

## Schiff Hardin LLP Class Action Newsletter

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## THIRD CIRCUIT UPHOLDS DISMISSALS OF SIX AUTO INSURANCE CLASS ACTIONS CHALLENGING COMPUTERIZED MEDICAL FEE REVIEWS

### SUMMARY

In our [Class Action Newsletter of September 30, 2008](#), we discussed a group of decisions by a New Jersey federal district court dismissing six putative class actions challenging the use by auto insurers of medical fee review software to adjust medical payments (“medpay” or “PIP”) claims. The district court also struck the class action allegations, holding that individualized issues of facts and law predominated: the determination whether the insurers had breached their contractual obligations under the insurance policies to pay “reasonable and necessary” medical expenses would require an individualized assessment under each state’s law of the medical expenses incurred by each insured.

On July 22, 2009, the Third Circuit affirmed, although on a ground not addressed by the parties or the district court. In an unpublished decision (which may be cited under Federal Rule of Appellate Procedure 32.1), the Third Circuit held that the plaintiffs had failed to state a cognizable claim for breach of contract, because there was no contractual provision prohibiting the insurers from using computerized software, or requiring them to use any particular claims adjustment method, when they determine the reasonableness and necessity of medical expenses. *St. Louis Park Chiropractic, P.A. v. Federal Ins. Co.*, No. 08-3808, 2009 WL 2171221 (3d Cir. July 22, 2009).

The decisions by the district court and the Third Circuit should prove valuable to insurers defending class action suits challenging the use of computerized databases in the adjustment of claims, particularly claims involving policy language requiring the payment of “reasonable and necessary” medical expenses. Plaintiffs’ counsel in such class actions often attempt to avoid the difficulties of adjudicating classwide the reasonableness of each insured’s medical expenses by arguing that they are actually challenging the validity of the claims adjustment *process* (for example, the use of a computerized database), rather than the *outcome* of that process (the amount actually paid for the claim). In particular, the Third Circuit distinguished some recent decisions appearing to accept that very argument (see, for example, our summary of the Oregon Appellate Court’s decision in *Strawn v. Farmers Insurance Co.* in our [June 15, 2009 Newsletter](#)) as being the product of particular policy language or state regulatory requirements.

### **The District Court’s Decision**

Our prior Newsletter summarized in detail the district court’s decision. In brief, the class actions claimed that the computer databases used by the insurers (e.g., Mitchell Medical and Corvel, which in turn incorporated Ingenix and other fee schedule software) systematically failed to pay medical providers their “reasonable and necessary” fees by applying an arbitrary “percentile benchmark” (e.g., the 80th percentile) selected by the carriers.

The district court dismissed some of the class actions due to the presence of arbitration provisions; some because the defendant carrier did not issue the insurance policy and therefore could not be liable for breach of that contract; and others because of improper venue or *forum non conveniens*.

The district court also granted the carriers' motions to strike the class allegations, concluding, among other things, that the claims of the putative class members were highly individualized and would be governed by the laws of the states in which they reside, which varied materially.

### The Third Circuit's Decision

The Third Circuit affirmed on an issue that was unaddressed below: that the plaintiffs could not state a viable claim for breach of contract, because there was no contractual provision that (1) "prohibits [the insurers] from using a computerized auditing system; or (2) requires [the insurers] to consider — or prohibits them from considering — any particular criterion in determining whether an expense is 'reasonable.'" 2009 WL 2171221, at \*3.

The Court rejected the plaintiffs' suggestion that the Court had not properly characterized their contract claim. Although the plaintiffs argued that the carriers' use of the computerized fee review software breached the policy provision requiring them to pay "reasonable" medical expenses, the Third Circuit concluded that "the gravamen of [the plaintiffs'] claim is that [the insurers'] use of computerized auditing *itself* violated the insurance contracts." *Id.* (emphasis in original).

