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Lessons from *Thomas v. UBS AG* (7th Cir. 2013): Multistate Class Actions & Applicable Law in Federal Diversity

On February 7, 2013 the Seventh Circuit Court of Appeals handed down a scathing, but informative, decision affirming the dismissal of a putative class action. The case, *Thomas v. UBS AG*, sought to seek redress on a class wide basis for injuries sustained by the would-be class members for damages suffered by the 2008 UBS tax evasion scandal. The author of the decision is the legendary Judge Richard Posner – a man who has become very well known for his analytical and economic approaches to deciding cases as well as his often vitriolic opinions. For further discussion on Judge Posner, consult our previous discussion from January 18 – *Biting 7th Circuit Decision Reverses Denial of Social Security Disability Benefits*.

Despite the decision to affirm dismissal of the case on the merits, it provides a tremendous resource for attorneys seeking to prosecute a multistate class action case, especially within the 7th Circuit. It does this, primarily through a figurative defenestration of plaintiffs' counsel in the *Thomas v. UBS AG* case. That is to say, the case is quite informative as a guide of what not to do. Perhaps a more appropriate title for this week's post would have been, "*Thomas v. UBS AG*: Lessons learned so as to avoid having Judge Posner call your case 'a travesty' and express

surprise that defendant did not seek sanctions.” It is with this framework that we shall delve into the *Thomas v. UBS AG* decision and discuss some of the vitally important lessons that should be taken from this case.

The case came before the court of appeals after the trial court granted dismissal of the claims pursuant to Rule 12(b)(6). Peculiarly, the decision by Judge Posner repeatedly indicates that this was a decision upon the merits. Looking at the order from the trial court, this was not a decision upon the merits. It was a decision upon the face of the complaint, which came with the right to amend and re-file – with the exception of one specific allegation under California law that was dismissed with prejudice. It is unclear whether Judge Posner’s reference to the decision having been one on the merits is a reference to the appeal of the determination extinguishing the right to amend or whether it is just used as a juxtaposition to highlight that it was a dispositive decision made prior to class certification.

The notation of dismissal on the merits by the court is notable because:

Normally the issue of certification should be resolved first . . . because if a class is certified this sets the stage for a settlement and if certification is denied the suit is likely to be abandoned, as the stakes of the named plaintiffs usually are too small to justify the expense of suit, though that may not be true in this case.

This is the norm, not just because it stands to benefit plaintiffs/class members but also because it can provide a substantial benefit to defendants as well. As the court noted in this case, “a defendant with a winning case has much to gain from it—the judgment for the defendant will be res judicata in any suit by a class member who had not opted out of the class, provided ‘that the named plaintiff at all times adequately represent the interests of the absent class members.’” Nevertheless, the case came before the court of appeals prior to a determination of class certification.

Lesson #1: Understand What Law Applies

The very first issue addressed by the court provides us the opportunity to address the first lesson to be learned from this case. The court, almost instantly, noted that the parties failed to make any recognition of what law governs the case. Given that the case was filed with three named plaintiffs – each from a different state: Arizona, California, and New York – was filed in federal court, was filed in a fourth state – Illinois – and was against a Swiss defendant, there is a very real question of what jurisdiction’s law applies.

The parties “are allowed to specify within reason what law shall govern[.]” Moreover, the “specification can be implicit.” However, in this case the parties made no declaration of the applicable law and rampantly cited to cases from Arizona, California, New York, and Illinois without any apparent explanation of the justification for the application of each. Further, the putative class was intended to cover all fifty states. As such, there would be no apparent basis to limit the applicable law to these four states. “When the parties to a diversity case do not mention what state’s law applies, the court applies the law of the state in which the court is located.”

In class action practice, it is not uncommon to file an action based upon the common law of multiple states. In handling these cases, federal courts are not permitted to apply some hypothetical federal common law to govern the actions. It is ultimately the law of each state that must govern. This problem “is usually solved by the district court’s certifying a different subclass for class members in each jurisdiction whose law differs in some relevant respect from that of the other jurisdictions in which members of the class reside or the allegedly unlawful acts were committed.” In this case the parties made no proposition to do that.

Thus, the lesson to be taken from this case is to make certain that you have fully vetted the possible angles of applicable law before filing the case. Use this information to help specify to the court what law you deem applies to the case and try to direct the case in accordance therewith. Moreover, know what you are going to do to address the potential problems of applying multiple states’ laws. The synthesis and comparison of various laws to determine the necessity for creating subclasses is no small task and should not be taken lightly when the entirety of your case hinges upon it.

