light of the Supreme Court's decision in *Amex III*. In addition to *Sutherland*, this has already happened in Massachusetts.[22] The Second Circuit's decision in *Sutherland* certainly raises by itself the question about whether the effective vindication doctrine is, in fact, a viable argument to invalidate an arbitration agreement on the basis of economic infeasibility. In light of these trends, businesses and individuals should review their current and future approaches to arbitration and dispute resolution.

14 *Sutherland*, 2013 U.S. App. LEXIS 16513 at *6.
15 *Id.* at *13 (internal citations omitted).
16 *Id.* at *16, *quoting* 29 U.S.C. § 216(b).
17 *Id.* at *16.
18 531 U.S. 79, 90 (2000).

19 2013 U.S. App. LEXIS 16513 . at *23 (emphasis added) (quoting *Amex III*, 133 S. Ct. at 2310-11).
20 2013 U.S. App. LEXIS 16513 at *22.
21 *Id*. at *24.
22 See our prior alert, UPDATE: Massachusetts SJC clarifies rule on class waivers in light of *Amex III*.

Chief Justice questions cy pres remedies

By Christopher M. Mason, Bruce E. Copeland, W. Daniel Deane, and Kevin T. Saunders

On Monday, November 4, 2013, the Supreme Court denied a petition for a writ of *certiorari* in *Marek v. Lane*. The petition involved objections to the settlement of a class action lawsuit involving Facebook. Rather than paying money or other benefits to any class member, the settlement involved a *cy pres* remedy—that is, a benefit given to a third party that theoretically provides some benefit "as near as possible" to the individual members of the class.

Denials of *certiorari* are not usually noteworthy. But here, Chief Justice John Roberts—while voting to deny the petition—issued a four-page summary of the issues and then concluded by stating that "[i]n a suitable case, this Court may need to clarify the limits of the use of such remedies."

Facts

The *Marek* case concerned Facebook's "Beacon" programming, which automatically reported Facebook user activity. This included, for example, online purchases from a participating company's website or comments about such companies. Data collected included the user's personally identifiable information ("PII"), even if the user was not a Facebook member. The online activities of Facebook members were automatically posted to their profiles absent an affirmative "opt out."

The launch of Beacon resulted in a significant public outcry against Facebook. One month after the launch, Facebook ended up changing the default settings for the programming from an "opt in" result to an "opt out" result. In other words, user information would not be collected and reported unless the user affirmatively agreed.

Despite the quick change by Facebook, several individuals brought a putative class action lawsuit in the Northern District of California against Facebook and companies that had participated in the Beacon program. The putative class, made up of only those individuals whose PII was disclosed during the one-month window where Beacon's default setting was "opt in," alleged violations of several federal and state privacy laws and sought damages and equitable relief, including enjoining Facebook from continuing to use Beacon.

Before a decision on class certification for purposes of litigation, the individual plaintiffs settled with these defendants for Facebook's promise to discontinue the Beacon program (but with no guaranty that prevented Facebook from commencing another similar program) and $9.5 million. Plaintiffs' counsel took nearly one-quarter of the settlement and the named plaintiffs were awarded small "incentive payments." The remaining unnamed class members received nothing. Instead, the settling parties designated the remaining $6.5 million a *cy pres* remedy that would fund the creation of a new foundation designed to help fund organizations to educate the public about online privacy. The settlement barred subsequent claims from individuals injured both before and after Facebook changed Beacon's default setting.

District and circuit courts

The district court approved the settlement over the objections of Megan Marek and three other unnamed class members who had raised concerns about what they considered the low amount of the settlement and questions as to whether the new foundation would really serve the interests of the class. (Among other things, the foundation was brand new, had no track record of success, and might be influenced by a Facebook executive designated to sit on its board of directors.) Both the district court and a divided Ninth Circuit panel rejected these objections. The Ninth Circuit also denied a petition for rehearing *en banc* over the dissent of six judges.