The Third Circuit went on to hold that, in any event, a claim that the use of the software breached the policy provision requiring the carriers to pay "reasonable" expenses "remains non-cognizable." *Id.* at \*4. According to the Court, the insurance policies at issue required only that the carriers pay "reasonable" and "necessary" medical expenses. These insurance policy provisions, the Court held, cannot be construed as "requiring or prohibiting a particular manner of expense review." The Court distinguished recent authority suggesting that the use of such computer fee software alone was improper (*see Strawn v. Farmers Ins. Co.*, 209 P.3d 357, 365-66 (Or. Ct. App. 2009), summarized in our [June 15, 2009 Newsletter](#)) on the grounds that the insurance policies, or the particular state law, in those cases required the use of a particular claims adjusting methodology. *See* 2009 WL 2171221, at \*4.

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LOUISIANA FEDERAL DISTRICT COURT REFUSES TO CERTIFY CLASS ACTION  
AGAINST STATE FARM AND ESTIMATING SOFTWARE VENDOR CHALLENGING  
STRUCTURAL DAMAGE REPAIR ESTIMATES PREPARED USING ESTIMATING SOFTWARE

## SUMMARY

A Louisiana federal district court has refused to certify a Louisiana class of homeowners claiming that State Farm and a vendor of computer estimating software (Xactware) systematically underestimated the cost to repair property damage arising from claims submitted from the time of Hurricanes Katrina and Rita to the present. *Schafer v. State Farm Fire & Cas. Ins. Co.*, No. 06-8262, 2009 WL 2391238 (E.D. La. Aug. 3, 2009).

The court denied class certification on the ground that individual factual issues predominated: “[T]here are too many individual issues regarding what the proper market price of a line item was at a specific time, what method an adjuster used to make an estimate, whether labor was included in the estimate, and whether any class members actually were overpaid” on their claims as a whole. *Id.* at \*8.

### The Decision

The plaintiffs sought to represent a class of Louisiana insureds who submitted claims to State Farm pursuant to their homeowners policies for dwelling damages. The proposed class included such claimants from the time of Hurricanes Katrina and Rita to the present. The plaintiffs alleged that State Farm used a computer software program produced by a third-party vendor, Xactware, Inc., called “Xactimate” in estimating the cost to repair damaged dwellings. *Id.* at \*1-2.

The plaintiffs claimed that Xactimate “systematically underestimated the required replacement costs” below the “true” local market cost for repair materials and labor. The plaintiffs sought to recover the difference between the amount that State Farm had estimated as the cost to repair each damaged property and the “real” market price that the plaintiffs claimed State Farm should have used when the estimate was prepared. *See id.*

The court denied class certification after concluding that the plaintiffs had failed to satisfy Rule 23(b)(3)’s predominance requirement, and found it unnecessary to rule on the remaining arguments the defendants had raised in opposition to class certification.

The court first rejected the plaintiffs’ contention that they could establish the allegedly “most significant common issue in this litigation — the “ ‘should-have-been’ price,” or the “correct market price” of thousands of repairs and materials — through common proof. The plaintiffs argued that they would use “common evidence” to establish the “correct” market prices, including other commercially available price lists for material and labor costs. *Id.* at \*4. Once the “correct market price is determined,” the plaintiffs contended, the court “would simply have to compare the line items of each class member’s incorrect estimate against the line items with the correct market price to determine damages.” *Id.*

The court disagreed, and held that the case presented “significant predominance problems.” *Id.*

First, “the measure of damages requires individualized determinations.” *Id.* The court stated that individual damages issues may predominate, and preclude class certification, when damages cannot be determined “by reference to a mathematical or formulaic calculation.” *Id.* (internal quotations omitted). The court rejected the plaintiffs’ claim that damages could be calculated by a “simple calculation” of the difference between the prices in State Farm’s estimates and the supposed “true” price of “potentially over a million line items” for dwelling repair. The plaintiffs had failed to present any expert testimony regarding how these “fair market values would be calculated efficiently on a class-wide basis.” *Id.*

In addition, the court held that individual issues existed because Xactimate pricing was not the only factor used by State Farm in the preparing repair estimates. *Id.* at \*5.

Finally, the court held that individual issues predominated “in the context of affirmative defenses.” *Id.* at \*6. The court observed that even if State Farm had underestimated the cost of some elements of a particular repair, State Farm still could have “provided customers with a reasonable payment as a *whole*,” and therefore satisfied its contractual obligation to pay “the reasonable and necessary cost to repair or replace the damaged buildings for equivalent use . . . with commonly used materials that are readily available in the areas where the building is located. *Id.* (emphasis in original).

