

High Court Review Sought in Deepwater Horizon Securities Litigation



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Last fall, the U.S. Court of Appeals for the Fifth Circuit upheld a district court order denying class certification to a group of BP plc shareholders in the securities litigation, *Ludlow v. BP plc*, 800 F.3d 674 (5th Cir. 2015). The proposed class of investors purchased BP securities before the April 20, 2010, catastrophic blowout of the Deepwater Horizon oil rig that resulted in more than 5 million barrels of oil spilling into the Gulf of Mexico. These “pre-spill” investors alleged that, for several years before the spill, BP, which had leased

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the rig and co-owned the well site where the explosion occurred, made material misrepresentations overstating the strength of BP's safety processes and procedures and understating the risk of catastrophe in violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder.

Both the district court and the Fifth Circuit held that the pre-spill plaintiffs failed to satisfy the U.S. Supreme Court's "common damages burden," recently set forth in an antitrust case, *Comcast v. Behrend*, 133 S. Ct. 1426 (2013). Under *Comcast*, a plaintiff seeking class certification must present a damages methodology that is both consistent with the plaintiff's theory of liability and capable of measuring damages across the entire proposed class. (The district court certified, and the Fifth Circuit affirmed, a "post-spill" class of investors who alleged that BP misrepresented the company's internal estimates of the flow rate of the oil spill, which lasted 87 days. Those decisions are beyond the scope of this article.) The Fifth Circuit denied the pre-spill plaintiffs a rehearing en banc. On Jan. 25, the plaintiffs filed a petition for a writ of certiorari, asking that the U.S. Supreme Court determine whether *Comcast's* common damages burden applies to securities fraud class actions invoking the fraud-on-the-market presumption and to "clarify the scope of inquiry into the merits of a damage model at class certification."

The Fifth Circuit's Decion

As described in the Fifth Circuit's opinion, the pre-spill plaintiffs claimed that, prior to the spill, BP made statements "suggesting that [it] had made safety and process improvements that [it] had not actually implemented," and that such assurances "lulled the market into believing that BP was a safer company than it actually was." Relying on a "materialization-of-the-risk" damages theory, the plaintiffs alleged that "BP had understated the risk of catastrophe, and when that risk materialized, [the plaintiffs] could recover its resulting damages." The plaintiffs argued that "the economic effects of the spill, as captured by the fall in BP's stock price after the spill occurred, were the 'foreseeable consequences of the materialized misstated risk.'" Accordingly, the plaintiffs sought recovery of "the entire fall in stock price caused by materialization of the risk of the spill." Because the parties did not dispute that the proposed pre-spill class met the requirements of Federal Rule of Civil Procedure 23(a) for class certification, the court focused only on Rule 23(b)(3), which requires "that the questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy." Specifically, the court assessed whether, as required under *Comcast*, the plaintiffs' damages methodology was "susceptible of measurement across the entire class for purposes of Rule 23(b)(3)." The Fifth Circuit concluded that the district court did not abuse its discretion in holding

that the plaintiffs' damages model was not capable of classwide measurement. As the court explained: "[Plaintiffs'] theory hinges on a determination that each plaintiff would not have bought BP stock at all were it not for the alleged misrepresentations—a determination not derivable as a common question, but rather one requiring individualized inquiry."

The court illustrated its reasoning with a comparison between two hypothetical investors: a low-risk pension fund that does not invest in companies where the risk of a catastrophic event is greater than 1 percent, and a high-risk fund whose risk threshold is more than 2 percent. In the court's hypothetical, the low-risk fund "would not have bought BP stock at all had it known the true risk of catastrophe. This is the type of plaintiff the materialization-of-the-risk theory is designed to compensate." The high-risk fund, however, "still might have purchased the stock, even had it known the 'true' risk, though presumably at a lower price that accounted for the increased risk." Importantly, "for the second type of plaintiff, full materialization-of-the-risk damages would prove a windfall." And because the plaintiffs' damages methodology "did not provide any mechanism for separating these two classes of plaintiffs," the court concluded that the model "cannot provide an adequate measure of class-wide damages under *Comcast*."

In reaching this decision, the court rejected the plaintiffs' argument that, because they had met their burden of establishing a fraud-on-the-market presumption of reliance allowed under *Basic v. Levinson*, 485 U.S. 224 (1988), they were entitled to a presumption that BP's alleged misrepresentations were a cause-in-fact of their losses. As the court explained: "The fraud-on-the-market theory does not provide any presumptions with regard to loss causation. . . . And here, where the economic loss depends on the posture of the plaintiff vis-à-vis risk tolerance, that loss causation, and thus damage, cannot be presumed nor can it be found class-wide." Indeed, as the court further opined, the plaintiffs' own damages model—which asserted that the plaintiffs "relied on something other than price: risk"—may have, in effect, rebutted the fraud-on-the-market presumption.

Plaintiffs' Petition For Supreme Court Review

In their petition, the plaintiffs ask that the Supreme Court review the following questions presented:

"1. Whether a classwide flaw in a damage model defeats predominance and precludes class certification under *Comcast v. Behrend* when damages are nonetheless capable of measurement on a classwide basis.

2. Whether *Comcast* applies to securities fraud class actions invoking the fraud-on-the-market presumption.”

The plaintiffs argue in their petition that the Fifth Circuit inappropriately examined the merits of their proposed damages model and that such approach was “particularly erroneous” in this case since the plaintiffs had invoked the fraud-on-the-market presumption of reliance allowed under *Basic*. According to the plaintiffs: “When the *Basic* presumption applies, damages will always be formulaic. Using the wrong formula at the class certification stage does not undermine the truth that a correct, classwide formula exists.” The plaintiffs further contend that, by focusing on the correctness of their damages model, the Fifth Circuit improperly “reintroduce[d] questions of loss causation into class certification.” As their petition explains: “One cannot evaluate the correctness of a damage model without evaluating what losses were caused by the defendant. For this reason, reading *Comcast* to require examination of a classwide damage model invites courts to evaluate loss causation at the stage of class certification.”

The plaintiffs acknowledge in their petition that the Fifth Circuit’s interpretation of *Comcast* as imposing a “common damages burden” on all parties seeking class certification joins the D.C. Circuit’s decision in *In re Rail Freight Fuel Surcharge Antitrust Litigation*, MDL No. 1869, 725 F.3d 244 (D.C. Cir. 2013) (holding that *Comcast* requires proof of injury on a classwide basis before certification). But they also point out that the Third, Sixth and Seventh circuits have declined to apply the *Comcast* standard in non-antitrust cases. None of those decisions involved securities fraud claims, however. Moreover, the Third Circuit cited an earlier Fifth Circuit class certification opinion, *In re Deepwater Horizon*, 739 F.3d 790, 815 & n.104 (5th Cir. 2014), in support of its decision not to apply the *Comcast* standard in *Neale v. Volvo Cars of North America LLC*, 794 F.3d 353, 374-75 (3d Cir. 2015), which involved consumer claims against Volvo for a uniform design defect. As the Fifth Circuit itself explained in *Ludlow*, its prior decision in *Deepwater Horizon*, a nonsecurities case, “applies only to classes where predominance was based on the commonality of liability, not, as here, liability and damages, where we ask whether in operation the commonality is undone by the damages theory.”

Unless and until the Supreme Court decides the questions presented by the plaintiffs’ petition in *Ludlow*, lower courts will continue to grapple with whether the *Comcast* common damages burden applies in securities fraud cases. Given this current state of uncertainty, plaintiffs should be prepared to present at the class certification stage a damages model that meets the *Comcast* standard.