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This month's Alert discusses three Supreme Court decisions handed down in the past several weeks. In *Amgen Inc. v. Connecticut Retirement Plans & Trust Funds*, 133 S. Ct. 1184 (2013) (Ginsburg, J.), the Court held that plaintiffs do not have to prove materiality to obtain class certification in fraud-on-the-market cases brought under Section 10(b) and Rule 10b-5. In *Standard Fire Ins. Co. v. Knowles*, 2013 WL 1104735 (Mar. 19, 2013) (Breyer, J.), the Court held that a plaintiff in a proposed class action cannot avoid removal under the Class Action Fairness Act of 2005 ("CAFA") by stipulating to damages of less than $5 million. And in *Gabelli v. SEC*, 133 S. Ct. 1216 (2013) (Roberts, C.J.), the Court held that Section 2462's limitations period for government penalty actions begins to run in fraud cases when the allegedly fraudulent conduct occurs, not when it is discovered.

We also address an Eleventh Circuit decision affirming dismissal of a securities fraud action brought under Section 10(b) and Rule 10b-5 against the St. Joe Company on the ground that the plaintiffs had failed to plead loss causation.

In addition, we discuss a ruling from a hearing panel of the Financial Industry Regulatory Authority, Inc. ("FINRA") holding that class action waivers in pre-dispute arbitration agreements with brokerage customers are enforceable notwithstanding FINRA rules to the contrary.

Save the Date for Our Annual CLE Program

On Monday, June 24th at 4:00 p.m., we will host our annual CLE panel discussion on recent decisions, emerging trends and breaking developments in securities and corporate litigation. Cocktails to follow. Please RSVP for this event by contacting Emma Rotenberg at erotenberg@stblaw.com or 212-455-3529.

The Supreme Court Holds That Plaintiffs Do Not Have to Prove Materiality to Obtain Class Certification in Fraud-on-the-Market Cases

In *Amgen Inc. v. Connecticut Retirement Plans & Trust Funds*, 133 S. Ct. 1184 (2013) (Ginsburg, J.), the Supreme Court considered "whether district courts must require plaintiffs to prove, and must allow defendants to present evidence rebutting, the element of materiality before certifying a class action under § 10(b) and Rule 10b-5" based on the fraud-on-the-market presumption of reliance set forth in *Basic Inc. v. Levinson*, 485 U.S.

The Securities Law Alert is edited by Paul C. Gluckow (pgluckow@stblaw.com/212-455-2653), Peter E. Kazanoff (pkazanoff@stblaw.com/212-455-3525) and Jonathan K. Youngwood (jyoungwood@stblaw.com/212-455-3539).

224 (1988).

Justice Ginsburg, writing for a 6-3 majority, held that proof of materiality "is not a prerequisite to class certification." The Court found that materiality "is a *question* common to all members of the class" and explained that "Rule 23(b)(3) requires a showing that questions common to the class predominate, not that those questions will be answered, on the merits, in favor of the class." The Court further ruled that consideration of evidence rebutting materiality should be reserved for summary judgment or trial.

Background

Connecticut Retirement Plans and Trust Funds brought suit against Amgen Inc. and several of its officers (collectively, "Amgen") alleging that Amgen had "violated § 10(b) and Rule 10b-5 through certain misrepresentations and misleading omissions regarding the safety, efficacy, and marketing of two of its flagship drugs." Connecticut Retirement alleged that "these misrepresentations and omissions artificially inflated the price of Amgen's stock." Like most plaintiffs in securities fraud actions brought under Section 10(b) and Rule 10b-5, Connecticut Retirement invoked the fraud-on-the-market presumption of reliance adopted by the Supreme Court in *Basic*. The *Basic* Court held that "[b]ecause most publicly available information is reflected" in a company's stock price in an efficient market, "an investor's reliance on any public material misrepresentations … may be presumed for purposes of a Rule 10b-5 action."

In 2009, the Central District of California granted Connecticut Retirement's motion for class certification. *Connecticut Ret. Plans & Trust Funds v. Amgen, Inc.*, 2009 WL 2633743 (C.D. Cal. Aug. 12, 2009) (Gutierrez, J.). The court held that Connecticut Retirement did not have to *prove* that Amgen's alleged misrepresentations were material in order "to trigger the presumption of reliance" at the class certification stage. The court also declined to consider evidence rebutting the

presumption of reliance, explaining that "inquiries into issues such as materiality … are properly taken up at a later stage in [the] proceeding." Amgen appealed.

In 2011, the Ninth Circuit affirmed the district court's decision, holding that "[p]roof of materiality, like all other elements of a 10b-5 claim, is a merits issue that abides the trial or motion for summary judgment." *Connecticut Ret. Plans & Trust Funds v. Amgen Inc.*, 660 F.3d 1170 (9th Cir. 2011) (Silverman, J.). The court determined that "plaintiffs cannot both fail to prove materiality yet still have a viable claim for which they would need to prove reliance individually." In the event that "the misrepresentations turn out to be material, then the fraud-on-the-market presumption makes the reliance issue common to the class, and class treatment is appropriate." If, on the other hand, "the misrepresentations turn out to be immaterial, then *every* plaintiff's claim fails on the merits" because "materiality is an element of the *merits* of their securities fraud claim." The Ninth Circuit explained that in either case, "the plaintiffs' claims stand or fall together—the critical question in the Rule 23 [class certification] inquiry." The Ninth Circuit further held that the district court had "correctly refused to consider" evidence rebutting the fraud-on-the-market presumption at the class certification stage.

