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SECOND CIRCUIT REVIEW

Expert Analysis

The Second Circuit In the U.S. Supreme Court

With the U.S. Supreme Court beginning its 2010 term next month, we conduct our 26th annual review of the performance of the U.S. Court of Appeals for the Second Circuit over the past term, and briefly discuss the Second Circuit decisions scheduled for review during the new term.

Before the 2009 term began, President Barack Obama nominated Second Circuit Judge Sonia Sotomayor to fill the vacancy left by the retirement of Justice David Souter. Upon taking office, Justice Sotomayor became the first Second Circuit judge elevated directly from the Second Circuit since John Marshall Harlan II in 1955. (Thurgood Marshall became a Supreme Court Justice after having served on the Second Circuit, but he was the Solicitor General at the time of his nomination.)

During its 2009 term, the Supreme Court issued 67 merits decisions reviewing opinions by the federal courts of appeals (in addition to 11 summary reversals, the highest number of summary reversals in more than 15 years.) The Court reversed or vacated judgments in 44 of those 67 decisions, as the performance table below shows.

Although the Second Circuit's reversal rate was high (85.7 percent), its performance was roughly in line with the overall performance of the other courts of appeals (an average 65.6 percent reversal rate), and with its own performance the prior year. By way of comparison, in the 2008 term, the Supreme Court reversed seven of the nine cases from the Second Circuit.

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By **Martin Flumenbaum** | And **Brad S. Karp**

We describe below the Second Circuit decisions reviewed in the 2009 term.[1]

In the first so-called "F-cubed" suit to reach the Supreme Court, the Court held in *Morrison v. National Australia Bank Ltd.* that foreign investors who bought securities of a foreign issuer on a foreign exchange could not bring private actions in U.S. courts against the foreign issuer under §10(b) of the Securities Exchange Act of 1934.[2] ("F-cubed" cases are named for their three foreign components—foreign issuers, foreign investors, and purchases on foreign exchanges.)

The Exchange Act's antifraud provisions are silent as to any extraterritorial application. Prior to *Morrison*, federal courts followed Second Circuit precedent, and allowed "F-cubed" suits to proceed if: (1) the wrongful conduct at issue had a substantial effect in the United States or upon U.S. citizens; or (2) the wrongful conduct occurred in the United States.[3] The Second Circuit crafted this "conduct-and-effects test" in an attempt to "discern" when Congress would have wanted the antifraud provisions of the Exchange Act to apply to otherwise foreign transactions.[4]

In *Morrison*, Australians who had purchased shares of National Australia Bank (NAB) on non-U.S. securities exchanges sued NAB under §10(b) for fraud relating to NAB's purchase of a Florida-based mortgage servicer called HomeSide Lending Inc.[5] In 2001, NAB announced it was writing down the value of HomeSide Lending's assets based on a failure to anticipate lower interest rates. Plaintiffs sued NAB in the Southern District of New York, alleging that HomeSide Lending had manipulated

Supreme Court October 2009 Term
Performance of the Circuit Courts

Circuit	Cases	Affirmed	Reversed or Vacated	Affirmed/ Reversed in Part	% Reversed or Vacated
First	2	1	0	1	0
Second	7	1	6	0	85.7
Third	5	3	2	0	40
Fourth	4	1	3	0	75
Fifth	3	0	2	1	66.6
Sixth	6	0	6	0	100
Seventh	10	1	9	0	90
Eighth	3	0	2	1	66.6
Ninth	14	4	8	2	57.1
Tenth	2	2	0	0	0
Eleventh	7	2	5	0	71.4
D.C.	3	0	1	2	33.3
Federal	1	1	0	0	0

its financial models, and that NAB was aware of HomeSide Lending's manipulation but had done nothing to stop it.

Applying the conduct-and-effects test, the district court dismissed for lack of subject matter jurisdiction, finding that the aspects of the alleged fraud that occurred in the United States were "at most, a link in the chain of an alleged overall securities fraud scheme that culminated abroad."[6] The Second Circuit affirmed.[7]

The Supreme Court, in a majority opinion authored by Justice Antonin Scalia, affirmed the judgment but rejected the conduct-and-effects test, and instead adopted a new, bright-line "transactional test." Under this new "transactional test," a private investor can bring suit under §10(b) of the Exchange Act "only in connection with a purchase or sale of a security listed on an American stock exchange, and the purchase or sale of any other security in the United States."