U.S. Supreme Court

In his statement, the Chief Justice agreed that the Supreme Court should deny the petition for a writ of *certiorari* because the petitioners' objections focused on the peculiarity of the specific settlement. These peculiarities "might not have afforded the Court an opportunity to address more fundamental concerns surrounding the use of such remedies." Justice Roberts then went on to list several concerns he considered fundamental:

- when, if ever, a *cy pres* remedy should be considered;
- how to evaluate its fairness;
- whether new organizations can be established as part of the remedy;
- if not, how to select existing organizations;
- what roles the judge and the parties should play in determining the remedy; and
- how closely a selected organization's goals must correspond to the interests of the class.

In Chief Justice Roberts' view, the Supreme Court had never addressed any of these issues. Because *cy pres* remedies are becoming more common in class action litigation, however, the Chief Justice believed the Court may need to "clarify the limits" in a "suitable case."

Implications

While the Supreme Court may not have addressed the issue, debate over *cy pres* settlements is not new.[1] Such awards have, in fact, been around long enough to become a material source of benefit for a number of bar associations and legal aid organizations. For one example, see the comments of the Legal Aid for Washington Law Fund soliciting *cy pres* benefits.[2]

Not surprisingly, criticism has focused on abuses and potential abuses, many of which involve details the Chief Justice might well consider peculiarities. Good

1 *See, e.g.,* Steward Shepherd*, Damage Distribution in Class Actions: The* Cy Pres *Remedy*, 39 U. Chi. L. Rev. 448 (1972).

2 Click here to read Legal Aid for Washington Law Fund, "Cy Pres and Residual Fund Awards." See also the resources listed here.

examples appear in a Florida Law Review article the Chief Justice cited,[3] and in a report recently issued by the U.S. Chamber of Commerce.[4] While *cy pres* issues are often fact-specific, we believe it is likely that the Supreme Court will, in an appropriate case, announce some general principles to limit use of the remedy (perhaps particularly in cases where generous statutory damages per person or incident produce ludicrously large notional damages)[5] just as it has announced some general principles to try to limit the size of class actions.[6] We doubt the Court will outlaw the remedy altogether.

3 *See* Martin H. Redish, Peter Julian, and Samantha Zyontz, *Cy Pres Relief and the Pathologies of the Modern Class Action: A Normative and Empirical Analysis*, 62 Fla. L. Rev. 617 (2010) (available here).

4 *See "The New Lawsuit Ecosystem: Trends, Targets, and Players,"* U.S. Chamber Institute for Legal Reform, October 2013 (available here).

5 *See, e.g.,* prior alerts on the TCPA: "Attention all businesses that market by phone, text or fax: New FCC rules are set to go into effect October 16 and penalties for noncompliance are severe. Are you ready?" and "TCPA: Your last minute questions answered."

6 *See, e.g.,* our prior alerts and articles on this subject: "U.S. Supreme Court rejects class certification based on the damages model: *Comcast Corp. v. Behrend*," "*Dukes* redux: plaintiffs seek certification of smaller class sizes in two states," "Supreme Court raises the bar for class certification in landmark sex discrimination decision," and "Supreme Court Addresses Problems of Size: 'Too big' and 'too small' cases pose a struggle."

The Supreme Court restricts the scope of "mass action" removals under CAFA

By Christopher M. Mason, Dan Deane, and Melisa E. Gerecci

Less than a year ago, the United States Supreme Court strengthened removal jurisdiction under the Class Action Fairness Act of 2005 ("CAFA"), 28 U.S.C. § 1332(d)(2), (5), by holding that a plaintiff could not avoid the jurisdictional minimum for removal simply by disclaiming damages above $5 million.[1] Monday, the Court again clarified one of the outer edges of CAFA removal jurisdiction by holding unanimously that a lawsuit by a state attorney general on behalf of state citizens is not a "mass action" for purposes of such removal jurisdiction.[2]

Overview

From its enactment seven years ago, CAFA has presented interesting questions about its scope and procedures.[3] While such questions continue to be raised, it unclear to what extent the Act has succeeded in its primary purposes—lessening the quantity of litigation in state courts while moving cases to federal court to reduce perceived local biases. Whatever the overall effects of CAFA, the *Hood v. AU Optronics* decision will not reduce state caseloads.