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## EIGHTH CIRCUIT AFFIRMS DISMISSAL OF “NO INJURY” CLASS ACTION INVOLVING ALLEGEDLY DEFECTIVE CRIB

### SUMMARY

The Eighth Circuit has upheld the dismissal with prejudice of a “no-injury class action” involving an allegedly defective baby crib that had been recalled by the Consumer Product Safety Commission. *O’Neil v. Simplicity, Inc.*, No. 08-2278, \_\_\_ Fed. 3d \_\_\_, 2009 WL 2168891 (8th Cir. July 22, 2009).

In “no injury” class actions like this one, the supposedly defective consumer product has not manifested the alleged defect (and may never do so). The plaintiff, however, typically seeks damages for supposed “economic injury,” consisting essentially of “benefit of the bargain” contract damages: the difference between the price the consumer actually paid for the product, and the price of a “defect-less” product.

The Eighth Circuit held that purchasers of an allegedly defective product “have no legally recognizable claim where the alleged defect has not manifested itself in the product they own.” Although this case nominally involved the federal Magnuson-Moss Act and Minnesota state law, the Eighth Circuit’s decision cited authorities from other jurisdictions, and therefore has application to “no injury” class actions filed in state and federal courts across the country.

### The District Court’s Decision

The plaintiffs purchased a crib manufactured by Simplicity under the Graco brand. On September 21, 2007, the CPSC and Simplicity announced a voluntary recall of the crib. According to the CPSC, the recall was prompted by a hardware defect that made it possible for the drop-side to detach from the crib, creating a gap in which a child could get caught. The defendants offered to mail a retrofit repair kit at the consumer’s request, but not to refund the price of the crib or repair the alleged defect. *Id.* at \*1.

The plaintiffs had used their crib without incident for four years, but stopped using it after the recall and did not request or install a retrofit repair kit. Instead, they joined a class action suit (eventually becoming the sole plaintiffs) pending in the United States District Court for the District of Minnesota. *Id.*

The plaintiffs brought claims for a declaratory judgment, violations of the Magnuson-Moss Warranty Act, 15 U.S.C. §§ 2301 *et seq.*, breach of express and implied warranty, unjust enrichment, and violations of three Minnesota consumer protection statutes. They sought to represent a class of all Minnesota purchasers of the recalled crib, other than those who suffered a personal injury caused by the allegedly defective crib. *Id.*

The district court granted the defendants’ motions to dismiss to dismiss, refused to grant the plaintiffs leave to amend, and dismissed the complaint with prejudice. The plaintiffs appealed. *Id.* at \*2.

### The Eighth Circuit’s Decision

The Eighth Circuit affirmed.

The Court first held that “purchasers of an allegedly defective product have no legally recognizable claim where the alleged defect has not manifested itself in the product they own.” *Id.* (internal quotations

omitted). “It is not enough to allege that a product line contains a defect or that a product is at risk for manifesting this defect; rather, the plaintiffs must allege that their product *actually exhibited* the alleged defect.” *Id.* (emphasis added).

The plaintiffs did not allege that the defect at issue ever manifested in their own crib, an omission the Court branded as “fatal to their case.” *Id.* The Court also rejected the plaintiffs’ contention that they had suffered an “economic injury” because they had not received “the benefit of the bargain.” Because the plaintiffs’ crib never exhibited the alleged defect, they necessarily received the benefit of *their* bargain:

The [plaintiffs] purchased a crib with a functioning drop-side and that crib continues to have a functioning drop-side. Their bargain with Simplicity and Graco did not contemplate the performance of cribs purchased by other consumers.

*Id.* at \*3.

