

From Justice Kennedy To Justice Kavanaugh

Is a Shift in Securities Law Underway?

by Michael Mathai and Kate Aufses

The change in the makeup of the Supreme Court may portend significant changes in investor rights in years to come. Which way will Kavanaugh lean on securities law?

On October 6, 2018, Justice Brett M. Kavanaugh was sworn in as the newest Associate Justice of the Supreme Court, assuming the seat recently vacated by retiring Justice Anthony Kennedy. During his 30-year tenure on the Court, Justice Kennedy joined both pro-investor and anti-investor decisions, though on balance, he tended to side against plaintiff investors in federal securities cases. By contrast, during Justice Kavanaugh's twelve years as a judge on the DC Circuit Court of Appeals, he appears to have taken a decidedly more negative view of federal investor protections than Justice Kennedy did. The change in staffing on the high court may portend significant changes in investor rights in years to come.

While Justice Kennedy was not a particularly vocal jurist in the realm of securities litigation, in the last decade, he authored majority opinions in two significant securities cases — *Stoneridge Investment Partners v. Scientific-Atlanta, Inc.* (2008) and *CalPERS v. ANZ Securities, Inc.* (2017).

Both of these decisions curtailed investors' ability to enforce the federal securities laws. In *Stoneridge*, the Court broke from long-standing precedent among the lower courts and held that investors cannot hold lawyers and accountants liable as "aiders and abettors" of a company's scheme to commit securities fraud. More recently, Justice Kennedy's majority opinion in *ANZ Securities* limited the amount of time that investors can take to decide whether they will remain part of a securities class action or, instead, file their own individual suit. As we have explained in previous editions of *The Advocate*, this ruling limits investors' options and, in certain circumstances, forces them into tough choices regarding litigation strategy.

At the same time, Justice Kennedy joined several pro-investor opinions that the Supreme Court has issued over the years. For example, Justice Kennedy joined the Court's unanimous 2011 *Matrixx* opinion, which explained several ways in which the Securities Exchange Act of 1934



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Justices Brett Kavanaugh and Anthony Kennedy at Kavanaugh's swearing in. (Photo by Fred Schilling/Supreme Court of the United States via Getty Images)

contains strong protections for plaintiff investors. Justice Kennedy also joined the Court's majority in the 2007 *Tellabs* decision, which reiterated the Court's long-held view that private securities class actions under the Exchange Act are an "indispensable tool" for regulating the US public securities markets. *Tellabs* also set forth a reasonable standard for investors to follow when pleading violations of the Exchange Act, rejecting the calls of Justices Scalia and Alito, who favored a higher pleading standard for investors who seek redress for such violations.

As a judge on the DC Circuit Court of Appeals, Justice Kavanaugh, by contrast, has not built any substantial record of supporting investor rights. Rather, Judge Kavanaugh regularly affirmed orders dismissing private suits by institutional investors to enforce the federal securities laws. For example, in *In re InterBank Funding Corp. Securities Litigation*, he was a member of a panel that affirmed

the dismissal of securities claims because, contrary to the investor's view, he believed the investor was required to plead a reliance on alleged misrepresentations, but failed to do so. Similarly, in *Wu v. Stomber*, Judge Kavanaugh authored an opinion affirming dismissal of securities claims. The opinion disagreed with investors regarding what company disclosures were pertinent, and held that "reasonable" investors "surely would have paid close attention" to certain supplemental disclosures relating to a securities offering that contained corrective information. Judge Kavanaugh has also authored opinions affirming dismissals of corporate governance actions, including in *Pirelli v. Raines*. In *Pirelli*, the court affirmed the dismissal of derivative claims for failing to first make a demand on the board of directors, reasoning that the investors did not meet the "stringent" standards for such claims under Delaware law.

Justice Kavanaugh's most well-known authorship on a securities case while serving as a judge on the DC Circuit may be his dissent in *Lorenzo v. SEC*. In *Lorenzo*, a two-judge majority affirmed a ruling that an investment banker was liable for a scheme to mislead investors by emailing false and misleading statements to investors. Then-Judge Kavanaugh dissented from the majority, disputing what he viewed as an overly aggressive application of the federal securities laws. He wrote that the investment banker should not be held liable because the banker's boss—not the banker—had drafted the emails in question and asked the banker to send them to clients. Judge Kavanaugh disagreed with the factual finding by the judge who handled the case that the banker's actions were "willful." He also disagreed with the SEC's characterization of the facts, and called into question the heavy sanctions imposed on the investment banker, including a lifetime ban from the securities industry. "So much for a fair trial," he lamented, expressing a surprising amount of sympathy for an investment banker who had sent false and misleading statements to investors.

The comparison of Justice Kennedy's and Justice Kavanaugh's records regarding federal securities claims suggests that corporate management may well view Justice Kavanaugh's confirmation to the Supreme Court as welcome news. While this change to the Supreme Court's makeup may ultimately result in no significant change in the Court's view of the federal securities laws—depending on the cases brought, the makeup of the Court at the time, and the issues to be de-

ecided—evidence suggests that Justice Kavanaugh may be more skeptical of private securities actions than Justice Kennedy was. In this context, it remains incumbent on institutional investors to employ experienced counsel and sound strategy in seeking to enforce the protections of the securities laws in federal courts.

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