1 *See Standard Fire Ins. Co. v. Knowles*, No. 11-1450, 2013 U.S. LEXIS 2370 (Mar. 19, 2013), *explained in* Christopher M. Mason, Sara E. Farber and Scott O'Connell, *The Supreme Court Tightens Up on CAFA—and on class plaintiffs* (Mar. 20, 2013), *available here*.

2 *Mississippi ex rel. Hood v. AU Optronics Corp*., No. 12-1036, 2014 U.S. LEXIS 645 (Jan. 14, 2014).

3 *See, e.g.*, Christopher M. Mason and Philip M. Berkowitz, Decisions Begin To Interpret the Class Action Fairness Act (Mar. 21, 2005), available *here*.

Background

In 2011, Mississippi Attorney General Jim Hood sued certain makers of liquid crystal display ("LCD") panels in Mississippi state court, alleging that those companies had formed an international cartel in violation of state antitrust laws to restrict competition and raise prices in the LCD market. (Full disclosure: Nixon Peabody LLP successfully represented a major purchaser against some LCD manufacturers in a different, but somewhat similar antitrust suit in California earlier this year.) Shortly after commencement of the lawsuit, the manufacturer defendants removed the case to federal court under CAFA as a "mass action" pursuant to 28 U.S.C. § 1332(d)(11).

To qualify as a "mass action," a case must be one "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, except that jurisdiction shall exist only over those plaintiffs whose claims in a "mass action" each satisfy the $75,000 amount in controversy requirements of 28 U.S.C. § 1332(a).[4] There are many nuances to this requirement. For example, unlike the class action provisions of CAFA, jurisdiction does not exist under the mass action provisions of the Act unless the "mass action" definition is first satisfied.[5] But the principal issue for Attorney General Hood's claim was not when jurisdiction existed, but whether it existed at all given

4 *See id.* § 1332(d)(11)(B)(i).

5 *Compare, e.g., id.* § 1332(d)(5)(A) (jurisdiction exists, but then may be defeated if it is established that the total number of class members "is less than 100") *with id.* § 1332(d)(11) (jurisdiction created only if "claims of 100 or *more* persons *are* proposed to be tried jointly," and then only as to those who meet the jurisdictional minimum) (emphasis added).

that only one plaintiff (the state) was identified.

The lower courts' decisions

To some extent, an issue like that in *Hood v. AU Optronics* has been addressed in the private context in cases such as *Anwar v. Fairfield Greenwich Ltd*.[6] There, a claim made by two funds did not satisfy the "mass action" provisions of CAFA because, even though the funds had members totaling more than 100, those members were not proposed to be joined as plaintiffs themselves (just as the citizens of Mississippi were not proposed to be joined as plaintiffs in Attorney General Hood's case).[7]

In *Hood v. AU Optronics*, the district court held on a motion to remand that the state court proceedings initially qualified as a "mass action" because, under controlling Fifth Circuit precedent,[8] the words "persons" and "plaintiffs" in CAFA's "mass action" definition mean "real parties in interest."[9] The district court pierced the pleadings to conclude that more than 100 Mississippi consumers were the real parties in interest under Attorney General Hood's restitution claim.[10] But the district court still granted the motion to remand on the grounds that the "general public exception" to CAFA's "mass actions" definition applied.[11] On appeal, the Fifth circuit reversed, upholding the district court's conclusion that the Attorney General's action satisfied the definition of "mass action," but rejecting the district court's application of the "general public exception." The Fifth circuit's application of a "real parties in interest" test thus underscored an existing split in circuit authority.[12] The Ninth, Fourth, and Seventh circuits have all held, contrary to the Fifth circuit, that these similar, state-initiated lawsuits are not "mass actions" removable under CAFA.