Finally, the Court also upheld the district court’s refusal to allow the plaintiffs to file an amended complaint. The Court observed that the plaintiffs had filed three versions already, and before they filed their last complaint they were made aware of the “fatal flaw in their allegations.” *Id.* at \*4. The plaintiffs “made a tactical decision to file a no-injury case and specifically exclude all customers who were injured by the cribs. Not only is it unlikely that they would now allege that the cribs owned by [them] and other class members manifested the defect, but it would not be fair to the defendants to allow such a significant change to the justification for their claims at this late stage.” *Id.*

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**NINTH CIRCUIT HOLDS THAT EMPLOYERS' UNIFORM "EXEMPT"  
CLASSIFICATION OF EMPLOYEES DOES NOT PRESUMPTIVELY SATISFY  
RULE 23(B)(3) PREDOMINANCE REQUIREMENT IN OVERTIME CLASS ACTION**

## SUMMARY

In a pair of rulings issued on the same day (July 7, 2009), the Ninth Circuit declined in both cases to adopt a rule that a Rule 23(b)(3) class is presumptively proper when an employer uniformly classifies a group of employees as "exempt" from federal and state overtime pay requirements. *Vinole v. Countrywide Home Loans, Inc.*, 571 F.3d 935 (9th Cir. 2009); *In re Wells Fargo Home Mortgage Overtime Pay Litig.*, 571 F.3d 953 (9th Cir. 2009).

Moreover, as described elsewhere in this Newsletter, in the *Countrywide* case the Court held that Rule 23 does not preclude a defendant from bringing a "preemptive" motion to deny certification before the plaintiff files a motion for class certification.

## Proceedings in the District Courts

In *Countrywide*, the plaintiffs sought to represent a proposed class of current and former Countrywide employees who are or were employed as External Home Loan Consultants ("HLCs"). 571 F.3d at 937. They alleged that Countrywide had misclassified HLCs as "exempt" outside sales employees and, as a result, impermissibly failed to pay premium overtime and other wages. *Id.* In a procedural wrinkle, Countrywide filed its motion to deny certification before the plaintiffs had filed a motion for class certification and before the pretrial motion deadline and discovery cutoff. *Id.* The district court agreed to consider Countrywide's motion, rejecting the plaintiffs' assertion that the motion to deny certification was "unripe." *Id.* at 939. The district court denied certification under Rule 23(b)(3) on the grounds that individual issues predominated over common issues, notwithstanding the fact that Countrywide had uniformly classified its HLCs as exempt. *Id.*

Similarly, in the *Wells Fargo* case, the plaintiffs sought to represent a proposed class of current and former Wells Fargo California home mortgage consultants ("HMCs"). 571 F.3d at 955. The Wells Fargo plaintiffs also alleged that Wells Fargo violated California and federal overtime pay requirements by treating nearly all of its HMCs as exempt from state and federal overtime requirements. *Id.* Unlike the district court in the *Countrywide* case, the district court in the *Wells Fargo* case *granted* class certification — despite concluding that numerous individualized inquiries would be necessary — due to Wells Fargo's uniform exemption policies. *Id.* at 956.

## The Ninth Circuit's Decisions

The Ninth Circuit affirmed in *Countrywide* and reversed in *Wells Fargo*.

In *Countrywide*, the Ninth Circuit held that the district court had properly applied Rule 23 in denying class certification based on a lack of predominance. 571 F.3d at 947-48. In contrast, in the *Wells Fargo* decision, the Ninth Circuit held that the district court had abused its discretion in finding Rule 23(b)(3)'s predominance requirement was met based on Wells Fargo's internal policy of treating all HMCs as exempt from state and federal overtime laws. 571 F.3d at 959.

The legal framework was the same in both cases. Federal and California law provide exemptions for “outside salespersons.” *Wells Fargo*, 571 F.3d at 956. Under both California and federal FLSA law, a court evaluating the applicability of the outside salesperson exemption must conduct an individualized analysis of the way each employee actually spends his or her time, and not simply review the employer’s job description. *Countrywide*, 571 F.3d at 945; *Wells Fargo*, 571 F.3d at 956. The plaintiffs in both cases asked the Ninth Circuit to adopt a rule that class certification is warranted under Rule 23(b)(3) whenever an employer uniformly classifies a group of employees as exempt, notwithstanding the California and federal requirements that the district court conduct an individualized analysis of each employee’s actual work activity. *Countrywide*, 571 F.3d at 945; *Wells Fargo*, 571 F.3d at 958

The Ninth Circuit declined in both cases to adopt such an approach, holding that a district court abuses its discretion in relying on an employer’s internal uniform exemption policy to the near exclusion of other factors relevant to the predominance inquiry. *Wells Fargo*, 571 F.3d at 959. The Ninth Circuit criticized a presumptive rule that class certification is proper when an employer’s internal exemption policies are applied uniformly to the employees, because such an approach disregards the existence of other potential individual issues that may make class treatment difficult, and perhaps impossible. *Countrywide*, 571 F.3d at 947; *Wells Fargo*, 571 F.3d at 956. Focusing on a uniform exemption policy alone does little to further the purpose of Rule 23(b)(3)’s predominance inquiry, which requires an assessment of the relationship between individual and common issues. *Wells Fargo*, 571 F.3d at 959.