Amgen, citing a circuit split on whether proof of materiality is required for class certification, petitioned the Supreme Court for certiorari to review

the Ninth Circuit's decision. Amgen pointed out that the Ninth Circuit had joined the Seventh and Third Circuits in holding that plaintiffs relying on the fraud-on-the-market theory need not prove materiality in order to obtain class certification.[1] The Second and Fifth Circuits, on the other hand, required plaintiffs to prove materiality at class certification;[2] the First and Fourth Circuits had also suggested, albeit in dicta, that materiality was required at the class certification stage.[3] And both the Second and Third Circuits permitted defendants to rebut the presumption of reliance at the class certification stage by disproving the materiality of the alleged misrepresentations.[4]

1. *See Schleicher v. Wendt*, 618 F.3d 679 (7th Cir. 2010) (observing that "whether a statement is materially false is a question common to all class members and therefore may be resolved on a class-wide basis after certification;" also explaining that "[i]t is possible to certify a class under Rule 23(b)(3) even though all statements turn out to have only trivial effects on stock prices"); *In re DVI, Inc. Sec. Litig.*, 639 F.3d 623 (3d Cir. 2011) ("To invoke the fraud-on-the-market presumption of reliance, plaintiffs must show they traded shares in an efficient market … and the misrepresentations at issue became public.").

2. *See In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474 (2d Cir. 2008) (noting that "plaintiffs must show the materiality of the misrepresentation" to benefit from the fraud-on-the-market presumption at the class certification stage); *Oscar Private Equity Invs. v. Allegiance Telecom, Inc.*, 487 F.3d 261 (5th Cir. 2007) (explaining that "[r]eliance is presumed if the plaintiffs can show [among other things] that … the defendant made public material misrepresentations" and stating that "[w]ithout this presumption, questions of individual reliance would predominate, and the proposed class would fail"), *abrogated on other grounds by Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S.Ct. 2179 (2011).

3. *See In re PolyMedica Corp. Sec. Litig.*, 432 F.3d 1 (1st Cir. 2005) (describing materiality as one of the prerequisites to invoke the fraud-on-the-market presumption); *Gariety v. Grant Thornton, LLP*, 368 F.3d 356 (4th Cir. 2004) ("To gain the benefit of the presumption, a plaintiff must prove … that the misrepresentations were material."). But the question of materiality was not directly before the court in either case.

4. *Salomon*, 544 F.3d 474 (stating that "defendants are allowed to rebut the presumption [of reliance], prior to class certification, by showing, for example, the absence of a price impact"); *DVI*, 639 F.3d 623 ("[A] defendant's successful rebuttal demonstrating that misleading material statements or corrective disclosures did not affect the market price of the security defeats the presumption of reliance for the entire class, thereby defeating the Rule 23(b) predominance requirement.").

On June 11, 2012, the Court granted Amgen's petition to consider two questions:

1. Whether, in a misrepresentation case under SEC Rule 10b-5, the district court must require proof of materiality before certifying a plaintiff class based on the fraud-on-the-market theory.

2. Whether, in such a case, the district court must allow the defendant to present evidence rebutting the applicability of the fraud-on-the-market theory before certifying a plaintiff class based on that theory.

The Majority Holds That under the "Plain Language" of Rule 23(b)(3), Proof of Materiality Is Not Required for Class Certification in Fraud-on-the-Market Cases

On February 27, 2013, Justice Ginsburg delivered the opinion of the Court, in which Chief Justice Roberts and Justices Breyer, Alito, Sotomayor and Kagan joined.

The Court explained at the outset that *Amgen* "involve[d] the interaction between federal securities-fraud laws and Rule 23's requirements for class certification." To obtain certification of a class action for money damages under Rule 23(b)(3), plaintiffs must demonstrate that "questions of law or fact common to class members predominate over any questions affecting only individual members," among other requirements. "To recover damages in a private securities-fraud action" under Section 10(b) and Rule 10b-5, a plaintiff must prove, among other factors, "reliance upon the [alleged] misrepresentation or omission." The reliance requirement "would ordinarily preclude certification" of securities fraud class actions "because individual reliance issues would

overwhelm questions common to the class." However, *Basic*'s fraud-on-the-market theory "facilitates class certification" in securities fraud cases "by recognizing a rebuttable presumption of classwide reliance on public, material misrepresentations when shares are traded in an efficient market."

The *Amgen* Court found that the "only issue" before it was "whether Connecticut Retirement ha[d] satisfied Rule 23(b)(3)'s requirement that 'questions of law or fact common to class members predominate over any questions affecting only individual members.'" The Court stated that the "key question" was "not whether materiality is an essential predicate of the fraud-on-the-market theory; indisputably it is." Rather, "the pivotal inquiry is 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' as the litigation progresses." The Court concluded that for two reasons "the answer to this question is clearly 'no.'"

First, the Court determined that materiality is a "common question for Rule 23(b)(3) purposes" because "materiality is judged according to an objective standard" and "can be proved through evidence common to the class." Second, the Court found "no risk whatever that a failure of proof on the common question of materiality [would] result in individual questions predominating" because such a failure "would end the case for one and for all." The *Amgen*

Court therefore held that "under the plain language of Rule 23(b)(3), plaintiffs are not required to prove materiality at the class-certification stage." Rather, the question of materiality "is properly addressed at trial or in a ruling on a summary-judgment motion."

The Court further held that the district court "did not err" in "disregarding" Amgen's rebuttal evidence challenging the materiality of the alleged misrepresentations and omissions. The Court explained that "[j]ust as a plaintiff class's inability to prove materiality creates no risk that individual questions will predominate, so even a definitive rebuttal on the issue of materiality would not undermine the predominance of questions common to the class."

In so holding, the Court emphasized that "Rule 23 grants courts no license to engage in free-ranging merits inquiries at the certification stage." The Court stated that "[m]erits questions may be considered to the extent—but only to the extent—that they are relevant to determining whether the Rule 23 prerequisites for class certification are satisfied."

The Court Rejects Amgen's Policy Arguments for Requiring Plaintiffs to Prove Materiality at the Class Certification Stage

Amgen contended that materiality "should be treated no differently" at the class certification stage than the two other predicates of the fraud-on-the-market theory, market efficiency and the public nature of the alleged misrepresentations. Rejecting this argument, the Court explained that "market efficiency and publicity are not indispensable elements of a Rule 10b-5 claim." If there is no "common, classwide proof on the issues of market efficiency and publicity," a case may still proceed based on "individualized proof of reliance." But "the failure of common proof on the issue of materiality ends the case for the class and for

all individuals alleged to compose the class."

