LOS ANGELES
Daily Journal
www.dailyjournal.com
TUESDAY, MARCH 4, 2014

High court focus on securities class actions

By Mark R.S. Foster

The Supreme Court's spot light is on securities class actions. In the course of a week, it has granted review in one case to consider liability for statements of opinion; it has issued a decision in another case on whether a certain type of securities class action can proceed in state court; and it is now set to hear oral argument in a third case that may determine the future viability of securities class actions brought under Section 10(b) of the Securities Exchange Act of 1934, the antifraud statue most frequently invoked by private plaintiffs.

Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund, No. 13-435

On March 3, the court granted review in *Omnicare* to consider whether, for purposes of liability under Section 11 of the Securities Act of 1933 (which comes into play most frequently in connection with initial public offerings) a plaintiff may plead that a statement of opinion is untrue merely by alleging that the opinion itself was objectively wrong, or must also allege that opinion was subjectively false, meaning that the speaker did not honestly believe the opinion.

In the decision under review, the 6th U.S. Circuit Court of Appeals ruled that only objective falsity was required, putting it in direct conflict with the 2nd, 3rd and 9th Circuits, which have required both objective and subjective falsity. The *Omnicare* case has significant implications for public companies, directors and officers, underwriters, auditors, and other market professionals who often make statements of opinion about a company's business affairs in SEC filings, on earnings calls, at investor conferences, and in road shows. Adoption of the 6th Circuit standard would likely chill speech of market participants who would face enhanced risk for sharing their honestly held opinions. Oral argument in *Omnicare* will likely be held in the fall of 2014, with a decision expected by the end of June 2015.

Chadbourne & Park LLP v. Troice, No. 12-79

Last week, the Supreme Court issued a decision in *Chadbourne*, which is its third opinion addressing the scope of the Securities Litigation Uniform Standards Act (SLUSA). SLUSA made federal courts the exclusive venue for most securities class actions. The goal was to prevent plaintiffs from evading the protections that federal law provides against abusive securities litigation.

Since SLUSA, there has been debate about what, if any, securities class actions can proceed in state court. *Chadbourne* helps answer that question, providing that a small subset can go forward in state court. *Chadbourne* interpreted SLUSA's prohibition of any state law class action predicated on any alleged "misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security." A "covered security" is one traded on a national securities exchange or issued by an investment company.

Enter Allen Stanford and his infamous Ponzi scheme. Stanford and crew sold the plaintiffs certificates of deposit, which were not "covered securities." Stanford allegedly represented that their money was being invested in safe, liquid investments, including "covered securities," such as first grade investment bonds and publicly-traded stock. Everyone knows the end of the story. The Ponzi scheme unfolded, investors lost money, and the deep pockets left standing were targeted in litigation.

The *Chadbourne* plaintiffs pursued claims against so-called secondary actors, which include lawyers, investment advisors, and other professionals, who allegedly played some contributing role in facilitating the scheme. Knowing that Supreme Court precedent barred them from bringing federal securities claims against secondary actors, the plaintiff filed state law claims in state court. Invoking SLUSA, the defendants successfully removed the class actions to federal court and secured early dismissal. But that win was fleeting. The 5th Circuit reversed for the plaintiffs and the Supreme Court affirmed.

In ruling for the investors, the Supreme Court's decision focusses on SLUSA's language, which only precludes state class actions involving "covered securities." There was no dispute that the certificates of deposit were not covered securities. Thus, Justice Stephen Breyer's opinion for the court concluded that SLUSA did not preclude the claims from going forward in state court. The court rejected the defendants' argument that the certificates of deposit were purchased "in connection with" covered securities (and thereby governed by SLUSA) given that the certificates were allegedly backed by covered securities. In rejecting that contention, the court ruled that a "connection" exists only where a "misrepresentation makes a significant difference to someone's decision to purchase or to sell a covered security, not to purchase or to sell an uncovered security, something about which [SLUSA] expresses no concern."