The Supreme Court's decision

Writing for a unanimous Supreme Court, Justice Sonia Sotomayor held that, according to the plain language of CAFA, a "mass action" must involve monetary claims brought by 100 or more persons who propose to try those claims jointly as named plaintiffs. But in the case before it, the State of Mississippi (in the person of its attorney general) was the only named plaintiff. The Court held on that basis that the case must be remanded to state court.[13]

In reaching this conclusion, the Court sharply rejected the Fifth circuit's use of a "real parties in interest" test to define the meaning of the words "persons" and "plaintiffs" in the definition of a "mass action." First, Justice Sotomayor noted that Congress could have, but did not, use more expansive language, such as "100 or more named or unnamed real parties in interest."[14] Second, the terms "persons" and "plaintiffs" have well established and specific meanings in the law, neither of which include "anyone, named or unnamed, whom a suit may benefit."[15] To the contrary, Congress most likely intended "persons" and "plaintiffs" to have the same meanings in Section 28 U.S.C. § 1332(d)(11)(B)(i) as they do in Rule 20 of the Federal Rules of Civil Procedure, which similarly provides that "[p]ersons may join in one action as plaintiffs if they assert any right to relief jointly…and any question of law or fact common to all plaintiffs will arise in the action."[16] The most logical reading of both joinder provisions would therefore be that "persons" "refers to the individuals who are proposing to join as plaintiffs in a single action."[17]

The Court also observed that applying the Fifth circuit's "real parties in interest" definition to the word "plaintiffs" would cause absurdities in interpreting other facets of the "mass action" provision and consequently create an "administrative nightmare" for courts that "Congress could not possibly have intended."[18] Finally, because it was flatly rejecting the Fifth circuit's "real parties in interest" analysis, the Court deemed it unnecessary to address the "general public exception" issue, which might have also mandated remand to the state court.

Conclusion

The Supreme Court's decision was not unexpected to some of us in the private bar and will be welcomed by state attorneys general. Because suits like those brought by Attorney General Hood will remain in state

6 676 F. Supp. 2d 285 (S.D.N.Y. 2009)

7 *See Anwar,* 676 F. Supp. 2d at 293-94, 296.

8 *See Louisiana ex rel. Caldwell v. Allstate Ins. Co*., 536 F.3d 418 (5th Cir. 2008).

9 *See Mississippi ex rel. Hood v. AU Optronics Corp*., 876 F. Supp. 2d 758, 771 (S.D. Miss. 2012).

10 *Id*., 876 F. Supp. 2d at 769.

11 *See* 28 U.S.C. § 1332(d)(11)(B)(ii)(III) (excluding from "mass action" definition all claims asserted on behalf of the general public).

12 *Compare Nevada v. Bank of Am. Corp*., 672 F.3d 661 (9th Cir. 2012) (holding that state, as real party in interest, asserted deceptive trade practices claims on behalf of Nevada citizens) *with AU Optronics Corp. v. South Carolina*, 699 F.3d 385 (4th Cir. 2012) (holding that state, as real party in interest, asserted antitrust claims on behalf of South Carolina citizens) *and LG Display Co. v. Madigan*, 665 F.3d 768 (7th Cir. 2011) (holding that state, as real party in interest, asserted antitrust claims on behalf of general Illinois public and not individual claimants or members of purported class).

13 *Hood*, 2014 U.S. LEXIS 645, at *6.

14 *Id*. at *13-14.

15 *Id*. at *14-16.

16 *Id*. at *15 (quoting Fed. R. Civ. P. 20).

17 *Id*.

18 *Id*. at *17.

court, companies likely to worry about class action exposure will also continue to face that issue in the context of potential proceedings in multiple jurisdictions, and thus will require greater strategic foresight to reach successful resolutions.

Supreme Court interprets SLUSA narrowly, allowing state law class actions to proceed against advisors ensnared in frauds

By Christopher M. Mason, Carolyn G. Nussbaum, Constance M. Boland and Kate A.F. Martinez

On Wednesday, the United States Supreme Court affirmed the Fifth Circuit and held that state law class actions against investment advisors, insurance brokers and law firms alleging that they helped Allen Stanford and his companies perpetrate a fraud were not subject to, and therefore were not precluded by, the Securities Litigation Uniform Standards Act (commonly referred to as "SLUSA").[1] The Court's less expansive interpretation of SLUSA led the dissent, authored by Justice Kennedy, to warn of a corresponding limitation on the enforcement authority of the SEC, which the majority painstakingly dispelled.