Amgen also argued that the settlement pressures generated by class certification orders "militate in favor of requiring precertification proof of materiality." The Court found that "materiality does not differ" in this respect "from other essential elements of a Rule 10b-5 claim." The Court noted that it has previously held that "loss causation and the falsity or misleading nature of the defendant's alleged statements or omissions are common questions that need not be adjudicated before a class is certified."[5]

Moreover, the Court found it "significant" that Congress "has addressed the settlement pressures associated with securities-fraud class actions through means other than requiring proof of materiality at the class-certification stage." Although Congress enacted the Private Securities Litigation Reform Act ("PSLRA") and the Securities Litigation Uniform Standards Act ("SLUSA") to "curb abusive securities-fraud lawsuits," it "rejected calls to undo the fraud-on-the-market presumption of classwide reliance endorsed in *Basic*." The *Amgen* Court determined that it had "no warrant to encumber securities-fraud litigation by adopting an atextual requirement of precertification proof of materiality that Congress, despite its extensive involvement in the securities field, has not sanctioned."

Ultimately, the Court found that Amgen was asking it to "put the cart before the horse" by requiring plaintiffs to prove that they would "win the fray" in order to obtain class certification. The Court explained that "the office of a Rule 23(b)(3) certification ruling is not to adjudicate the case; rather, it is to select the 'metho[d]' best suited to adjudication of the controversy 'fairly and efficiently.'"

In a Concurring Opinion, Justice Alito Suggests That Reconsideration of the *Basic* Presumption May Be Appropriate

In a one-paragraph long concurrence, Justice Alito stated that "recent evidence suggests that the [fraud-on-the-market] presumption may rest on a faulty economic premise." He posited that "[i]n light of this development, reconsideration of the *Basic* presumption may be appropriate."[6]

The Dissent Finds That Materiality Must Be Proved at the Class Certification Stage to Establish That Reliance Is a Common Question under Rule 23(b)(3)

Justice Thomas authored a dissenting opinion, in which Justice Kennedy joined and Justice Scalia joined in part. Justice Thomas stated that "a securities-fraud plaintiff invoking *Basic*'s fraud-on-the-market

5. The *Amgen* Court cited *Erica P. John Fund*, 131 S. Ct. 2179 (holding that loss causation need not be proved at the class certification stage) and *Basic*, 485 U.S. 224 (holding that the false or misleading nature of the alleged misstatement is a common question).

6. Justice Thomas also found that "[t]he *Basic* decision itself is questionable" but limited his dissent to "demonstrating that the Court [was] not following *Basic*'s dictates" because the Court had not been "asked to revisit *Basic*'s fraud-on-the-market presumption."

presumption to satisfy Rule 23(b)(3) should be required to prove each of the predicates of that theory at [class] certification in order to demonstrate that questions of reliance are common to the class." He explained that "[m]ateriality was central to the development, analysis, and adoption of the fraud-on-the-market theory both before *Basic* and in *Basic* itself." He found that "[t]his history confirms that materiality must be proved at the time that the theory is invoked—*i.e.*, at certification."

In Part I-B of his dissent (which Justice Scalia did not join), Justice Thomas stated that the majority erred "when, instead of asking whether the element of *reliance* is susceptible to classwide proof, the Court focuse[d] on whether *materiality* is susceptible to classwide proof." He explained that "[w]ithout materiality, there is no fraud-on-the-market presumption, questions of reliance remain individualized, and Rule 23(b)(3) certification is impossible." Justice Thomas emphasized that "nothing in logic or precedent justifies ignoring at certification whether reliance is susceptible to Rule 23(b)(3) classwide proof simply because one predicate of reliance—materiality—will be resolved, if at all, much later in the litigation on an independent merits element."

In a Separate Dissent, Justice Scalia Cautions against an Overbroad Reading of *Basic*

Justice Scalia joined in the principal dissent, except for Part I-B. In a separate dissent, Justice Scalia underscored that "the *Basic* rule of fraud-on-the-market … governs not only the question of substantive liability, but also the question whether certification is proper." He stated that "[a]ll of the elements of that rule, including materiality, must be established if and when it is relied upon to justify certification."

Stating that class certification is frequently "the prelude to a substantial settlement," Justice Scalia found that *Basic* should not be read to permit "all market-purchase and market-sale class-action suits" to "pass beyond the crucial certification stage … no matter what the alleged misrepresentation." He suggested that the majority opinion "expands" the "consequences of the four-Justice opinion in *Basic*" from "the arguably regrettable to the unquestionably disastrous."

The Supreme Court Holds That a Plaintiff in a Proposed Class Action Cannot Avoid Removal under CAFA by Stipulating to Total Class Damages of Less Than $5 Million

On March 19, 2013, the Supreme Court considered the effect of a precertification stipulation that a plaintiff "and the class he seeks to represent … will not seek damages that exceed $5 million in total." *Standard Fire Ins. Co. v. Knowles*, 2013 WL 1104735 (Mar. 19, 2013) (Breyer, J.). The Court unanimously held that such a stipulation "does not resolve the amount-in-controversy question" for purposes of the Class Action Fairness Act of 2005 ("CAFA") because "a named plaintiff cannot bind precertification class members."

Background

Under CAFA, district courts have "original jurisdiction" over any civil class action "in which the matter in controversy exceeds the sum or value of $5,000,000" and certain other requirements are met. 28 U.S.C. § 1332(d)(2). CAFA further provides that "the claims of the individual class members shall be aggregated to determine whether the matter in controversy exceeds the sum or value of $5,000,000."