Instead of adopting what would essentially be a bright-line presumption in favor of class certification, the Ninth Circuit observed that it favors an approach that takes into consideration all factors that militate in favor of, or against, class certification. The overarching focus remains whether trial by class representation would further the goals of efficiency and judicial economy. *Countrywide*, 571 F.3d at 947; *Wells Fargo*, 571 F.3d at 959.

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## SECURITIES FRAUD: “FRAUD ON THE MARKET” AND OTHER THEORIES OF PRESUMED RELIANCE

- FIFTH CIRCUIT UPHOLDS DENIAL OF CLASS CERTIFICATION FOR FAILURE TO DEMONSTRATE LOSS CAUSATION UNDER “FRAUD ON THE MARKET” THEORY
- NINTH CIRCUIT DECLINE TO ADOPT NOVEL “INTEGRITY OF THE MARKET” THEORY IN STOCK MANIPULATION CLASS ACTION

### SUMMARY

The Fifth and Ninth Circuits recently upheld denials of class certification in securities fraud class actions. *Fener v. Operating Engr's Constr. Indus. & Misc. Pension Fund (Local 66)*, No. 08-10576, \_\_\_ F.3d \_\_\_, 2009 WL 2450674 (5th Cir. Aug. 12, 2009); *Desai v. Deutsche Bank Secs. Ltd.*, No. 08-55081, \_\_\_ F.3d \_\_\_, 2009 WL 2245223 (9th Cir. July 29, 2009). Both cases dealt with various methods by which a securities fraud plaintiff can establish reliance on a classwide basis — and both held that the plaintiffs there had failed to do so.

In a typical Section 10(b) securities fraud case, the plaintiff must prove (1) a material misrepresentation or omission by the defendant, (2) scienter, (3) a connection between the misrepresentation or omission and the purchase or sale of a security, (4) reliance, (5) economic loss, and (6) “loss causation” (a causal connection between the material misrepresentation and the loss).

Recognizing that requiring individualized proof of actual reliance by all plaintiff class members would make it impossible to certify securities fraud claims, courts have recognized a rebuttable presumption of reliance in two situations: (1) if there is an omission of a material fact by one with a duty to disclose, *see Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153-54 (1972); and (2) in cases of “fraud on the market” — generally, when shareholders in publicly traded companies rely on public material misstatements that affect the price of the stock. *See, e.g., Stoneridge Inv. Partners, LLC v. Scientific Atlanta, Inc.*, 552 U.S. 148, 128 S. Ct. 761, 769 (2008). The “fraud on the market” presumption is “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.” *Basic, Inc. v. Levinson*, 485 U.S. 224, 241 (1988) (internal quotations omitted).

In *Fener*, the Fifth Circuit upheld the denial of class certification because the plaintiffs there could not establish “loss causation” on a classwide basis. The plaintiffs did not satisfy the “fraud on the market” reliance presumption, because the evidentiary record failed to demonstrate that the drop in stock price was due to the disclosure of false statements or omissions, rather than to other, nonfraudulent disclosures.

In *Desai*, the Ninth Circuit declined to adopt a third (and new) method for presuming reliance in stock manipulation cases: “a novel presumption of reliance on the ‘integrity of the market.’” As support for its ruling that the district court did not abuse its discretion in refusing to recognize this new presumption, the Court cited the Supreme Court’s recent decision in *Stoneridge* for the proposition that the Section 10(b) private right of action “should not be extended beyond its present boundaries.” By contrast, the Fifth Circuit in *Fener* viewed *Stoneridge* as engaging only in a “general summary of the fraud-on-the-market theory” — one that did not disturb the “room” given each federal circuit court “to develop its own fraud-on-the-market rules.”

