Milbank

Litigation

Beijing Frankfurt Hong Kong London Los Angeles Munich New York Singapore Tokyo Washington, DC

December 8, 2008

SECOND CIRCUIT LIMITS ABILITY OF INVESTMENT ADVISORS TO SUE ON BEHALF OF THEIR CLIENTS

The United States Court of Appeals for the Second Circuit issued an important decision last week limiting the ability of investment advisors to sue on behalf of their clients under federal securities laws. In reversing a lower court decision, the Second Circuit held that an investment advisor that has the discretionary authority to make investment decisions on its client's behalf and the power of attorney to file suit on its client's behalf, but does not have ownership or title of the claim itself, lacks constitutional standing to bring a securities action in a representative capacity on behalf of that client. The Court's decision in *W.R. Huff Asset Management Co. v. Deloitte & Touche*[1] is the Second Circuit's first interpretation of the standing requirements under Article III of the Constitution since the United States Supreme Court relaxed those requirements in *Sprint Communications Co., L.P. v. APCC Services, Inc.*[2]

The Facts and Proceedings Below

The case arose out of Adelphia Communication's implosion into bankruptcy in 2002. Plaintiff W.R. Huff Asset Management Co., LLC ("Huff"), an investment advisor for institutional investors and pension funds, provided investment advice to its clients and purchased Adelphia securities on their behalf. As a result of Adelphia's collapse, Huff's clients suffered significant financial losses, but Huff itself was not an investor in Adelphia. Huff brought suit as "the investment advisor and attorney-in-fact" on behalf of its clients against firms that provided underwriting, auditing, and legal services to Adelphia, alleging that they were complicit with the misleading disclosures in Adelphia's financial statements in violation of sections 11 and 12(a)(2) of the Securities Act of 1933 and sections 10(b) and 18 of the Securities Exchange Act of 1934.[3]

Defendants moved to dismiss the complaint, challenging Huff's constitutional standing to sue on behalf of its investment clients. The District Court initially decided that Huff's status as attorney-in-fact satisfied the requirements of constitutional standing.[4] Defendants brought a motion for reconsideration, citing the Second Circuit's decision in *Advanced Magnetics, Inc. v. Bayfront Partners, Inc.*, which held that a company that possessed powers of attorney from shareholders, but did not have a valid assignment of the shareholders' claims, lacked constitutional standing to sue on behalf of the shareholders.[5] The District Court adhered to its original decision on the ground that not only was Huff an attorney-in-fact, but he was also an investment advisor with complete

[1] *W.R. Huff Asset Management Co. v. Deloitte & Touche*, Nos. 06-1664-cv(L), 06-1749(con) (2d Cir. December 3, 2008).
[2] *Sprint Communications Co., L.P. v. APCC Services, Inc.*, 554 U.S. __, 128 S.Ct. 2531 (2008).
[3] *Huff*, at 4.
[4] *See Huff I*, 2005 WL 2087811, at *3.
[5] *Advanced Magnetics, Inc. v. Bayfront Partners, Inc.*, 106 F.3d 11, 17-18 (2d Cir. 1997).

For further information about this Client Alert, please contact:

Sander Bak
(212) 530-5125
sbak@milbank.com

Patrick Marecki
(212) 530-5653
pmarecki@milbank.com

You may also contact any member of Milbank's Litigation Group. Contact information can be found at the end of this Client Alert or on Milbank's website at: http://www.milbank.com/en/PracticeAreas/LitigationArbitration_alpha.htm

discretion to make investment decisions.[6] Defendants appealed, and, while the appeal was pending, the United States Supreme Court held in *Sprint* that an assignee who holds legal title to an injured party's claim has constitutional standing to pursue that claim, even if the assignee agreed to remit all proceeds from the litigation to the assignor.[7]

The Decision on Appeal

The Second Circuit's analysis focused on the injury-in-fact element of Article III standing, which requires a "concrete and particularized harm to a legally protected interest."[8] Huff had not alleged any injury, and brought suit based only on injuries suffered by its clients, so the dispositive question faced by the Court was whether Huff could demonstrate injury-in-fact through an assignment of claims.[9]

The Court discussed its ruling in *Advanced Magnetics*, where injured parties had assigned to the named plaintiff "the power to commence and prosecute" lawsuits.[10] The Court noted that although the injury-in-fact requirement can be satisfied where a party with standing assigns its claims to a third party who stands in place of the injured party, the assignor, to do so, must transfer the *entire interest* in the subject of the assignment.[11] The transfer in *Advanced Magnetics* did not meet this standard because it did not transfer title or ownership of the claim to the assignee. Because the assignor retained the right to terminate the assignee's authority to pursue the claims, the assignment "amounted to little more than a grant of a power of attorney," which is not sufficient to confer standing.[12]

The Second Circuit found that *Advanced Magnetics* survived the Supreme Court's decision in *Sprint*, which held that assignees of legal claims have standing to pursue those claims, even where the assignees were to remit all the proceeds of the litigation to the assignors.[13] Interpreting *Sprint*, the Second Circuit found that "the minimum requirement for injury-in-fact is that the plaintiff have legal title to, or a property interest in, the claim."[14] The Court explained that "*Sprint* therefore implicitly supports the holding of *Advanced Magnetics* that a mere power-of-attorney…does not confer standing to sue in the holder's own right because a power-of-attorney does not confer an ownership interest in the claim."[15] Because Huff's power-of-attorney did not confer legal title to the claims it brought, it did not have standing to pursue them.