28 U.S.C. § 1332(d)(6).

In *Standard Fire*, the plaintiff filed a proposed class action in Arkansas state court against The Standard Fire Insurance Company alleging that Standard Fire had failed to include a general contractor fee when it made certain homeowner's insurance loss payments. The plaintiff "sought to certify a class of 'hundreds, and possibly thousands' of similarly harmed Arkansas policyholders." The complaint attached an affidavit stipulating that the plaintiff would "not at any time during this case … seek damages for the class … in excess of $5,000,000 in the aggregate."

Standard Fire relied on CAFA to remove the case to the Western District of Arkansas; the plaintiff moved to remand. The district court found that Standard Fire had "presented evidence … that the class as defined in [the] [p]laintiff's [c]omplaint has an actual amount in controversy of slightly over $5 million." *Knowles v. Standard Fire Ins. Co.*, 2011 WL 6013024 (W.D. Ark. Dec. 2, 2011) (Holmes, III, J.). Nevertheless, the court determined that the plaintiff's sworn stipulation was "sufficient to limit the total award" and "effectively bar removal" under CAFA. The district court remanded the action to state court; the Eighth Circuit declined Standard Fire's request for permission to appeal.

Shortly thereafter, in *Rolwing v. Nestle Holdings, Inc.*, 666 F.3d 1069 (8th Cir. 2012) (Gruender, J.), the Eighth Circuit affirmed an order of remand under CAFA in a case involving a similar damages stipulation. The Eighth Circuit held that "remand based on CAFA's amount-in-controversy requirement was appropriate" because the plaintiff had "shown that it [was] legally impossible for the amount in controversy in this case to meet CAFA's threshold."

Citing a circuit split,[7] Standard Fire petitioned the Supreme Court for certiorari of the District of Arkansas' decision. On August 31, 2012, the Court granted certiorari of the following question:

> When a named plaintiff attempts to defeat a defendant's right of removal under [CAFA] by filing with a class action complaint a "stipulation" that attempts to limit the damages he "seeks" for the absent putative class members to less than the $5 million threshold for federal jurisdiction, and the defendant establishes that the actual amount in controversy, absent the "stipulation," exceeds $5 million, is the "stipulation" binding on absent class members so as to destroy federal jurisdiction?

The Supreme Court Holds That a Precertification Damages Stipulation Is Not Binding on Absent Class Members and Therefore Does Not Resolve the "Amount in Controversy" Question under CAFA

The Supreme Court held that the District of Arkansas had "wrongly concluded that [the plaintiff's] precertification stipulation could overcome its finding that the CAFA jurisdictional threshold had been met." The Court explained that "a plaintiff who files

7. In contrast to the Eighth Circuit's decision in *Rolwing*, the Tenth Circuit in *Frederick v. Hartford Underwriters Ins. Co.*, 683 F.3d 1242 (10th Cir. 2012) had ruled that "a plaintiff's attempt to limit damages in the complaint is not dispositive when determining the amount in controversy" for CAFA purposes.

a proposed class action cannot legally bind members of the proposed class before the class is certified." Since no class had been certified, the plaintiff could "not speak for those he purport[ed] to represent" and therefore "lacked the authority to concede the amount-in-controversy issue for the absent class members."

The Court agreed with the plaintiff that "a federal district court might find it simpler to value the amount in controversy on the basis of a stipulation than to aggregate the value of the individual claims of all who meet the class description." However, the Court explained that "to ignore a nonbinding stipulation does no more than require the federal judge to do what she must do in cases without a stipulation and what the statute requires, namely 'aggregat[e]' the 'claims of the individual class members.'"

The Court also distinguished case law permitting individual plaintiffs to avoid removal "by stipulating to amounts at issue that fall below the federal jurisdictional requirement." The "key characteristic" of those stipulations is that "they are legally binding on all plaintiffs" whereas, in this case, the plaintiff "cannot yet bind the absent class." Thus, concluding that the district court "should have ignored [the plaintiff's] stipulation" and "follow[ed] the statute to aggregate the proposed class members' claims," the Court vacated the district court's judgment and remanded the case for further proceedings consistent with its opinion.

The Supreme Court Holds That Section 2462's Limitations Period for Government Penalty Actions Begins to Run in Fraud Cases When the Allegedly Fraudulent Conduct Occurs, Not When It Is Discovered

Section 2462 of Title 28 provides that a Government action "for the enforcement of any civil fine, penalty, or forfeiture" must be "commenced within five years from the date when the claim first accrued" unless "otherwise provided by" Congress. 28 U.S.C. § 2462. In *Gabelli v. SEC*, 133 S. Ct. 1216 (2013) (Roberts, C.J.), the Supreme Court considered "whether the five-year clock begins to tick" in fraud cases "when the fraud is complete or when the fraud is discovered." Chief Justice Roberts, writing for a unanimous Court, held that "a claim based on fraud accrues—and the five-year clock begins to tick—when a defendant's allegedly fraudulent conduct occurs."

Background

In 2008, the SEC brought suit against Marc J. Gabelli ("Gabelli"), the portfolio manager of the Gabelli Global Growth Fund ("GGGF"), and Bruce Alpert, the chief operating officer for GGGF's adviser, Gabelli Funds, LLC. The SEC alleged that from 1999 until 2002, Alpert and Gabelli permitted a preferred investor to engage in so-called market timing in exchange for an investment in a hedge fund managed by Gabelli. The SEC claimed, *inter alia*, that both Alpert and Gabelli had aided and abetted the Gabelli Funds' violations of the antifraud provisions of the Investment Advisers Act of 1940.

Claims under the Investment Advisers Act are subject to the five-year limitations period set forth in Section 2462. Although the market timing at issue ended in August 2002, more than five years prior to

the date the SEC brought suit, the SEC contended that its claims were still timely because it did not discover the fraud until September 2003. The SEC argued that under the "discovery rule" applicable to fraud claims, Section 2642's five-year clock begins to run when the fraud or misstatement is discovered and not when the violation occurs.