### *Fener* (Fifth Circuit)

*Fener* involved Belo Corporation, a media company that owns, among other things, the *Dallas Morning News* (“DMN”), which accounted for 30% of Belo’s total revenue. 2009 WL 2450674, at \*1. The plaintiffs claimed that Belo and some of its officers and directors had engaged in a fraudulent scheme artificially to inflate DMN’s circulation — in the face of a nationwide downward trend in newspaper circulation — thereby leading to increased reported advertising revenues for DMN and larger profits for Belo. *Id.*

Belo eventually disclosed the fraudulent practices in a press release, and the next day the company’s stock price dropped. *Id.* The plaintiffs filed this securities fraud class action, alleging that they had purchased Belo stock when its price was artificially inflated due to Belo’s fraud, and were damaged when Belo’s stock price fell after the fraud announcement. *Id.* at \*1-2.

The class certification hearing featured a “battle of the experts.” The plaintiffs’ expert testified that the stock price decline was “entirely or almost entirely” attributable to the fraud. The defendants’ expert, on the other hand, testified that the Belo press release had contained three separate “items of news” — that DMN’s circulation resulted from (1) the fraudulent statements, (2) changes in the DMN’s methodology, and (3) the industry-wide decline in newspaper circulation — and that the stock price dropped primarily because of the “non-fraudulent disclosures instead of the fraudulent one.” *Id.* at \*2, 4. The district court denied class certification.

The Fifth Circuit affirmed. Significantly, the Court began and ended its legal discussion with a warning about the problems inherent in class certification, particularly in securities cases:

[C]lass certification creates insurmountable pressure on defendants to settle, whereas individual trials would not. The risk of facing an all-or-nothing verdict presents too high a risk, even when the probability of an adverse judgment is low. This risk is particularly high in securities-fraud class actions, in which the current class-based compensatory damages regime in theory imposes remedies that are so catastrophically large that defendants are unwilling to go to trial even if they believe the chance of being found liable is small. Some have observed that seeking class certification to force favorable settlements does not benefit small investors but instead resembles a “shakedown” or “judicial blackmail.”

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Securities fraud litigation is not “a scheme of investor’s insurance,” but instead is designed to protect those who buy stock at fraudulently inflated prices. If the fraud did not cause the price of the stock to increase, and its disclosure does not cause the price to go down, no injury has occurred.

*Id.* at \*2, 7 (internal quotations, citations, and footnotes omitted).

The Court agreed with the district court that the plaintiffs had not “presented enough information to show loss causation under rule 23,” and that “the testimony of an expert — along with some kind of analytical research or event study — is required.” *Id.* at \*3, 5. The Court examined the competing expert testimony at the class certification hearing and agreed with the defendants’ expert that the press release consisted of three separate disclosures — both fraudulent and non-fraudulent — and that the plaintiffs had failed to establish that the stock price decline was due to the fraud: “We reject any event study that shows only how a stock reacted to the *entire bundle* of negative information, rather than examining the evidence linking the

*culpable* disclosure to the stock-price movement.” *Id.* at \*5 (emphasis in original; internal quotations omitted).

### *Desai* (Ninth Circuit)

The plaintiff investors in *Desai* brought securities fraud class actions against various banking entities that allegedly engaged in a stock manipulation scheme.

The district court identified the two traditional methods by which reliance in securities fraud class actions may be presumed: (1) the material omission standard of *Affiliated Ute*, and (2) “fraud on the market.” The district court ruled that the plaintiffs did not satisfy either standard. The *Affiliated Ute* standard did not apply because the case “was not primarily an omissions case,” but one of “market manipulation” — that is, a case involving “activities designed to affect the price of a security artificially by simulating market activity that does not reflect genuine investor demand.” *Id.* at \*7. The “fraud on the market” presumption did not apply because the plaintiffs admitted that they could not demonstrate an efficient market. *Id.* at \*6, 7.

The district court then rejected the plaintiffs’ invitation to create a new method of presuming reliance: “a novel presumption of reliance on the ‘integrity of the market’ in the context of manipulation cases.” *Id.* at \*7. Without a classwide presumption of reliance, the plaintiffs were unable to meet the Rule 23(b)(3) predominance requirement, and the district court denied class certification. *Id.*

The Ninth Circuit affirmed. The Court agreed with the district court that neither the *Affiliated Ute* nor the “fraud on the market” tests for presumption of reliance applied. *Id.* at \*7-8. The Court then turned to the plaintiffs’ invitation to recognize “a new presumption for manipulative conduct cases.”

