March 28, 2017

Second Circuit Signals That a Bare Violation of a Disclosure Statute Will Not Confer Standing

In a February 23, 2017 summary decision in *Ross* v. *AXA Equitable Life Insurance Company* and three companion cases heard in tandem,[1] the United States Court of Appeals for the Second Circuit affirmed the dismissals of putative class actions under a New York State anti-fraud insurance statute for failure to allege injury-in-fact. The decision in *Ross* continues the narrowing of standing doctrine with respect to purported violations of disclosure requirements carrying statutory penalties. *Ross* confirms that defendants facing alleged disclosure violations for which the relevant statute provides statutory damages or statutory penalties without proof of actual damage can successfully defeat such claims at the threshold, on a Rule 12 motion to dismiss, where plaintiffs fail to articulate a credible theory of actual or imminent injury. Such a strategy can—as in *Ross* and its companion cases—cut off putative class claims seeking billions of dollars at their inception.

Ross is the Second Circuit's latest analysis of the issues left open by the Supreme Court's decision last Term in *Spokeo, Inc.* v. *Robins*, 136 S. Ct. 1540 (2016). In *Spokeo*, the Supreme Court held that, while Congress may make an injury "legally cognizable" by creating a statutory cause of action, a plaintiff must still articulate a "real," "*de facto*" injury caused by the statutory violation.[2] The Supreme Court left unresolved, however, what allegations will suffice to plead Article III standing in such circumstances. Before its decision in *Ross*, the Second Circuit had most recently addressed that question in *Strubel* v. *Comenity Bank*, 842 F.3d 181 (2d Cir. 2016). In *Strubel*, reviewing the district court's grant of summary judgment, the Second Circuit had considered four alleged statutory violations of the federal Truth in Lending Act, which requires specific disclosures to consumers about their credit information and provides for statutory damages to redress violations. *Strubel* held that two of the violations conferred standing, even though the plaintiff had not suffered any direct injury as a result, because the alleged nondisclosures related to information that the statute specifically required the lender to give consumers concerning the *consumers'* obligations.[3] The nondisclosure itself thus gave rise to a "real risk of harm," because a

---

1 The four cases before the Second Circuit were *Ross* v. *AXA Equitable Life Insurance Co.*, No. 15-2665, *Robainas* v. *Metropolitan Life Insurance Co.*, No. 15-3504, *Intoccia* v. *Metropolitan Life Insurance Co.*, No. 15-4189, and *Yarbrough* v. *AXA Equitable Life Insurance Co.*, No. 15-3553. Paul, Weiss represented AXA Equitable Life Insurance Company before the district courts and on appeal in the *Ross* and *Yarbrough* cases.

2 *Id.* at 1549, 1551.

3 *Id.* at 190.

consumer would be unlikely to meet obligations of which he or she was unaware.[4] The other two violations, however, did not confer standing, because the plaintiffs did not allege that those violations could have adversely affected (or did so affect) their behavior and asserted no injury beyond the bare violation.[5]

Ross builds upon *Spokeo* and *Strubel* by holding that a bare violation of a general anti-fraud statute—in *Ross*, New York Insurance Law Section 4226, which provides a private right of action against an insurer that misrepresents its financial condition—is not sufficient to invoke federal jurisdiction without a concrete injury-in-fact. The decision in *Ross* confirms that courts in the Second Circuit will take a hard look at Article III standing on a motion to dismiss when considering lawsuits that allege violations of statutes intended to police companies' disclosures, whether the laws in question require specific disclosures, as in *Strubel*, or generally prohibit misrepresentations, as in *Ross*. That the statute does not itself require actual damages is of no moment, because Article III standing is a constitutional requirement that a legislature cannot circumvent.

BACKGROUND

In *Ross* and its companion cases (collectively, the "Captive Reinsurance Cases"), the Second Circuit considered appeals from the decisions of three judges in the Southern District of New York dismissing four actions, all alleging violations of Section 4226. The cases challenged the defendant insurers' use of captive reinsurance, a common capital management tool in the life insurance industry through which an insurer cedes portions of its risk to an affiliate.

The plaintiffs filed these cases on the heels of a position paper issued in June 2013 by the New York State Department of Financial Services ("NYDFS") arguing that captive reinsurance places the stability of the broader financial system at greater risk and should be more stringently regulated (the "NYDFS Report"). In that paper, however, NYDFS did not find that any insurer it had studied had violated any statute or regulation, nor did it suggest that any of the insurers studied were facing any imminent risk of financial distress due to their use of captive reinsurance—but it noted that the use of captive reinsurance improved insurers' "risk-based capital ratios," a statutory measure of their financial strength, without actually increasing their capital.

Section 4226 provides a private right of action to any policyholder "aggrieved" by an insurer who has "ma[d]e any misleading representation, or any misrepresentation of [its] financial condition." N.Y. Ins. Law § 4226. An aggrieved policyholder may recover a statutory penalty in the amount of the premium paid to the insurer.

---

[4] *Id.*

[5] *Id.* at 191–94.