Analysis

The decision in *Chadbourne & Parke* is viewed as a rare win for the plaintiffs' securities bar, allowing state law claims to proceed against secondary actors, such as advisors, accountants and counsel, which the federal securities laws would otherwise bar.[2] On the other hand, the Court took great pains to limit its holding to this case, repeatedly stressing that its decision would not disturb a single case that the SEC has brought in 80 years, or the Court's own precedent, and that it applies only to fraud involving securities not traded on national exchanges.

Defendants facing securities claims can only hope that the Court will adopt a similarly strict reading of the securities laws in *Halliburton Co. v. Erica P. John Fund, Inc.*,[3] when it may reconsider the contours of the "fraud-on-the-market" doctrine that the Court created twenty-five years ago in *Basic, Inc. v. Levinson*.[4] Commentators agree that the elimination or significant limitation of that doctrine could sound the death knell for securities class actions, and (perhaps with some hyperbole) have labelled *Halliburton* as the most important case to come before the Supreme Court in years, if not decades. With the Court having now given plaintiffs two class action "wins" (in the sense of permitting more, rather than fewer, class actions) this year, the arguments scheduled for next week may provide some insight into whether the Court will continue its trend of imposing a high bar for securities class actions, or will use *Halliburton* to provide some relief from marginal securities fraud class actions and the high costs they impose.

Background

Allen Stanford and his companies were convicted of running a multibillion dollar Ponzi scheme. Plaintiffs here alleged that Stanford sold certificates of deposit in the Stanford International Bank (the "Bank") and falsely represented that the investments were safe and secure because the Bank would invest the proceeds in high-quality stocks and bonds, which it did not. Stanford is presently serving an extended prison sentence and was ordered to forfeit $6 billion. The SEC also successfully pursued a civil case against Stanford and his associates.

Plaintiffs filed four class actions in Texas federal court and Louisiana state court against various entities that provided Stanford with investment, trust, legal, insurance and accounting services, alleging the defendants helped the Bank perpetrate the fraud or conceal it from regulators. The Louisiana cases were removed to federal court, consolidated and transferred to the Northern District of Texas.

The lower courts' decisions

Defendants in each case moved to dismiss, arguing that SLUSA required dismissal. SLUSA precludes state law class actions alleging "a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security."[5] Covered

1 15 U.S.C. § 78bb(f)(1)(A). *See Chadbourne & Parke LLP v. Troice*, No. 12-79 (U.S. Feb. 26, 2014). This is the second decision from the Court to favor more state class actions. A little more than a month ago, the Court reversed the Fifth Circuit and held, in *Mississippi ex rel. Hood v. AU Optronics Corp.,* No. 12-1036, 2014 U.S. LEXIS 645 (Jan. 14, 2014), that a lawsuit by a state attorney general on behalf of state citizens is not a "mass action" for purposes of federal removal jurisdiction under the Class Action Fairness Act of 2005 ("CAFA"), 28 U.S.C. § 1332(d)(11)(B). *See Christopher M. Mason, Dan Deane, and Melisa E. Gerecci, The Supreme Court Restricts the Scope of "Mass Action" Removals Under CAFA (Jan. 15, 2014),* available at http://www.nixonpeabody.com/Supreme_Court_restricts_scope_of_mass_action_removals_under_CAFA.

2 See, e.g., *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 189 (1994) (cited in, e.g., *Chadbourne & Parke LLP*, slip op. at 5 (Kennedy, J., dissenting)).

3 No. 13-317 (to be argued on March 5, 2014).

4 485 U.S. 224 (1988).

5 *See* 15 U.S.C. § 78bb(f)(5)(E).

securities include stocks and bonds traded on national exchanges. The district court granted the motions to dismiss, concluding that because each complaint alleged misrepresentations relating to the Bank's ownership of covered securities and plaintiffs relied on these statements in purchasing the CDs, the claims were within the scope of SLUSA.