According to the plaintiffs, investors typically rely on the “integrity of the market” — that is, “that no one has destroyed its efficiency by manipulation.” The plaintiffs contended that this consideration justifies a presumption of reliance “when manipulation allegedly destroys the efficiency of the market, and with it the reliability of the market’s price.” *Id.* at \*9.

The Ninth Circuit rejected the invitation: “We are chary.” *Id.* The Court observed that the Supreme Court “has adopted a rather restrictive view of private suits under § 10(b),” under which the private right of action “‘should not be extended beyond its present boundaries.’” *Id.* (quoting *Stoneridge*, 128 S. Ct. at 773). The Ninth Circuit noted that the Supreme Court in *Stoneridge* recently listed the two “reliance presumptions” (*Affiliated Ute* and “fraud on the market”) and “did not inquire into any other presumption that seemed appropriate, but simply analyzed whether the plaintiffs could prove reliance directly.” *Id.* According to the Ninth Circuit, “[t]hese passages may not forbid the recognition of new presumptions, but they do illustrate that the district court did not have to recognize this one.” *Id.*

Judge O’Scannlain filed a concurring opinion, agreeing that the district court’s refusal to certify the class should be affirmed. Judge O’Scannlain wrote, however, that “because the validity of a presumption of reliance in securities class actions is a matter of law and because errors of law are per se abuses of discretion, we must explicitly decide whether [the plaintiffs] are entitled to this novel presumption as a matter of law.” *Id.* In an extensive opinion, Judge O’Scannlain concluded that the “integrity of the market” presumption was “legally unsupported and logically inadvisable.” *Id.* at \*10-12. Judge Graber responded with his own concurring opinion, writing that the Court did not need to decide definitively whether to recognize the “integrity of the market presumption.” According to Judge Graber, all the Court was required to do (and did) was decide whether the district court had abused its discretion in refusing to recognize the new presumption. *See id.* at \*13.

## NINTH CIRCUIT UPHOLDS DEFENDANTS' USE OF "PREEMPTIVE" MOTIONS TO DENY CLASS CERTIFICATION

### SUMMARY

In a case of first impression for the Ninth Circuit, the Court held that Rule 23 does not preclude a defendant from bringing a "preemptive" motion to deny class certification, even before the class plaintiff has filed a motion for class certification, and before the pretrial motions deadline and the discovery cutoff. *Vinole v. Countrywide Home Loans, Inc.*, 571 F.3d 935 (9th Cir. 2009).

Moreover, as described elsewhere in this Newsletter, the Court in *Countrywide* and a companion overtime class action upheld the denial of class certification, holding that the employers' uniform "exempt" classification of employees did not presumptively satisfy Rule 23(b)(3)'s predominance requirements.

### The Ninth Circuit's Decision

In the district court, Countrywide filed a motion to deny class certification — before the plaintiff had filed a motion to certify the class, and before the discovery cutoff and pretrial motions deadlines. The district court held that it had the authority to consider Countrywide's motion to deny class certification, and granted that motion.

The Ninth Circuit affirmed. Noting that it had never addressed the issue "directly," the Court observed that the timing of class certification decisions is governed by Rule 23(c)(1)(A), which provides: "Time to Issue: At an early practicable time after a person sues or is sued as a class representative, the court must determine by order whether to certify the action as a class action." 571 F.3d at 939.

The Court held that "[n]othing in the plain language of Rule 23(c)(1)(A) either vests plaintiffs with the exclusive right to put the class certification issue before the district court or prohibits a defendant from seeking early resolution of the class certification question." *Id.* at 939-40. The Court cited decisions from other federal courts permitting such defense motions. *See id.* at 940. The Court concluded that even though the district court had considered the defendants' certification motion three weeks before the close of discovery, the plaintiffs were provided with adequate time in which to conduct discovery related to the question of class certification, and the district court therefore did not abuse its discretion.

