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Federal Court Grants Class Certification in the LendingClub Case Over Objections from State Court Plaintiffs, But Denies Federal Court Plaintiff's Motion to Enjoin the State Court Case

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Class Action Recovery for Mutual Funds

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LendingClub is facing two parallel securities litigation cases stemming from alleged false statements it made in connection with its initial public offering ("IPO"). One case is proceeding in the U.S. District Court for the Northern District of California (the "federal court case"), while another, filed about three-months before the Federal Court Case, is pending in the Superior Court of the State of California, County of San Mateo (the "California state court case"). As we have discussed in prior posts (here, here and here), plaintiffs generally allege that LendingClub's registration statement issued in connection with the IPO misrepresented the strength of LendingClub's internal control procedures and misrepresented that LendingClub used a "sophisticated risk assessment" process to evaluate potential borrowers. The federal court case raises claims under Sections 11 and 15 of the Securities Act and Section 10(b), Rule 10b-5 and Section 20(a) of the Exchange Act, while the California state court case asserts claims under Sections 11, 12(a)(2) and 15 of the Securities Act.

In June of 2017, the judge overseeing the California state court case certified a class. Meanwhile, before the state court case plaintiffs sent a notice of class certification, in the federal court case, the lead plaintiff filed a motion for class certification, seeking to certify a class consisting of "[a]ll persons and entities who purchased o otherwise acquired the common stock of LendingClub during the period from December 11, 2014 through May 6, 2016." As expected, LendingClub (and the individual director defendants) filed an opposition to the motion. However, in a somewhat rare move, the lead plaintiff in the California state court case filed a motion to intervene in the federal court case and also filed an opposition to the federal court plaintiff's motion for class certification. In response, the federal court plaintiffs asked the federal court to enjoin the California state court case.

BATTLE BETWEEN STATE AND FEDERAL COURT THE LEAD PLAINTIFFS

With respect to the motion to intervene, the federal court granted the motion, for the limited purpose of allowing the state court case plaintiffs the opportunity to "set forth their argument for why they are the better representative" of the class. Additionally, the federal court granted the motion to intervene "on the condition that they remain under this Court's jurisdiction so that the undersigned judge may coordinate their action with the federal action to avoid any prejudice to absent class members." Concerning such coordination, the federal court noted:

> To a limited degree, such coordination is already underway. At the hearing on this motion, state

> plaintiffs agreed they will participate in the settlement conference before Chief Magistrate Judge Joseph Spero on November 28, and have further assured the undersigned judge that they will not send class notification until this order issued. Moreover, state plaintiffs agreed that they will not discuss settlement (except at the settlement conference) until the Supreme Court issues a decision in *Cyan, Inc. v. Beaver Cty. Employees Ret. Fund*… which decision has the potential to jeopardize their case by revoking state court jurisdiction over Securities Act claims.

The California state court plaintiff then argued that class certification should be denied in the federal court case because certain theories of recovery that were dismissed in the federal court case remained active in the California state court case, making the state court case "superior." They contended their additional Section 11 theories could increase their potential recovery by at least $200 million because Section 11(e) provides that if a defendant can show that any portion of the plaintiff's claimed damages arise from something other than their claimed theory of liability, "such portion of or all such damages shall not be recoverable."

The federal court plaintiffs responded that their proposed class was in fact superior because the price of LendingClub's stock was lower on the day they brought the federal suit. Specifically, under Section 11 damages are limited to "the difference between the amount paid for the security … and [] the value thereof as of the time such suit was brought." The state plaintiffs' filed their Section 11 suit when the closing price of LendingClub's stock was $8.41 per share. The day the federal plaintiffs filed suit LendingClub's stock closed at $3.94 per share. Therefore, the federal plaintiffs asserted that the state plaintiffs were foreclosed from pursuing $4.47 per share that is available to the federal plaintiffs. The federal court sided with the federal plaintiffs, holding the federal case was superior because the different stock prices on the days the suits were filed "presents a difficult issue (not decided here) that could seriously hamper state plaintiffs, limiting their damages to a number well below that of our plaintiff."