The majority's analysis relied on the presumption against extraterritoriality, which it described as a "longstanding principle of American law that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States." Rather than "guess anew in each case" when Congress would have wanted the Exchange Act to apply to fraud that culminated abroad, courts must now "apply the presumption [against extraterritoriality] in all cases, preserving a stable background against which Congress can legislate with predictable effects."[8]

Justice John Paul Stevens, joined by Justice Ruth Bader Ginsburg, concurred in the judgment, but would have preserved the Second Circuit's conduct-and-effects test. Justice Stevens noted that bright-line tests should not apply in the context of §10(b) jurisprudence, which, borrowing Justice William H. Rehnquist's phrase, he described as a "judicial oak which has grown from little more than a legislative acorn."[9] Justice Stevens noted that it was particularly the Second Circuit's historical role to interpret §10(b): "The 'Mother Court' of securities law tended to that oak."[10]

The Court's decision in *Morrison* has already, and will continue to have, a significant impact on §10(b) suits, both as to whether certain claims may be brought in the first place, and also as to the size and composition of plaintiff classes.[11] One important, open question is whether *Morrison* prohibits so-called "F-squared" suits, i.e., suits brought by American investors who purchased shares of foreign issuers directly from foreign exchanges. One district court has already found such suits barred by *Morrison*.[12] As that court noted, however, American investors who purchase directly from foreign exchanges may still be protected by the Securities and Exchange Commission (SEC). The recently enacted Dodd-Frank Act reinstated the Second Circuit's conduct-and-effects test for purposes of determining the extraterritorial reach of SEC actions.[13]

Class Actions

The Court issued two important opinions concerning class action procedures. First, in *Stolt-Nielsen S.A. v. AnimalFeeds International Corp.*, the Court held that imposing "class arbitration" on parties whose arbitration clauses are "silent" on the issue is inconsistent with the Federal Arbitration Act (FAA).[14] The case arose in the wake of a Justice Department criminal investigation into illegal price-fixing conspiracies in the shipping industry. Numerous shipping customers, including AnimalFeeds International Corp., filed class action antitrust suits in federal courts. In one of these suits, the Second Circuit held that the claims against the shipping companies were arbitrable pursuant to the arbitration agreements contained in the standard shipping contracts ("charter parties").[15] AnimalFeeds thereafter served a demand for class arbitration against Stolt-Nielsen.

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Even though the charter parties were "silent" on the issue of class arbitration, meaning that "[a]ll parties agree[d] that when a contract is silent on an issue there's been no agreement that has been reached on the issue," the arbitration panel allowed the "class arbitration" to proceed. The Second Circuit affirmed, holding that "class arbitration" was not in manifest disregard of federal maritime rules of custom and usage, nor in manifest disregard of New York law (which had no rule against "class arbitration").[16]

The Supreme Court, in a 5-3 opinion by Justice Samuel A. Alito, reversed. The Court reasoned that unbargained-for "class arbitration" violates the "consensual nature of private dispute resolution." Since consent is a fundamental principle of the FAA, "a party may not be compelled under the FAA to submit to class arbitration unless there is a contractual basis for concluding that the party agreed to do so."

Justice Ginsburg, in a dissent joined by Justices Stevens and Stephen G. Breyer, argued both that the arbitrators' decision was not final and hence not ripe for review in federal court; and also that the majority overstepped its authority under the FAA to vacate an arbitration panel's decision "only in very unusual circumstances." According to Justice Ginsburg, there was nothing very unusual about "arbitrators decid[ing] a threshold issue, explicitly committed to them, about the procedural mode available for presentation of AnimalFeeds' antitrust claims."[17]

In *Shady Grove Orthopedic Associates v. Allstate Insurance Co.*, the Court addressed a conflict between Federal Rule of Civil Procedure 23 and a New York state law—C.P.L.R. §901(b)—which prohibits class actions in suits seeking "a penalty" or statutory minimum damages.[18]

Shady Grove, a medical provider, alleged that Allstate Insurance routinely refused to pay the statutory interest that accrues on overdue insurance benefits, in violation of New York law. Shady Grove filed a diversity suit in the Eastern District of New York, seeking relief on behalf of itself and a class of all others to whom Allstate owed interest. The district court concluded that statutory interest was a "penalty" as the term is used in §901(b), and therefore no class action could lie under New York law.[19]

The Second Circuit affirmed,[20] agreeing with the district court that §901(b) is a "substantive" state law within the meaning of *Erie Railroad v. Tompkins*,[21] and therefore must be applied by federal courts in diversity. The Second Circuit further reasoned that there was no Supremacy Clause issue because, whereas Federal Rule 23 concerns only the criteria for determining whether a given class can and should be certified, §901(b) addresses an "antecedent question" of whether a particular claim is eligible for class treatment.[22]