The Court distinguished three decisions from the Northern District of California. *See id.* at 941. Two of the cases involved Rule 12 motions to strike class allegations before the defendants had answered the complaint and before discovery had commenced; under those circumstances, the district courts concluded that ruling on class certification at that time would be premature. *See id.* The third case involved a motion under Rule 23(d)(4) to "compel amendment of the pleadings to eliminate class allegations," which the district court concluded was procedurally improper, because the question of class certification was not yet before the court and discovery was ongoing. *See id.* The Ninth Circuit concluded that in none of these cases did the district courts announce a "per se rule" prohibiting preemptive motions to deny class certification.

## Schiff Hardin Class Action Litigation Group

Schiff Hardin LLP has an active and experienced team of litigators who concentrate their practice in defending corporations against class actions and other complex civil litigation. Our attorneys have defended our corporate clients in class action cases in both state and federal courts throughout the United States.

### For more information on this Newsletter, please contact:

Marci A. Eisenstein  
312.258.5545  
[meisenstein@schiffhardin.com](mailto:meisenstein@schiffhardin.com)

Aphrodite Kokolis  
312.258.5601  
[dkokolis@schiffhardin.com](mailto:dkokolis@schiffhardin.com)

Paula M. Ketcham  
312.258.5539  
[pketcham@schiffhardin.com](mailto:pketcham@schiffhardin.com)

### Schiff Hardin Offices:

One Atlantic Center  
Suite 2300  
1201 West Peachtree  
Atlanta, GA 30309

225 Franklin Street  
Suite 2600  
Boston, MA 02110

233 South Wacker Drive  
Suite 6600  
Chicago, IL 60606

One Westminster Place  
Suite 200  
Lake Forest, IL 60045

900 Third Avenue  
New York, NY 10022

One Market, Spear Street Tower  
32nd Floor  
San Francisco, CA 94105

1666 K Street, NW  
Suite 300  
Washington, DC 20006

### Partners and Counsel in the Schiff Hardin Class Action Litigation Group:

Eric L. Barnum  
404.437.7013  
[ebarnum@schiffhardin.com](mailto:ebarnum@schiffhardin.com)

David C. Blickenstaff  
312.258.5637  
[dblickenstaff@schiffhardin.com](mailto:dblickenstaff@schiffhardin.com)

Joseph A. Cancila, Jr.  
312.258.5613  
[jcancila@schiffhardin.com](mailto:jcancila@schiffhardin.com)

William J. Carroll  
415.901.8754  
[wcarroll@schiffhardin.com](mailto:wcarroll@schiffhardin.com)

Heidi Dalenberg  
312.258.5564  
[hdalenberg@schiffhardin.com](mailto:hdalenberg@schiffhardin.com)

Marci A. Eisenstein  
312.258.5545  
[meisenstein@schiffhardin.com](mailto:meisenstein@schiffhardin.com)

James P. Gaughan  
312.258.5616  
[jgaughan@schiffhardin.com](mailto:jgaughan@schiffhardin.com)

Thomas J. Henehan  
312.258.5531  
[thenehan@schiffhardin.com](mailto:thenehan@schiffhardin.com)

Paula M. Ketcham  
312.258.5539  
[pketcham@schiffhardin.com](mailto:pketcham@schiffhardin.com)

Aphrodite Kokolis  
312.258.5601  
[dkokolis@schiffhardin.com](mailto:dkokolis@schiffhardin.com)

Neil Lloyd  
312.258.5628  
[nlloyd@schiffhardin.com](mailto:nlloyd@schiffhardin.com)

Catherine M. Masters  
312.258.5565  
[cmasters@schiffhardin.com](mailto:cmasters@schiffhardin.com)

William E. Meyer, Jr.  
312.258.5526  
[wmeyer@schiffhardin.com](mailto:wmeyer@schiffhardin.com)

Paula J. Morency  
312.258.5549  
[pmorency@schiffhardin.com](mailto:pmorency@schiffhardin.com)

Brian J. Neff  
212.745.0858  
[bneff@schiffhardin.com](mailto:bneff@schiffhardin.com)

Christopher J. Rillo  
415.901.8631  
[crillo@schiffhardin.com](mailto:crillo@schiffhardin.com)

Jay Williams  
312.258.5629  
[jwilliams@schiffhardin.com](mailto:jwilliams@schiffhardin.com)

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