On appeal, the Fifth Circuit reversed. It held that claims that defendants facilitated Stanford's sale of CDs (which are not covered securities) by falsely representing that the CDs were to be backed by covered securities were outside the scope of SLUSA. The Fifth Circuit reasoned that the "crux" of the fraud was the false portrayal of the CDs, and the claimed misrepresentations about the Bank's ownership of covered securities were only "tangentially related" to this fraud. Thus, the court concluded that the claims were not covered by SLUSA.[6] Defendants in each of the class actions sought *certiorari*, which the Supreme Court granted.[7]

The Supreme Court's decision

Perhaps as a signal of the Court's independence, Justice Breyer rejected the almost-universal acronym of "SLUSA" used by the securities bar and bench and opened his opinion with a declaration that "we shall refer to [it] as the 'Litigation Act.'"[8] Ultimately, the decision turned on the Court's interpretation of the extent to which the claimed fraud was "in connection with" the purchase or sale of a "covered security." Writing for a seven-member majority, Justice Breyer held that the language and intent of SLUSA require that the claimed misrepresentations make "a significant difference" to the purchase or sale of a covered security.[9] In addition, the person who "took, tried to take, or maintained an ownership position in the statutorily relevant securities through 'purchases' or 'sales' induced by the fraud," must have been someone other than the fraudster.[10] Here, the alleged misstatements were alleged to have been material to the purchasers of uncovered securities (the CDs) and only the Stanford affiliates purchased or sold covered securities. However, as the dissent aptly notes, SLUSA does not include the word or concept of an "ownership position,"[11] and does not specify who must be the buyer or seller of a covered security.

The most interesting part of the decision may be the debate between the majority and dissenters over the implications of the Court's ruling. The majority stressed that its ruling was fully consistent with precedent, claiming that every securities case to come before the Court has "involved victims who took, who tried to take, who divested themselves of, who tried to divest themselves of, or who maintained an ownership interest" in securities.[12] However, the narrow interpretation applied here of the "in connection with" phrase may seem inconsistent with language in prior decisions of the Court that expressly state the phrase should be given a "broad interpretation" and read "flexibly."[13] The dissent (echoing the position of the Government) warned that the restrictive application of the phrase (found throughout the securities statutes) will impinge on the enforcement powers of the SEC, and may also limit investors' rights. But the majority gives short shrift to that prediction of dire consequences, claiming that its interpretation would not preclude a single case that the SEC has brought in 80 years, and noting that the decision actually will "*also* preserve the ability for investors to obtain relief under state laws when the fraud bears so remote a connection to the national securities market that no person actually believed he was taking an ownership position in that market."[14] Justice Breyer pointed out that that the Government, invoking the provisions of the federal securities laws that reach fraud in connection with the purchase or sale of all securities, had managed to convict Stanford, obtain a 110-year sentence, and obtain billion-dollar fines.

Conclusion

While assertedly based on statutory interpretation methods, the *Chadbourne & Parke* decision reads very much like a straight common law opinion, picking and choosing among a number of reasonably possible arguments to achieve an outcome that a particular jurist or set of jurists considers appropriate to this time, place and circumstance. In truth, this is only the warm-up to the main act of *Halliburton*. Perhaps the oral arguments in that case will provide some clue of whether a majority of the Court will revisit its 25-year old precedent of *Basic, Inc. v Levinson.*

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6 *Roland v. Green*, 675 F.3d 503, 520, 522 (5th Cir. 2012).

7 *Chadbourne & Parke LLP v. Troice*, 133 S. Ct. 977 (2013); *Willis of Colo. Inc. v. Troice*, 133 S.Ct. 977 (2013); *Proskauer Rose LLP v. Troice*, 133 S. Ct. 978 (2013).

8 *Chadbourne & Parke LLP,* No. 12-79, slip op. at 1.

9 *Chadbourne & Parke LLP,* No. 12-79, slip op. at 8.

10 *Id.,* slip op. at 10 (emphasis added).

11 (*id.,* slip op. at 15-16 (Kennedy, J., dissenting))

12 *Id.,* slip op. 9-10.

13 *Id*., slip op. at 14; *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71, 85-86 (2006); *SEC v. Zandford*, 535 U.S. 813, 819 (2002).

14 *Chadbourne & Parke LLP,* No. 12-79, slip op. at 16 (emphasis in original).