The Supreme Court reversed. In a plurality opinion joined in parts by Justices John G. Roberts, Stevens, Sotomayor and Clarence Thomas, Justice Scalia wrote that Rule 23 and §901(b) "flatly contradict each other."[23] The plurality interpreted Rule 23 as creating a "categorical rule entitling a plaintiff whose suit meets the specified criteria to pursue his claim as a class action." Because §901(b) addresses "the same question…it cannot apply in diversity suits unless Rule 23 is ultra vires." (Justice Scalia's plurality opinion went on to hold that Rule 23 was valid under the Rules Enabling Act.)[24]

Justice Ginsburg, joined by Justices Anthony M. Kennedy, Breyer and Alito, argued in dissent that the plurality misconstrued §901(b) to find a conflict where none existed, since the New York statute only "defines the dimensions of the claim itself."[25]

Copyright

In *Reed Elsevier Inc. v. Muchnick*,[26] the Court unanimously ruled that 17 U.S.C. §411(a), which requires registration of a copyright as a precondition to filing a copyright infringement claim, does not deprive federal courts of subject matter jurisdiction over infringement claims involving unregistered works. The Second Circuit had concluded that a district court lacked jurisdiction to certify a class that included both authors who had registered their works and those who had not. But the Supreme Court ruled that §411(a)'s registration requirement was akin to a claims-processing rule, not a jurisdictional limitation.

ERISA Plan Administrator

In *Conkright v. Frommert*, the Court held that an ERISA plan administrator's interpretation of a plan provision is entitled to deference under *Firestone Tire & Rubber Co. v. Bruch*,[27] even when the plan administrator had previously interpreted the same provision a different way, and the previous interpretation had been rejected as unreasonable.[28]

In 2006, the Second Circuit rejected a plan administrator's interpretation of an accounting provision in Xerox Corporation's pension plan.[29] On remand, the administrator offered a different interpretation of the same provision, to which the Second Circuit refused to grant deference. The Second Circuit held that it need not apply a deferential standard of review "where the administrator ha[s] previously construed the same [plan] terms and we found such a construction to have violated ERISA."[30]

The Supreme Court rejected what it labeled a "one-strike-and-you're-out" approach to *Firestone* deference, finding no basis for such a rule in *Firestone* or in the principles of trust law. According to the 5-3 majority, *Firestone* "set out a broad standard of deference without any suggestion that the standard was susceptible to ad hoc exceptions like the one adopted by the Court of Appeals."

Proximate Cause Under RICO

Finally, in *Hemi Group, LLC v. City of New York*, the Court again reversed the Second Circuit and held that New York City failed to state a claim under the Racketeer Influenced and Corrupt Organizations Act (RICO) against online cigarette sellers. Online cigarette sellers do not pay state or local sales taxes, but are required by federal law—the Jenkins Act—to report customer information to the states into which they ship cigarettes so that the states can collect taxes directly from purchasers.[31] No such obligation runs to municipalities, but New York State has executed an agreement with New York City agreeing to cooperate on the collection of cigarette taxes. New York City sued Hemi Group and others, alleging that their failure to file Jenkins Act information with New York State cost the city hundreds of millions of dollars in lost tax revenue.

The Supreme Court, in a plurality opinion by Justice Roberts, held that the city's complaint failed to allege proximate cause because the chain between the seller's failure to file customer information with the state and the city's failure to collect taxes was too attenuated.[32] "Put simply, [the cigarette seller's] obligation was to file the Jenkins Act reports with the State, not the City, and the City's harm was directly caused by the customers, not [the sellers]."

The 2010 Term

While additional Second Circuit cases likely will be added to the docket in the upcoming months, the Supreme Court is currently scheduled to review only one Second Circuit decision during its 2010 term. In *CIGNA Corp. v. Amara*, the Court will consider a circuit split as to the showing that a participant in an ERISA-governed plan must make to recover benefits based on an inconsistency between a Summary Plan Description (SPD) and the terms of the plan itself.[33] Under current Second Circuit precedent, a participant must only show "likely harm" from any discrepancy, not actual detrimental reliance on the inconsistency.[34]