In 2010, the Southern District of New York held that "the discovery rule does not apply to claims subject to the limitations of § 2462" and dismissed the SEC's complaint as untimely. *SEC v. Gabelli*, 2010 WL 1253603 (S.D.N.Y. Mar. 17, 2010) (Batts, J.).

The following year, the Second Circuit reversed the district court's dismissal of the SEC's complaint. The Second Circuit found that "it has been long established that the discovery rule applies" to the construction of limitations periods "where, as here, a claim sounds in fraud." *SEC v. Gabelli*, 653 F.3d 49 (2d Cir. 2011) (Rakoff, J.). Although "Section 2462 does not expressly state a discovery rule," the Second Circuit explained that it would have been "unnecessary for Congress to expressly mention the discovery rule … given the presumption that the discovery rule applies to [fraud] claims unless Congress directs otherwise."[8]

The Second Circuit held that "the discovery rule define[d] when the [SEC's] claim accrue[d]" in this case because the SEC's claim was brought under the antifraud provisions of the Advisers Act. The court further determined that "the SEC need not plead that the defendants took affirmative steps to conceal their fraud." Based on the discovery rule, the Second Circuit concluded that the SEC's claims were timely.

The defendants petitioned the Supreme Court for certiorari to review the Second Circuit's decision. On September 25, 2012, the Supreme Court granted certiorari of the following question:

> Where Congress has not enacted a separate controlling provision, does the government's claim first accrue for purposes of applying the five-year limitations period under 28 U.S.C. § 2462 when the government can first bring an action for a penalty?

The Supreme Court Holds That the "Discovery Rule" Does Not Apply to Section 2462's Limitations Period

In a decision issued on February 27, 2013, the Supreme Court held that under "the most natural reading" of Section 2462's limitations period, "a claim based on fraud accrues—and the five-year clock begins to tick—when a defendant's allegedly fraudulent conduct occurs." The Court reasoned that "[t]his reading sets a fixed date when exposure to the specified Government enforcement efforts ends" and advances the "basic policies of all limitations provisions: repose, elimination of stale claims, and certainty about a plaintiff's opportunity for recovery and a defendant's potential liabilities."

The Court found no "textual, historical, or equitable reasons to graft a discovery rule onto the statute of

8. The Second Circuit cited the Supreme Court's decisions in *Holmberg v. Armbrecht*, 327 U.S. 392 (1946) (stating that the discovery rule for claims of fraud "is read into every federal statute of limitation") and *Bailey v. Glover*, 88 U.S. 342 (1874) (holding that the discovery rule applies to fraud claims even if there are "no special circumstances or efforts on the part of the party committing the fraud to conceal it from the knowledge of the other party").

limitations of § 2462." First, the Court explained that it has "never applied the discovery rule" in cases "where the plaintiff is not a defrauded victim seeking recompense, but is instead the Government bringing an enforcement action for civil penalties."[9] The rule was established to "preserve the claims of victims who do not know they are injured and who reasonably do not inquire as to any injury." In contrast to "the private party who has no reason to suspect fraud," the Court emphasized that "the SEC's very purpose is to root it out, and it has many legal tools at hand to aid in that pursuit." The Court found the SEC to be "a far cry from the defrauded victim the discovery rule evolved to protect."

Second, the Court determined that "grafting the discovery rule onto § 2462" would "leave defendants exposed to Government enforcement actions not only for five years after their misdeeds, but for an additional uncertain period into the future." The expiration of Section 2462's limitations period "would hinge on speculation about what the Government knew, when it knew it, and when it should have known it." Resolving these questions would raise "particular challenges for the courts" because government agencies "often have hundreds of employees, dozens of offices, and several levels of leadership." In connection with "any inquiry as to what it knew when," the Government would likely "assert various privileges, such as law enforcement" or "deliberative process, further complicating judicial attempts to apply the discovery rule." The Court concluded that it had "no mandate from Congress to undertake that challenge here."

Lastly, the Court underscored the need to interpret limitations periods narrowly. The instances in which a limitations period "may be suspended by causes not mentioned in the statute itself … are very limited in character, and are to be admitted with great caution; otherwise the court would make the law instead of administering it."

The Court reversed the Second Circuit's decision, and remanded the action for further proceedings consistent with its opinion.

9. The Court found that the SEC's claims were "not saved" by the Supreme Court's decision in *Exploration Co. v. United States*, 247 U.S. 435 (1918). In that case, "the discovery rule was applied in favor of the Government, but the Government was itself a victim … suing to recover its loss," not "bringing an enforcement action for penalties."

The Eleventh Circuit Affirms Dismissal of a Securities Fraud Action against the St. Joe Company for Failure to Plead Loss Causation

On February 25, 2013, the Eleventh Circuit affirmed dismissal of a securities fraud action brought under Section 10(b) and Rule 10b-5 against the St. Joe Company based on the plaintiffs' failure to identify any viable corrective disclosures for loss causation purposes. *Meyer v. Greene*, 2013 WL 656500 (11th Cir. Feb. 25, 2013) (Wilson, J.). The Eleventh Circuit emphasized that "not every bit of bad news that has a negative effect on the price of a security necessarily has a *corrective* effect for purposes of loss causation."

Background

St. Joe is one of Florida's largest real-estate development corporations. On October 13, 2010, David Einhorn, a short-sale hedge fund investor, stated during a presentation (the "Einhorn Presentation") that "St. Joe's assets were significantly overvalued and therefore 'should be' impaired." Einhorn represented that his analysis was based on publicly available information. In the two days following the Einhorn Presentation, the price of St. Joe's stock dropped by 20%.

On November 3, 2010, investors filed suit against

St. Joe and its current and former officers under Section 10(b) and Rule 10b-5 alleging that St. Joe's "failure to take impairment charges resulted in material overstatements of the value of its holdings and of its performance." The district court dismissed the plaintiffs' suit for failure to plead loss causation, among other grounds.