Ninth Circuit says PAGA claims are not class actions under CAFA

By Dale A. Hudson and Rachel L. Fischetti

Bringing us one step closer to understanding California's Private Attorneys General Act ("PAGA"), which allows employees to enforce the state's Labor Code by pursuing civil penalties on behalf of the state's Labor and Workforce Development Agency, the United States Court of Appeals for the Ninth Circuit recently held that an action under PAGA is not a "class action" under the Class Action Fairness Act ("CAFA") and subsequently cannot be removed to federal court on the basis of that statute.

In *Baumann v. Chase Investments Service Corp.*, Joseph Baumann sued his employer, Chase Investment Services Corporation ("Chase"), under PAGA in a California superior court, alleging that Chase had failed to pay him and employees for overtime, to provide meal and rest periods and to timely reimburse business expenses. The complaint sought PAGA civil penalties for each alleged violation and asserted that Baumann's potential share of any penalties recovered, together with attorneys' fees, would be less than $75,000.

Chase filed for removal to federal court, invoking diversity jurisdiction by alleging that the amount in controversy would exceed $75,000 if all potential penalties and attorneys' fee awards were aggregated. Chase also alleged jurisdiction under CAFA, which authorizes removal to federal court if there is minimal diversity, a class of more than 100 members and the amount in controversy exceeds $5,000,000. The district court found the action could be removed under traditional diversity jurisdiction by aggregating the potential PAGA penalties against Chase. The district court did not address CAFA jurisdiction.

While the *Baumann* appeal was pending, the Ninth Circuit decided *Urbino v. Orkin Services,* which held that PAGA penalties against an employer may *not* be aggregated to meet the minimum amount in controversy requirement for traditional diversity. Thus, the sole question remaining on appeal was whether a PAGA action is a "class action" under CAFA. CAFA defines a class action as "any civil action filed under Rule 23 of the Federal Rules of Civil Procedure or a similar state statute . . . authorizing an action to be brought by one or more representative persons. . . ." Thus, the question boiled down to the PAGA suit "was 'filed under' a state statute . . . 'similar' to Rule 23 that authorizes a class action."

The court concluded that PAGA actions are not sufficiently similar to Rule 23 class actions to trigger CAFA jurisdiction. Unlike Rule 23, PAGA has no notice requirements for unnamed aggrieved employees, nor may such employees opt out of a PAGA action. In a PAGA action, the court does not inquire into the ability of plaintiff and class counsel to fairly and adequately represent unnamed employees—critical requirements in federal class actions. PAGA also contains no requirements of numerosity, commonality or typicality. In addition, the finality of PAGA judgments differs from that of class action judgments. Federal and state rules governing class actions generally provide that class members who receive notice of the action, and decline to opt out, are bound by any judgment. In contrast, PAGA provides that employees retain all rights "to pursue or recover other remedies available under state or federal law, either separately or concurrently with" a PAGA action. If the employer defeats a PAGA claim, the nonparty employees, because they were not given notice of the action or afforded an opportunity to be heard, are not bound by the judgment as to remedies other than civil penalties. The nature of PAGA penalties are also markedly different than damages sought in class actions, where damages are typically restitution for wrongs done to class members. The court concluded that a PAGA action is "at heart a civil enforcement action filed on behalf of and for the benefit of the state, not a claim for class relief."

The court declined to decide whether a federal court may allow a PAGA action otherwise within its original jurisdiction to proceed under Rule 23 as a class action.

Looking ahead

While this case means more PAGA claims will be kept out of federal court, a preferred venue for employers, it does provide much needed guidance for courts and litigants. As PAGA actions become more common, employers should expect to see more decisions defining the parameters of that law.

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As part of a commitment to give back to the community, Scott has dedicated substantial time to pro bono matters. He founded the Nixon Peabody Domestic Protection Team, which assists victims of domestic violence secure protective orders against their abusers. Scott also worked to secure the release of a client, who had been detained at Guantanamo Bay. For his work on this matter, Scott received the Frederick Douglass Human Rights Award from the Law Office of the Southern Center for Human Rights.

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