1. We do not address *United States v. Marcus*, 130 S. Ct. 2159 (2010), a 7-1 decision in which the Supreme Court held that the Second Circuit had employed an erroneous "plain error" standard to review an ex post facto clause claim not raised by a criminal defendant at trial. The Second Circuit held that it must recognize "plain error" if there was "any possibility" that the jury convicted the defendant exclusively on the basis of actions he had taken before the enactment of the statute that made those actions criminal. 538 F.3d 97, 102 (2d Cir. 2008) (per curiam). The Supreme Court reversed, holding that "plain error" review requires not "any possibility" but rather a "reasonable probability" that the error affected the outcome of trial. 130 S. Ct. at 2164. Justice Sotomayor was on the Second Circuit panel that decided *Marcus*, but had concurred separately to note that Second Circuit precedent regarding "any possibility" of an ex post facto error was not in line with the Supreme Court's jurisprudence on plain error. 538 F.3d at 102 (Sotomayor, J., concurring).
2. 130 S. Ct. 2869 (2010).
3. See, e.g., *SEC v. Berger*, 322 F.3d 187, 192-93 (2d Cir. 2003).
4. *Morrison v. National Australia Bank Ltd.*, 547 F.3d 167, 170 (2d Cir. 2008).
5. 130 S. Ct. at 2876 n. 1. The named plaintiff, Robert Morrison, was an American who had purchased American Depositary Receipts (ADRs) of NAB on the New York Stock Exchange, but his claims had been dismissed by the District Court for failure to allege damages.
6. *In re National Australia Bank Securities Litigation*, No. 03 Civ. 6537 (BSJ), 2006 WL 3844465, at *8 (S.D.N.Y. Oct. 25, 2006).
7. 547 F.3d at 175-176.
8. 130 S. Ct. at 2881-88 (internal citations and quotations omitted).
9. Id. at 2889 (Stevens, J. dissenting) (quoting *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 737 (1975) (Rehnquist, J.).
10. Id. at 2889-90 (Stevens, J. dissenting) (quoting *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 762 (1975) (Blackmun, J., dissenting).
11. See, e.g., *Stackhouse v. Toyota Motor Co. et al.*, No. CV-10-0922 DSF, 2010 WL 3377409 , at * 2 (C.D. Cal. July 16, 2010) (appointing as lead plaintiff the plaintiff with the largest losses tied to American Depository Shares in light of the Court's view that American plaintiffs who bought directly from non-American exchanges will have their claims foreclosed by *Morrison*).
12. *Cornwell v. Credit Suisse Group et al.*, No. 08 Civ. 3758 (VM), 2010 WL 3069597, at *5 (S.D.N.Y., July 27, 2010) ("[T]he *Morrison* opinions indicate that the Court considered that under its new test §10(b) would not extend to foreign securities trades executed on foreign exchanges even if purchased or sold by American investors").
13. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §§929P(b), 929Y, 124 Stat. 1376 (July 21, 2010).
14. 130 S. Ct. 1758 (2010).
15. *JLM Industries Inc. v. Stolt-Nielsen S.A.*, 387 F.3d 163, 183 (2004).
16. *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Co.*, 548 F.3d 85, 97-98 (2d Cir. 2008).
17. Id. at 1781 (Ginsburg, J., dissenting).
18. N.Y. C.P.L.R. §901(b) [West 2006] ("Unless a statute creating or imposing a penalty, or a minimum measure of recovery specifically authorizes the recovery thereof in a class action, an action to recover a penalty, or minimum measure of recovery created or imposed by statute may not be maintained as a class action").
19. *Shady Grove Orthopedic Assocs. v. Allstate Ins. Co.*, 466 F.Supp.2d 467 (E.D.N.Y. 2006).
20. 549 F.3d 137 (2d Cir. 2008).
21. 304 U.S. 64 (1938).
22. 549 F.3d at 143-44.
23. 130 S. Ct. 1431, 1441 (2010).
24. Id. at 1442-43. The plurality stressed that it was interpreting §901(b) as a complete bar to class actions that seek statutory penalties; it was "not decid[ing] whether a state law that limits the remedies available in an existing class action would conflict with Rule 23." Id. at 1439.
25. Id. at 1460 (Ginsburg, J., dissenting).
26. 130 S. Ct. 1237 (2010).
27. 489 U.S. 101 (1989).
28. 130 S. Ct. 1640 (2010).
29. *Frommert v. Conkright*, 433 F.3d 254, 257, 265-69 (2d Cir. 2006).
30. *Frommert v. Conkright*, 535 F.3d 111, 119 (2d Cir. 2008).
31. Id. at 987 (discussing the Jenkins Act, 15 U.S.C. §§375-378).
32. 130 S. Ct. 983 (2010).
33. 130 S. Ct. 3500 (June 29, 2010).
34. See *Burke v. Kodak Retirement Income Plan*, 336 F.3d 103 (2d Cir. 2003).