Lesson #2: Have a Sound Basis for Liability

In the vast majority of class action cases, it is not the fundamental theory of liability that stands in the way of success it is the difficulties – such as the creation of individual issues like reliance – in applying that theory on a class wide basis. To this end, it should be almost axiomatic that it is ill advised to bring a class action wherein the named plaintiff does not have a solid legal basis. In this case, the allegations were premised on peculiar and unsupported legal theories.

The plaintiffs were persons who had bank accounts with large amounts of money with UBS and the plaintiffs did not list the existence of those accounts on their 1040 federal income tax forms. The case was brought against UBS to recover “the penalties, interest, and other costs that the plaintiffs and other members of the class incurred from their scrape with the IRS, plus the profits . . . they claim UBS

made from the class as a result of the fraud . . . that they allege UBS committed by inducing them to maintain their accounts with it.”

The court characterized these plaintiffs/class members and their claims thusly:

The plaintiffs are tax cheats, and it is very odd, to say the least, for tax cheats to seek to recover their penalties (let alone interest, which might simply compensate the IRS for the time value of money rightfully belonging to it rather than to the taxpayers) from the source, in this case UBS, of the income concealed from the IRS. One might have expected the plaintiffs to try to show that they had forgotten they had accounts with UBS (though that would be preposterous, for these were significant investments for each of the plaintiffs). Or that UBS had told them that income earned in those accounts was somehow tax exempt and moreover that the accounts themselves were somehow not foreign bank accounts within the meaning of the tax code and so the plaintiffs didn’t have to acknowledge having accounts with UBS. They don’t make any of these feeble arguments. They do argue, as we’ll see, that UBS was obligated to give them accurate tax advice and failed to do so, but not that it gave them inaccurate, as distinct from no, advice.

There are grounds for avoiding penalties for admitted violations of federal tax law . . . such as reliance on plausible advice from a reputable-seeming lawyer or accountant. . . . But the plaintiffs do not invoke any of those grounds or argue that they asked UBS to advise them on U.S. tax law or that the bank volunteered such advice.

It may come as no surprise that there are likely difficulties with your case when your clients can easily be characterized as “tax cheats.”

The plaintiffs put forth numerous bases for liability with the general contention that UBS owed the plaintiffs and class members a duty to prevent them from breaking US tax law. The court went claim-by-claim dismissing each with relative ease. The most common ground noted by the court was the lack of specificity in the allegations required to “provide the minimum information that the defendant would need in order to be able to answer the complaint.” Of note, this specificity argument is typically couched in the fraud context through the heightened pleading requirements of Federal Rule 9. Indeed, the trial court applied a Rule 9 analysis to the complaint. However, on appeal the court found that the complaint was so lacking that it failed under more broad pleading standards than those under Rule 9.

The lesson, plead with sufficient specificity and do so with a claim that is rooted in a sound theory of liability. Certainly, there are times where action must be taken to expand the law or where there is uncertainty in its application. Indeed, a class action is often a very appropriate mechanism to do so. In these situations, it is not always possible to have an objectively “sound” theory of liability – i.e. one with certainty of application. Nevertheless, if that is what you seek to do then make sure to plead with most every operative fact necessary to form that basis.

Conclusion

Multistate class actions are very complicated and difficult matters. This is made even more so when a defendant is a foreign entity. Though this case proved an inappropriate application of the class action mechanism, it provides good lessons that ought to be heeded in pursuing future, more well founded, class cases.

Join us again next time for further discussion of developments in the law.

Sources

- [*Thomas v. UBS AG*, ___ F.3d ___, No. 12-2724 \(7th Cir. Feb. 7, 2013\).](#)
- [*Thomas v. UBS AG*, No. 11 C 4798, 2012 WL 2396866 \(N.D. Ill. June 21, 2012\), *aff'd*, ___ F.3d ___, No. 12-2724 \(7th Cir. Feb. 7, 2013\).](#)
- [Federal Rule of Civil Procedure 9.](#)
- [Federal Rule of Civil Procedure 12.](#)
- Sara Hansard, [UBS fined \\$780 million in tax evasion scandal](#), InvestmentNews (Feb. 19, 2009).

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