On January 10, 2011, St. Joe announced that the SEC had launched an informal inquiry into St. Joe's "policies and practices concerning impairment of investment in real estate assets." Six months later, St. Joe disclosed that "the SEC had issued an order of private investigation regarding St. Joe's compliance with federal antifraud securities provisions and ownership reporting requirements." The price of St. Joe's stock fell after each of these announcements. However, "the SEC never issued any finding of wrongdoing or in any way indicated that [St. Joe] had violated the federal securities laws."

The plaintiffs subsequently filed an amended complaint including new allegations concerning the SEC's inquiry and investigation. The district court again dismissed the amended complaint, but with prejudice this time. The court found, *inter alia*, that the plaintiffs had "failed to allege loss causation because the Einhorn Presentation was based solely on publicly available information, and the SEC investigations indicated nothing more than a risk of accounting problems." The plaintiffs appealed.

The Eleventh Circuit Finds the Plaintiffs Failed to Identify Any Corrective Disclosures for Loss Causation Purposes

In order "[t]o show loss causation in a § 10(b) claim, a plaintiff must offer 'proof of a causal connection between the misrepresentation and the investment's subsequent decline in value.'" Plaintiffs relying on the fraud-on-the-market theory typically establish loss causation "circumstantially" by:

> (1) identifying a 'corrective disclosure' (a release of information that reveals to the market the pertinent truth that was previously concealed or obscured by the company's fraud); (2) showing that the stock price dropped soon after the corrective disclosure; and (3) eliminating other possible explanations for this price drop ….

In a fraud-on-the-market case, the "loss causation analysis … focuses on the following question: even if the plaintiffs paid an inflated price for the stock as a result of the fraud … did the relevant truth eventually come out and thereby cause the plaintiffs to suffer losses?"

Here, the plaintiffs invoked the fraud-on-the-market theory of reliance and alleged loss causation based on "three purported corrective disclosures": the Einhorn Presentation; St. Joe's disclosure of an informal SEC inquiry; and its disclosure of the SEC's investigation. The Eleventh Circuit found that none of these "qualif[ied] as a corrective disclosure for purposes of [the] federal securities laws."

The Court Holds That the Einhorn Presentation Was Not a Corrective Disclosure Because It Did Not Reveal Any New Information to the Market

The plaintiffs contended that "the Einhorn Presentation qualifie[d] as a corrective disclosure

because it contained an in-depth analysis of information not readily available to the investing public and revealed to the market that St. Joe's real-estate assets 'needed to be impaired.'" The Eleventh Circuit found that this argument "ignores the very efficient market hypothesis upon which the [plaintiffs'] entire claim is based." The premise of the efficient market theory is that "all publicly available information about a security is reflected in the market price of the security." Thus, "disclosure of confirmatory information—or information already known to the market—will not cause a change in the stock price."

A corrective disclosure "must present facts to the market that are new, that is, publicly revealed for the first time." The Eleventh Circuit held that "the fact that the sources used in the Einhorn Presentation were already public" was "fatal" to the plaintiffs' claims.

Alternatively, the plaintiffs asserted that the Einhorn Presentation constituted a corrective disclosure because "it provided 'expert analysis of the source material' that was previously unavailable to the market." The Eleventh Circuit rejected this contention as well, finding that "the mere repackaging of already-public information by an analyst or short-seller is simply insufficient to constitute a corrective disclosure." The court reasoned that "[i]f every analyst or short-seller's opinion based on already-public information could form the basis for a corrective disclosure, then every investor who suffers a loss in the financial markets could sue under § 10(b) using an analyst's negative analysis of public filings as a corrective disclosure."

The Court Finds the Commencement of an SEC Investigation, Standing Alone, Insufficient to Constitute a Corrective Disclosure

The plaintiffs next contended that St. Joe's announcements regarding the SEC's inquiry and investigation "should qualify as corrective disclosures because the investigations caused St. Joe's stock price

to drop and covered the same subject matter—the value of St. Joe's real estate holdings—as the fraud alleged in the complaint." Rejecting this argument, the Eleventh Circuit held that "the commencement of an SEC investigation, without more, is insufficient to constitute a corrective disclosure for purposes of § 10(b)." Although "stock prices may fall upon the announcement of an SEC investigation, … that is because the investigation can be seen to portend an added *risk* of future corrective action." The drop in share price "does not mean … that a company's previous statements were false or fraudulent."

* * *

The Eleventh Circuit concluded that "the complaint as framed by" the plaintiffs "fails to adequately allege loss causation." The court underscored that the purpose of private securities fraud actions is "not to provide investors with broad insurance against market losses, but to protect them against those economic losses that misrepresentations actually cause." The Eleventh Circuit stated that its decision here "ensures that loss causation remains a key sentinel in striking that delicate balance."

A FINRA Panel Holds That Class Action Waivers in Pre-Dispute Arbitration Agreements with Brokerage Customers Are Enforceable

On February 21, 2013, a FINRA hearing panel (the "Panel") held that a class action waiver in a pre-dispute arbitration agreement with customers of Charles Schwab & Company, Inc. ("Schwab") was enforceable even though it violated FINRA rules permitting customers to pursue judicial class actions. *Dept. of Enforcement v. Charles Schwab & Co., Inc.*, FINRA No. 2011029760201 (Feb. 21, 2013). The Panel found that the Federal Arbitration Act ("FAA") preempts enforcement of the FINRA rules at issue.

FINRA's Department of Enforcement has appealed the Panel's ruling.

Background

In October 2011, Schwab notified over 6.8 million existing account holders of amendments to the customers' account agreements. The amendments included a waiver of the customers' rights to pursue judicial class actions against Schwab (the "Waiver"). The Waiver also provided that all claims against Schwab must be arbitrated only on an individual, case-by-case basis.[10] In addition to amending new customer agreements, Schwab also added the Waiver to account agreements for new customers.

