Many Years After Changing the Landscape for Adjudicating Motions to Dismiss Under Federal Rule of Civil Procedure 12, *Morrison* Officially Arrives in Rule 23 Jurisprudence

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Second Circuit Remands *Petrobras* Class Certification Order; Questions Whether Class Concerns Predominate Over "Domesticity" of Individual Transactions

On July 7, 2017, the United States Court of Appeals for the Second Circuit vacated parts of the District Court's class certification order in *In re Petrobras Securities Litigation* ("*Petrobras*"), holding that the District Court failed to address whether the need to establish the "domestic" nature of each class member's purchase of Petrobras securities—as required under *Morrison v. National Australia Bank Ltd.*,[1]—defeated the Rule 23 requirement that class issues "predominate" over issues unique to each class member.[2]

The Second Circuit's decision opens a new chapter in *Morrison* jurisprudence, extending the impact of the presumption of extraterritoriality to Rule 23's predominance requirement. Purported class actions arising out of the purchase of securities in the over-the-counter market or otherwise off-exchange now must grapple at the class certification stage with whether proof of "domesticity," in the language of the Second Circuit, is not sufficiently common for putative class members to satisfy Rule 23's predominance requirement.

Morrison and the Presumption Against Extraterritoriality

In its landmark 2010 ruling in *Morrison*, the United States Supreme Court reinvigorated the so-called "presumption against extraterritoriality," and held that Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") only applies to (1) "transactions in securities listed on domestic exchanges" and (2) "domestic transactions in other securities."[3]

Later, in *Absolute Activist Value Master Fund Ltd. v. Ficeto*,[4] the Second Circuit adopted a now widely accepted test to determine whether a transaction is sufficiently "domestic" to satisfy *Morrison*'s second prong. Under the *Absolute Activist* test, a transaction is only "domestic" when "irrevocable liability is incurred" in the United States, or when "title passes" in the United States.

Since *Morrison* and *Absolute Activist*, there have be numerous decisions in the context of motions to dismiss assessing whether or not a plaintiff has sufficiently alleged a domestic transaction under Morrison's second prong. The Second Circuit itself has previously made clear in that context that numerous facts and circumstances may bear on the question of whether a particular transaction is considered domestic under *Morrison's* second prong. The domicile of the plaintiffs is not necessarily dispositive, nor is the location of the broker. Instead, numerous other factors may impact the domesticity

[1] 561 U.S. 247 (2010).

[2] No. 16-1914-cv (2d Cir. July 7, 2017).

[3] 561 U.S. 247, 267.

[4] 677 F.3d 60, 67 (2d Cir. 2012).

determination, including the place or places where the contracts were signed, where negotiations occurred, and where consideration was directed.[5]

Rule *23*, *Morrison* and the *Petrobras* Decision

Securities cases, whether brought under Section 10(b) of the Exchange Act or Sections 11 or 12 of the Securities Act of 1933, must satisfy Federal Rule of Civil Procedure 23's requirements to be certified as class actions. Historically courts have certified many securities class actions, concluding that Rule 23's predominance requirement is satisfied, particularly in Section 11 and 12 cases, where proof of reliance is generally not required. Even in Section 10(b) cases, which do require proof of reliance, the fraud-on-the-market presumption, if applicable, often effectively eliminates the need to demonstrate class members' reliance on an individual basis. The *Petrobras* decision, however, opens up a new, important line of inquiry under Rule 23's predominance requirement in all cases based on transactions under prong two of *Morrison*, regardless of which federal securities law claims are asserted.

The *Petrobras* litigation consists of consolidated class action securities lawsuits brought against a Brazilian oil company following the discovery of a pattern of bid-rigging and corruption—and the drastic devaluation of the company's securities after news of the scandal broke.

The Second Circuit July 7 decision vacated the part of the class certification order relating to noteholder purchasers because the District Court failed to "meaningfully address" whether individualized proof of domesticity would predominate over common issues.

According to the Court, "[o]n the available record, the investigation of domesticity appears to be an 'individual question' requiring putative class members to 'present evidence that varies from member to member.'"

While the Court recognized that the *Morrison* inquiry nominally presents a common question, the Court noted that plaintiffs "bear the burden of showing that, more often than not, they can provide common *answers*." (emphasis in original). The Court noted that the potential for variation across putative class members—including (1) who sold them the securities, (2) how the transactions were effectuated, and (3) what forms of documentation might be offered to support domesticity—"appears to generate a set of individualized inquiries that must be considered" under Rule 23's predominance requirement.[6]

***Implications* of the Second Circuit's Opinion**

The Court expressly took no position on whether certification might be proper on remand, and noted that it expressed no opinion "on the wide range of conceivable circumstances" in which class claims might be asserted in connection with foreign-issued securities that do not trade on a domestic exchange.[7] Nonetheless, the opinion makes clear that plaintiffs seeking to use the leverage of Rule 23's class action device for claims based on off-exchange transactions face a high hurdle in establishing predominance at the class certification stage, even if the named plaintiffs themselves have sufficiently alleged domesticity as to their purchases.

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[5] *See*, *e.g.*, *Loginovskaya v. Batratchenko*, 764 F.3d 266, 274-75 (2d Cir. 2014); *City of Pontiac Policemen's & Firemen's Ret. Sys. v. UBS AG*, 752 F.3d 173, 180-81 (2d Cir. 2014).

[6] Elsewhere in the opinion, the Second Circuit clarified that its standard for "ascertainability" does not necessitate a separate showing that class definition would be feasible from an administrative standpoint. The Second Circuit therefore affirmed the class certification order as to the ascertainability requirement.

Also, the Second Circuit affirmed the District Court's finding that, based on both direct and indirect evidence, the Petrobras securities traded in an efficient market, so plaintiffs were entitled to invoke the fraud-on-the-market theory established in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), to satisfy their burden on reliance.

[7] *E.g.*, at footnote 27 in the Court's opinion.

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