The Second Circuit also rejected Huff's argument that it qualified for a prudential exception to the injury-in-fact requirement because of its authority to make investment decisions on behalf of its clients. It found that the investment advisor-client relationship is not the type of close relationship that creates a prudential exception, and that Huff's clients had the ability to protect their own interests and were not dependant on Huff's standing claim to do so.[16]

Finally, the Second Circuit rejected any notion that Huff satisfied the injury-in-fact requirement because of injuries it had personally suffered in its capacity as investment advisor. Huff argued that its reputation had been sullied and that it suffered "informational injury" by relying on untruthful information provided by Adelphia, but the appeals court held that those allegations were insufficient to meet the standing requirements. As Huff had brought suit on behalf of its clients, not itself, the remedies sought in the complaint would not redress these alleged injuries.[17]

The Decision's Implications

The import of the Second Circuit's decision, which extends beyond the Section 10(b) context, is that it places clear limits on the ability of a third-party to contract into lawsuits where the third-party suffers no actual injury and has no direct economic interest in the outcome of the lawsuit. By requiring, at a minimum, that a party have legal title to or a property interest in the claim, the Court made clear that nothing short of a valid assignment of a claim is sufficient to fulfill the constitutional requirement of an injury-in-fact.[18] If an injured client does not transfer to its advisor ownership of, or title to, its claims, that advisor will be barred from conducting litigation in its representative capacity on behalf of the client.

* * * * * * * * *

[6] *See Huff II*, 2005 WL 2667201, at *1.
[7] *Sprint Communications*, 554 U.S. __, 128 S.Ct. 2531, 2542-44 (2008).
[8] *Huff*, at 8.
[9] *Huff*, at 9.
[10] *Advanced Magnetics*, 106 F.3d at 18.
[11] *Huff*, at 9.
[12] *Huff*, at 9-10.
[13] *Sprint Communications*, 554 U.S. __, 128 S.Ct. 2531, 2533.
[14] *Huff*, at 10.
[15] *Huff*, at 11.
[16] *Huff*, at 13.
[17] *Huff*, at 13-14.
[18] *Huff*, at 10-11.

Milbank

For further information about this client alert, please visit our website at www.milbank.com or contact one of the Litigation partners listed below.

New York		
Wayne M. Aaron	212-530-5284	waaron@milbank.com
Thomas A. Arena	212-530-5328	tarena@milbank.com
Sander Bak	212-530-5125	sbak@milbank.com
Jeffrey Barist	212-530-5115	jbarist@milbank.com
James N. Benedict, *Chair*	212-530-5696	jbenedict@milbank.com
George S. Canellos	212-530-5174	gcanellos@milbank.com
James G. Cavoli	212-530-5172	jcavoli@milbank.com
Christopher E. Chalsen	212-530-5380	cchalsen@milbank.com
Scott A. Edelman	212-530-5149	sedelman@milbank.com
David R. Gelfand, *Practice Group Leader*	212-530-5520	dgelfand@milbank.com
John M. Griem, Jr.	212-530-5429	jgriem@milbank.com
Douglas W. Henkin	212-530-5393	dhenkin@milbank.com
Michael L. Hirschfeld	212-530-5832	mhirschfeld@milbank.com
Lawrence T. Kass	212-530-5178	lkass@milbank.com
Sean M. Murphy	212-530-5688	smurphy@milbank.com
Michael M. Murray	212-530-5424	mmurray@milbank.com
Stacey J. Rappaport	212-530-5347	srappaport@milbank.com
Richard Sharp	212-530-5209	rsharp@milbank.com
Alan J. Stone	212-530-5285	astone@milbank.com
Errol B. Taylor	212-530-5545	etaylor@milbank.com
Andrew E. Tomback	212-530-5971	atomback@milbank.com
Fredrick M. Zullow	212-530-5533	fzullow@milbank.com
Washington, DC		
David S. Cohen	202-835-7517	dcohen2@milbank.com
Robert J. Koch	202-835-7520	rkoch@milbank.com
Andrew M. Leblanc	202-835-7574	aleblanc@milbank.com
Michael D. Nolan	202-835-7524	mnolan@milbank.com
William E. Wallace, III	202-835-7511	wwallace@milbank.com
Los Angeles		
Linda Dakin-Grimm	213-892-4404	ldakin-grimm@milbank.com
Gregory Evans	213-892-4488	gevans@milbank.com
Jerry L. Marks	213-892-4550	jmarks@milbank.com
Daniel Perry	213-892-4546	dperry@milbank.com
Mark Scarsi	213-892-4580	mscarsi@milbank.com
London		
David Perkins	44-20-7615-3003	dperkins@milbank.com