On February 1, 2012, the FINRA Department of Enforcement ("Enforcement") brought a disciplinary action against Schwab asserting three causes of action in connection with the Waiver. First, Enforcement contended that the Waiver conflicted with FINRA Rule 12204(d) of the Code of Arbitration Procedure for Customer Disputes ("Arbitration Rule 12204(d)"), which provides that claims at issue in a judicial class action may not be arbitrated, and FINRA Rule 2268(d)(3), which provides as follows:

> No predispute arbitration agreement shall include any condition that:
>
> …
>
> (3) limits the ability of a party to file any claim in court permitted to be filed in court under the rules of the forums in which a claim may be filed under the agreement.

10. The Waiver provided as follows:

> Neither you nor Schwab shall be entitled to arbitrate any claims as a class action or representative action, and the arbitrator(s) shall have no authority to consolidate more than one parties' [sic] claims or to proceed on a representative or class action basis.
>
> You and Schwab agree that any actions between us and/or Related Third Parties shall be brought solely in our individual capacities. You and Schwab hereby waive any right to bring a class action, or any type of representative action against each other or any Related Third Parties in court. You and Schwab waive any right to participate as a class member, or in any other capacity, in any class action or representative action brought by any other person, entity or agency against Schwab or you.

Enforcement claimed that "Arbitration Rule 12204(d) 'permits' the filing of 'class action claims' in court" and therefore "the complete waiver of any ability to file class action claims in court constitutes a prohibited 'limit' on a 'claim' within the meaning of FINRA Rule 2268(d)(3)."

Second, Enforcement alleged that the Waiver violates FINRA Rule 2268(d)(1), which provides that a "predispute arbitration agreement" may not "include any condition" that "limits or contradicts the rules of any self-regulatory organization." Enforcement argued that "the Waiver, by doing away with judicial class actions, constitutes an impermissible 'limit' on or 'contradiction' of Arbitration Rule 12204(d)."

Third, Enforcement contended that the Waiver's restriction on a FINRA arbitrator's ability to "consolidate multiple individual claims" violates Rule 12312 of the FINRA Code of Arbitration Procedure for Customer Disputes ("Arbitration Rule 12312"), which provides in part that:

> One or more parties may join multiple claims together in the same arbitration if the claims contain common questions of law or fact and:
> - The claims assert any right to relief jointly and severally; or
> - The claims arise out of the same transaction or occurrence, or series of transactions or occurrences.

Enforcement alleged that the Waiver "is an impermissible 'limit' on or 'contradiction' of Arbitration Rule 12312 in violation of … FINRA Rule 2268(d)(1)."

The FINRA Panel Holds That the Waiver Bars Judicial Class Actions in Violation of FINRA Rules

The FINRA Hearing Panel found that Enforcement's "first two Causes of Action raise essentially the same

issue: whether, by eliminating any ability to bring or participate in judicial class actions, Schwab's Waiver deprives a customer of the ability to do something that the FINRA's Rules permit the customer to do." The Panel found that FINRA Rule 12204 "is clearly premised on the availability of judicial class actions" and "contemplates that a customer claim may be adjudicated in a judicial class action or in an arbitration proceeding." Moreover, "[t]he force of Rule 12204 is preserved by FINRA Rules 2268(d)(1) and (d)(3)." The Panel explained that for the past two decades, "the industry has understood these Rules to operate together to preserve customers' ability to bring or participate in judicial class actions."

"Because Schwab's Waiver would bar customers from bringing or participating in judicial class actions," the Panel determined that the Waiver violates FINRA Rule 2268(d)(1) and (d)(3), as alleged in Causes One and Two. However, the Panel found that this conclusion "does not end the analysis" because the Panel still had to determine "whether the Rules are enforceable under the FAA."

The FINRA Panel Determines That the FAA Precludes FINRA from Preserving a Judicial Class Action as an Option Where a Customer Has Entered into a Pre-Dispute Agreement to Arbitrate Claims

"The FAA was enacted in 1925 to prevent parties to arbitration agreements from evading their commitment to arbitrate disputes and to ensure the enforcement of valid arbitration agreements." Section 2 of the FAA provides that any "'written provision' in a 'contract evidencing a transaction in commerce'" pursuant to which the parties agree "'to settle by arbitration a controversy thereafter arising out of such contract or transaction' shall be 'valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.'"

At the outset of its analysis, the Panel found that the FAA governs Schwab's customer agreements because "Section 2 of the FAA expressly states that the Act applies to every written agreement to arbitrate contained in a contract 'evidencing a transaction involving commerce.'" Moreover, "Schwab's customer agreements themselves expressly state that the FAA governs Schwab's Arbitration Agreements."

The Panel next determined that under Supreme Court precedent, "the FAA bars enforcement of FINRA's Rules to the extent that the Rules require that customers be given the option to bring their claims in court in the form of judicial class actions, despite any pre-dispute agreement to resolve disputes in arbitration." The Panel explained that "[r]ules that override an agreement to arbitrate and allow a party to an arbitration agreement to avoid arbitration represent the kind of 'hostility' to arbitration that the Supreme Court has repeatedly found inappropriate and unenforceable under the FAA."

In *Shearson/American Express Inc. v. McMahon*, 482 U.S. 220 (1987), the Supreme Court held that the FAA "mandates enforcement of agreements to arbitrate statutory claims" unless "overridden by a contrary congressional command." The *Shearson* Court further stated that the "burden is on the party opposing arbitration … to show that Congress intended to preclude a waiver of judicial remedies for the statutory rights at issue." Here, the Panel found no "clear expression of *congressional* intent to preserve judicial class actions as an option for customer claims against a securities broker-dealer in direct contradiction of an agreement to arbitrate those claims." The Panel clarified that "FINRA's promulgation of a Rule pursuant to SEC approval and oversight that preserves judicial class actions as an option is not the same as a *congressional* command creating an exception to the FAA."