The plaintiffs in the Captive Reinsurance Cases alleged on behalf of putative classes of policyholders that two insurers—AXA Equitable Life Insurance Company and Metropolitan Life Insurance Company—violated Section 4226 by failing to disclose to NYDFS certain details of their captive reinsurance transactions, despite the absence of any specific legal requirement to do so. Notably, however, plaintiffs did not allege that they would not have purchased the policies if they had been aware of the undisclosed information.

Plaintiffs argued that the insurers' nondisclosure caused the financial metrics that the insurers reported to NYDFS, such as their risk-based capital ratios, to be misrepresented and claimed that the insurers were therefore less financially stable than represented. Plaintiffs hypothesized that in a severe economic downturn, the insurers would have less capital to meet their policyholder obligations than reported.

The Captive Reinsurance Cases were heard separately by three district court judges, and all were dismissed on Rule 12 motions on the ground that plaintiffs had failed to allege actual or imminent harm sufficient to satisfy the injury-in-fact requirement for standing under Article III.[6]

THE SECOND CIRCUIT DECISION

On February 23, 2017, eight days after oral argument, the Second Circuit issued a summary order affirming the dismissals in all four cases. The court agreed with the district courts that the plaintiffs had failed to allege actual or imminent harm sufficient to satisfy the injury-in-fact requirement of Article III.

The panel first considered the plaintiffs' argument that the injury inherent in a violation of Section 4226, without more, could satisfy the constitutional requirement of injury-in-fact. The panel held that, as with the two violations in *Strubel* that were found not to pose any material risk of harm, "[t]he mere fact that an insurer may make a misleading representation does not require or even lead to the necessary conclusion that the misleading representation is material or even likely to cause harm," particularly where the plaintiffs had failed to allege that they would not have purchased their policies or that consumers generally would not have purchased their policies had they known the undisclosed information. *Ross* v. *AXA Equitable Life Ins. Co.*, No. 15-2665, 2017 WL 730266, at *2 (2d Cir. Feb. 23, 2017) (summary order).

The panel in *Ross* also addressed plaintiffs' contentions that they were harmed by an increased risk that the insurers would not be able to pay their claims in the event of an economic downturn. Noting that the occurrence of such an economic downturn was itself speculative and but the first of many conditions that

[6] *Ross* v. *AXA Equitable Life Ins. Co.*, 115 F. Supp. 3d 424 (S.D.N.Y. 2015); *Robainas* v. *Metropolitan Life Ins. Co.*, No. 14-cv-9926 (DLC), 2015 WL 5918200 (S.D.N.Y. Oct. 9, 2015); *Yarbrough* v. *AXA Equitable Life Ins. Co.*, No. 15-cv-2585 (RJS), 2015 WL 6792225 (S.D.N.Y. Oct. 22, 2015); Order, *Intoccia* v. *Metropolitan Life Ins. Co.*, No. 15-cv-3061 (DLC) (S.D.N.Y. Dec. 2, 2015), Dkt. No. 44.

would need to occur in order for the insurers to default on their obligations, the Second Circuit held that the allegedly increased risk of nonpayment was too speculative to confer standing. Similarly, the Second Circuit rejected the plaintiffs' argument that the policies that they had purchased were inferior to policies that were issued by insurers who had not engaged in captive reinsurance because the value of the relevant policies is the amount that will be paid by the policy in the future, and "any injury for a possible inability of [defendants] to fully pay out the life insurance and annuity rider claims in the future is speculative and hypothetical."[7]

OBSERVATIONS

The *Ross* decision grapples with a question left open by the Supreme Court in *Spokeo*, concerning the circumstances in which violations of statutory disclosure requirements confer standing. While the Second Circuit had taken up this question in reviewing a summary judgment order in *Strubel*, *Ross* extends the analysis to a motion to dismiss. Moreover, *Ross* addresses a state general anti-fraud statute carrying a potentially draconian statutory penalty, rather than one of the many federal statutes like those addressed in *Spokeo* (the Fair Credit Reporting Act) and *Strubel* (the Truth in Lending Act) that require specific disclosures to specific categories of persons. That the *Ross* panel did not find the substance of the NYDFS Report, which criticized the practices underpinning the plaintiffs' claims as posing systemic financial risk, relevant to the standing analysis also confirms that the alleged harm must be particular to the plaintiff; an alleged heightened risk to the financial system in general—even if perceived by a regulator—is not a concrete and particularized injury-in-fact. The *Ross* decision thus should encourage defendants in federal court, and particularly in the Second Circuit, to be aggressive in mounting standing challenges at the earliest possible stage—including on motion to dismiss—to lawsuits that seek statutory penalties for alleged violations of disclosure statutes but articulate no theory of injury other than a speculative risk of future harm.

*   *   *

7 *Id*. at *3.

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

Bruce Birenboim 212-373-3165 bbirenboim@paulweiss.com	Brad S. Karp 212-373-3316 bkarp@paulweiss.com	Walter Rieman 212-373-3260 wrieman@paulweiss.com
Elizabeth M. Sacksteder 212-373-3505 esacksteder@paulweiss.com	Justin D. Lerer 212-373-3766 jlerer@paulweiss.com	

Associate Ezra Sternstein contributed to this client alert.