Not all the justices agreed. In dissent, Justices Anthony Kennedy and Samuel Alito opined that the majority's reading of the statute was inconsistent with earlier decisions that have favored a "broad construction" of the "in connection with" requirement. They foresee *Chadbourne* opening the floodgates to litigation in state court against secondary actors. According to the dissent, those individuals "whose profession it is to give advice, counsel, and assistance in investing in the securities markets," will now be subject to "complex and costly state-law litigation based on allegations of aiding and participating in transactions that are in fact regulated by the federal securities laws."

This threat of more litigation may be exaggerated. For one thing, *Chadbourne* only opens state courts to securities class actions involving uncovered securities. The holding thus does not directly bear on, and will not affect, typical securities class action litigation, which is largely directed against publicly traded companies and their executives. Securities class actions against secondary actors in state courts have been rare, and may remain so after *Chadbourne*, given the many defenses they have to allegations that they facilitated fraud by another. For example, investors face significant challenges in showing secondary actors knew about a fraud, participated in or aided it, induced investors, and caused investors' losses.

In the wake of the *Chadbourne*'s pro-plaintiff ruling, some question whether the court's purported pro-business leanings are softening. The question assumes a bias that may not actually exist in the realm of securities litigation. The Supreme Court's record in the last 10 years has actually been split down the middle. Seven of 13 securities decisions, including *Chadbourne*, have favored investors, while six decisions have favored business. This roughly balanced scorecard may suggest that the court leans less to a particular side than it hews to a mission of achieving what it has described as the "twin goals" of the securities laws: curbing frivolous, lawyer-driven litigation, while preserving investors' ability to recover on meritorious claims. The court has largely achieved that balance by containing securities class actions within the boundaries set by Congress, as in *Chadbourne*, or by the court's own precedent.

Halliburton Co. v. Erica P. John Fund Inc., No. 13-317

This balance could change with the court's forthcoming decision in *Halliburton*. The court is scheduled to hear oral argument March 5 to decide whether to overrule or substantially modify its own precedent, articulated in Justice Harold Blackmun's landmark 4-2 decision, *Basic v. Levinson*, 485 U.S. 224 (1988). The *Basic* court ruled that investors who buy or sell stock at the price set by the market presumptively do so in reliance on the integrity of that market price when shares trade in an efficient market. Without *Basic*'s fraud-on-the-market presumption, individual issues of reliance on allegedly false statements would predominate, making most securities class actions more difficult, if not impossible, to certify under Rule 23. In the decades after *Basic*, Congress comprehensively amended the securities laws twice (including with SLUSA), leaving *Basic* untouched.

While an outright overruling of *Basic* should be unlikely given how seldom, for good reason, the Supreme Court overturns itself (by some counts, no more than 10 times), it may not actually be such a long shot here in light of *Amgen Inc. v. Connecticut Retirement Plans and Trust*, 133 S.Ct. 1184 (2013). In *Amgen*, Alito, Kennedy, and Justices Antonin Scalia and Clarence Thomas variously expressed concurring or dissenting opinions that signaled a willingness to reconsider *Basic*'s fraud-on-the-market presumption. Chief Justice John Roberts was silent on his views, but joined that majority opinion in *Amgen* that assumed the presumption's continued viability for the sake of discussion, noting that it was not at issue.

Now that the presumption's viability is squarely presented in *Halliburton*, ears will be tuned to what the chief justice says during oral argument. He may hold the deciding vote, which may very well determine the fate of most private securities litigation premised on violations of Section 10(b). *Halliburton*'s outcome could indicate that the court's precedents stand the test of time. Alternatively, it could signal that landmark decisions from bygone eras are now up for grabs.

Mark R.S. Foster *is a partner at Morrison & Foerster LLP in San Francisco. He defends public companies and their directors and officers in securities class actions, shareholder derivative lawsuits, and other proceedings.*

MARK R.S. FOSTER
Morrison & Foerster