More recently, in *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011), the Supreme Court reversed a Ninth Circuit decision finding a consumer arbitration agreement unconscionable and unenforceable. The Ninth Circuit had relied on the California Supreme Court's decision in *Discover Bank v. Superior Court*, 30 Cal. Rptr. 3d 76 (Cal. 2005), in which the court found a class action waiver in a consumer contract of adhesion unenforceable because the small sums of money at issue in individual claims would render individual suits impractical. California courts had frequently cited *Discover Bank* to strike class action waivers in consumer arbitration agreements as unconscionable and unenforceable.

The *Concepcion* Court found that California's

Discover Bank rule "interferes with arbitration" and "is preempted by the FAA." The Court explained that Section 2 of the FAA reflects the "fundamental principle that arbitration is a matter of contract" and emphasized that "courts must place arbitration agreements on an equal footing with other contracts." While Section 2's "saving clause preserves generally applicable contract defenses," the Court stated that "nothing in it suggests an intent to preserve state-law rules that stand as an obstacle to the accomplishment of the FAA's objectives."

The Panel noted that "[i]n the short time since the Supreme Court's decision in *Concepcion*, the Court has four more times expressly reiterated that the FAA establishes a 'federal policy in favor of arbitral dispute resolution.'"[11] The Panel explained that "the Supreme Court has consistently held that the mandate of the FAA cannot be overridden by other policy makers."

The Panel therefore found that "any FINRA policy determination that judicial class actions should remain available to customers must give way to the FAA's mandate" and concluded that "Schwab's Waiver [must] be enforced to require customers to go to arbitration."

The FINRA Panel Determines That the FAA Does Not Limit a FINRA Arbitrator's Ability to Consolidate Multiple Claims

Turning to the provision of the Waiver stating that "arbitrator(s) shall have no authority to consolidate more than one parties' [sic] claims," the Panel explained that "nothing in the FAA prohibits FINRA from authorizing arbitrators to consolidate multiple claims" or "barring members from specifying different procedures that conflict with FINRA Rules." Rather, "consolidation—in contrast to class action procedure—is consistent with the goals of the FAA, because consolidation concerns considerations of efficiency and streamlined resolution of similar issues." The Panel ordered Schwab to "cease using the portion of the Waiver purporting to delimit the authority of the arbitrators."

11. *Citing Nitro-Lift Technologies, L.L.C. v. Howard*, 133 S. Ct. 500 (2012); *Marmet Health Care Center v. Brown*, 132 S. Ct. 1201 (2012); *Compucredit Corp. v. Greenwood*, 132 S. Ct. 665 (2012); and *KPMG LLP v. Cocchi*, 132 S. Ct. 23 (2011).

NEW YORK

Bruce D. Angiolillo
212-455-3735
bangiolillo@stblaw.com

Mark G. Cunha
212-455-3475
mcunha@stblaw.com

Paul C. Curnin
212-455-2519
pcurnin@stblaw.com

Michael J. Garvey
212-455-7358
mgarvey@stblaw.com

Paul C. Gluckow
212-455-2653
pgluckow@stblaw.com

Nicholas Goldin
212-455-3685
ngoldin@stblaw.com

David W. Ichel
212-455-2563
dichel@stblaw.com

Peter E. Kazanoff
212-455-3525
pkazanoff@stblaw.com

Joshua A. Levine
212-455-7694
jlevine@stblaw.com

Linda H. Martin
212-455-7722
lmartin@stblaw.com

Joseph M. McLaughlin
212-455-3242
jmclaughlin@stblaw.com

Lynn K. Neuner
212-455-2696
lneuner@stblaw.com

Barry R. Ostrager
212-455-2655
bostrager@stblaw.com

Thomas C. Rice
212-455-3040
trice@stblaw.com

Mark J. Stein
212-455-2310
mstein@stblaw.com

Alan C. Turner
212-455-2472
aturner@stblaw.com

Mary Kay Vyskocil
212-455-3093
mvyskocil@stblaw.com

George S. Wang
212-455-2228
gwang@stblaw.com

David J. Woll
212-455-3136
dwoll@stblaw.com

Jonathan K. Youngwood
212-455-3539
jyoungwood@stblaw.com

LOS ANGELES

Michael D. Kibler
310-407-7515
mkibler@stblaw.com

Chet A. Kronenberg
310-407-7557
ckronenberg@stblaw.com

PALO ALTO

Alexis S. Coll-Very
650-251-5201
acoll-very@stblaw.com

James G. Kreissman
650-251-5080
jkreissman@stblaw.com

WASHINGTON, D.C.

Peter H. Bresnan
202-636-5569
pbresnan@stblaw.com

Cheryl J. Scarboro
202-636-5529
cscarboro@stblaw.com

Peter C. Thomas
202-636-5535
pthomas@stblaw.com

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UNITED STATES

New York
425 Lexington Avenue
New York, NY 10017
+1-212-455-2000

Houston
2 Houston Center
909 Fannin Street
Houston, TX 77010
+1-713-821-5650

Los Angeles
1999 Avenue of the Stars
Los Angeles, CA 90067
+1-310-407-7500

Palo Alto
2475 Hanover Street
Palo Alto, CA 94304
+1-650-251-5000

Washington, D.C.
1155 F Street, N.W.
Washington, D.C. 20004
+1-202-636-5500

EUROPE

London
CityPoint
One Ropemaker Street
London EC2Y 9HU
England
+44-(0)20-7275-6500

ASIA

Beijing
3919 China World Tower
1 Jian Guo Men Wai Avenue
Beijing 100004
China
+86-10-5965-2999

Hong Kong
ICBC Tower
3 Garden Road, Central
Hong Kong
+852-2514-7600

Seoul
West Tower, Mirae Asset Center 1
26 Eulji-ro 5-gil, Jung-gu
Seoul 100-210
Korea
+82-2-6030-3800

Tokyo
Ark Hills Sengokuyama Mori Tower
9-10, Roppongi 1-Chome
Minato-Ku, Tokyo 106-0032
Japan
+81-3-5562-6200

SOUTH AMERICA

São Paulo
Av. Presidente Juscelino Kubitschek, 1455
São Paulo, SP 04543-011
Brazil
+55-11-3546-1000