The federal court next declined to enjoin the California state court case. The federal plaintiffs argued that an injunction was expressly authorized by the Private Securities Litigation Reform Act (PSLRA) and necessary to prevent the California state court from "seriously impair[ing] the federal court's flexibility and authority to decide [the] case." The federal court declined to enjoin the California state court case. However, it did express "concerns" with "the current form of state plaintiffs' class notice, which fails to notify class members of the parallel federal action, the pendency of *Cyan* and its potential effect on their case, or the potential that the filing date of their suit could substantially limit damages." (Our discussion of the *Cyan* case can be found here.) To alleviate these concerns the federal court ordered:

> Specifically, the notices must inform class members of the following:
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> (1) There are two lawsuits proceeding in parallel, one in state and one in federal court, which overlap in certain respects and not in others;
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> (2) Some important differences between these suits include:
>
> (a) the state action maintains certain theories of liability under which the class may be granted relief including as a result of LendingClub's allegedly usurious loan rates, and alleged problems with LendingClub's loan application procedures. The federal action does not contain these theories of liability and, therefore, risks a lower recovery depending upon whether defendants can successfully show that damages should be attributed to the state theories;
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> (b) class members in the federal action are potentially entitled to a greater recovery based upon the date federal lead plaintiff filed its action. Whether the state class members are entitled to this recovery remains uncertain; and,
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> (c) the state action may be subject to dismissal depending upon the outcome of *Cyan, Inc. v. Beaver Cty. Employees* Ret. Fund, _U.S. _, 137 S. Ct. 2325 (2017), a case currently pending before the United States Supreme Court, which challenges state courts' jurisdiction over the claims that state plaintiffs have asserted in this action; and,
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> (3) Class members will be notified of any settlement in either action, at which point they will have an opportunity to opt out of the settlement if they elect to do so.

TRACEABILITY

Lastly, the federal court addressed an issue of first impression raised by LendingClub and the individual defendants regarding the traceability of the federal plaintiffs shares. LendingClub argued that the lead plaintiff in the federal court case was not "typical" of class members because it was open to specific defenses, including that because it purchased some shares that were not traceable to the offering. Notably, LendingClub issued 295 million shares via a private offering prior to the IPO. LendingClub then issued 67 million shares in the IPO. The registration statement specified a 180-day "lock-up" period, beginning on December 11, 2014, during which only IPO shares were available to the public. When the lock-up period ended on June 9, 2015, both IPO and non-IPO shares became available on the open market. Therefore, the federal court ruled that only shares that were purchased in the IPO or on the open market before the end of the lock-out period on June 9, 2015 were traceable to the allegedly misleading offering materials. It was undisputed that the lead plaintiff did not purchase any privately issued shares prior to the IPO or during the lock-out period. It was also undisputed that it purchased and sold hundreds of thousands more shares during the post-lock-up market period than it had purchased in the lock-up period.

Because of this trading pattern, the traceability of the lead plaintiffs shares turned on whether the court adopted a "last-in, first-out" ("LIFO") or "first-in, first-out" ("FIFO") method to calculate holdings. If the lead plaintiff's transactions were accounted for using LIFO, all of its holdings as of the end of the lock-out period would remain traceable to the lock-up period. If, however, the court adopted a FIFO calculation, the lead plaintiff would have been deemed to have owned no shares traceable to the IPO. First, the court noted that "[w]hether LIFO or FIFO applies is a matter of first impression in the Section 11 traceability context." The court ultimately held that LIFO applied because the majority of courts use the LIFO method to estimate losses under the PSLRA when determining a putative lead plaintiff's stake in the litigation, and "[i]t would be incongruous to measure losses by one method, yet measure traceability by the opposite method." The court highlighted its reasoning by noting "[a] lead plaintiff who suffered the greatest losses under a Section 10(b) claim might also be deemed to lack standing under a Section 11 claim based on such an incongruity." Accordingly, the court held that the lead plaintiff could trace its shares to the IPO, and ordered that the plaintiffs adjust the class definition to only include those who purchased shares prior to the end of the lock-up period.