Expect Focus Life Insurance, December 2018

Class Certification Denied in Suitability Class Action

LIFE, ANNUITY, AND RETIREMENT LITIGATION | CLASS ACTIONS | LIFE, ANNUITY, AND RETIREMENT SOLUTIONS | SECURITIES & INVESTMENT COMPANIES | SECURITIES TRANSACTIONS AND COMPLIANCE | INSURANCE | DECEMBER 18, 2018

Todd M. Fuller

The Southern District of New York recently declined to certify a class in a suit relating to investments in certain closed-end mutual funds, holding that individual questions overwhelmed the class-wide questions in contravention of the typicality and predominance requirements of Federal Rule of Civil Procedure 23.

In *Fernandez v. UBS AG* , plaintiffs brought a putative class action alleging that their broker-dealer, UBS, breached its client agreement by failing to perform any suitability analyses in connection with plaintiffs' investment in certain mutual funds. The mutual funds, which contained a high percentage of Puerto Rico government bonds, were downgraded to junk bond status and ultimately collapsed as a result of Puerto Rico's financial crisis. Plaintiffs sought to certify a class of all investors that purchased the highly leveraged mutual funds. Recognizing the inherently individualized nature of whether an investment was suitable for a particular client, plaintiffs alleged that their claim was not a standard suitability claim – i.e., that the investment was not suitable – but rather simply that UBS was obligated to conduct a suitability analysis and failed to do so, regardless of whether the investment was suitable or not. Plaintiffs argued that by focusing on the conduct of UBS, together with a representative sample of client accounts, common proof could establish whether UBS failed to conduct suitability analyses for putative class members. The court disagreed.

With respect to Rule 23's typicality requirement, the court explained that the manner in which UBS allegedly failed to perform a suitability analysis before recommending the mutual funds was different for each class member, thus making each proposed class member's claim unique. The court noted that the review conducted by plaintiffs' own expert reflected that UBS's alleged suitability failures were far from uniform and depended largely on the investment needs and objectives of each individual investor. As a result, the court held that typicality was not satisfied.

With respect to Rule 23's predominance requirement, the court concluded that although the nature of UBS's duties pursuant to the suitability provision in the client agreement was a common issue, that single common issue was substantially outweighed by numerous individual questions. The court explained that the issue of whether UBS breached the client agreement by failing to perform any suitability analysis could only be resolved on a client-by-client, or transaction-by-transaction, basis. For example, the court noted that, like the typicality analysis, there were individual issues with respect to the alleged breach because each investor had unique circumstances, objectives, risk tolerances, needs, and investment experience that would need to be examined.

Plaintiffs nevertheless argued that generalized proof could be used to demonstrate that the mutual funds were not suitable per se, and that such evidence would answer the question of whether UBS breached its contractual obligation to plaintiffs. In other words, plaintiffs argued that if the funds were not suitable for any reasonable investor, and UBS recommended them anyway, it would be clear that UBS did not undertake any suitability analysis before making the recommendations. The court, however, disagreed, noting that plaintiffs' efforts to prove that the funds were unsuitable per se were unrealistic and misplaced. In particular, the court determined that plaintiffs' attempt to prove that the funds were not structured in accordance with one of the enumerated objectives set forth in the funds' prospectuses was not proof of inherent unsuitability, because a fund which is not suitable for one enumerated objective may nonetheless be suitable for another. Indeed, the court explained it would be illogical to elevate one of the funds' objectives for evaluation in isolation because the other fund objectives may be equally or more important to other investors. The court also explained that UBS's alleged concern about the funds' riskiness was not proof that UBS failed to conduct a product-focused suitability analysis, because a security that is excessively risky for one investor is not proof that the security is excessively risky or unsuitable for all investors. The court held that these questions would not provide a common answer to whether UBS breached the suitability provision of the client agreement.

The court also noted that individualized issues would predominate with respect to causation, affirmative defenses, and damages. The court explained that causation was not subject to generalized proof because each plaintiff would be required to prove that the mutual funds were actually unsuitable for them. The court noted that affirmative defenses, such as failure to mitigate and duty to object, would also require individualized proof particularly where some members of the proposed class opted to hold their investments in the funds in the face of a recommendation to sell, and other investors failed to comply with their obligation to alert their broker if they believed the investment was unsuitable. As to damages, the court concluded that plaintiffs' damages model failed to measure only those damages attributable to the theory of liability they were advancing – proposing a measure of damages that is "yet another issue subject only to individualized proof."

Accordingly, the court denied plaintiffs' motion to certify, concluding "that the sole question of law or fact common to members of the proposed class [was] significantly outweighed by a number of questions affecting only individual members."