05-3349-cv

United States Court of Appeals

FOR THE SECOND CIRCUIT

IN RE: INITIAL PUBLIC OFFERING SECURITIES LITIGATION

JOHN G. MILES, SASWATA BASU, MICHAEL HUFF, SEAN ROONEY, KRIKOR KASBARIAN, STATHIS PAPPAS, JAMES COLLINS, DIANE COLLINS, JOSEPH ZHEN, ZITTO INVESTMENTS, J. CHRIS ROWE, VASANTHAKUMAR GANGAIAH, FREDERICK HENDERSON, BARRY LEMBERG, ANITA BUDICH, SPIROS GIANOS, MARY JANE GIANOS AND HARALD ZAGODA,

Plaintiffs-Appellees,

-v.-

MERRILL LYNCH & CO., INC., GOLDMAN, SACHS & CO., MERRILL LYNCH, PIERCE, FENNER & SMITH INCORPORATED, CREDIT SUISSE FIRST BOSTON LLC, ROBERTSON STEPHENS, INC., MORGAN STANLEY & CO., INCORPORATED, BEAR STEARNS & CO., INC., THE BEAR STEARNS COMPANIES, INC., J.P. MORGAN SECURITIES INC., DEUTSCHE BANK SECURITIES, INC., (F/K/A DEUTSCHE BANC ALEX. BROWN, INC., DB ALEX. BROWN LLC AND BT ALEX. BROWN INCORPORATED), LEHMAN BROTHERS, INC., SG COWEN SECURITIES CORP., (N/K/A SG COWEN & CO., LLC), RBC DAIN RAUSCHER, INC. (F/K/A DAIN RAUSCHER, INC.) AND PRUDENTIAL SECURITIES, INCORPORATED,

Defendants-Appellants.

BRIEF FOR THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AS *AMICUS CURIAE* SUPPORTING DEFENDANTS-APPELLANTS AND SUPPORTING REVERSAL OF CLASS CERTIFICATION PURSUANT TO FEDERAL RULE OF CIVIL PROCEDURE 23(f)

Pursuant to June 30, 2005 Order Granting Permission to Appeal

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From an Order Granting Certification of Classes
Entered on October 13, 2004
By the United States District Court for the Southern District of New York
21 MC 92 (SAS), 01 Civ. 242 (SAS), 01 Civ. 3857 (SAS), 01 Civ. 6001 (SAS) (DC)
01 Civ. 7048 (SAS), 01 Civ. 8404 (SAS), 01 Civ. 9417 (SAS)
The Honorable Shira A. Scheindlin

October 13, 2005

(*Appearance list annexed*)

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INTEREST OF AMICUS CURIAE

The Chamber of Commerce of the United States of America ("the Chamber") is a non-profit corporation organized under the laws of the District of Columbia. The Chamber is the world's largest business federation, with an underlying membership of more than three million companies and professional organizations nationwide. It regularly advocates the interests of its members in matters before Congress, the Executive Branch, and the courts. The Chamber often submits briefs as *amicus curiae* in litigation raising issues of vital concern to the Nation's business community.

This is such a case. As explained in the Chamber's *amicus* brief filed in support of the Rule 23(f) petition, the class certification decision below raises legal questions of surpassing importance to the Chamber's members, who are themselves frequently targets of class action litigation. Class certification can transform a routine lawsuit into a "bet-the-company" proposition. With the stakes so high, companies are often compelled to settle even meritless cases rather than risk potentially crippling jury verdicts. Such settlements are destructive to the Chamber's members, their customers, and the national economy.

The problem is particularly acute in securities fraud litigation. Indeed, it was the "significant evidence of abuse" of class actions in this context that led Congress to enact the Private Securities Litigation Reform Act in 1995. H.R. Conf. Rep. 104-369, at 31 (1995). Too often, such litigation amounts to a retrospective effort by disappointed investors to have issuers and financial services professionals insure them against the consequences of ordinary market risks.

For these reasons, the Chamber has a special interest in ensuring that district courts certify class actions only after conducting the "rigorous analysis" required by *General Telephone Co.* v. *Falcon*, 457 U.S. 147, 161 (1982). In this case, however, Judge Scheindlin ruled that a class may be certified if plaintiffs merely make "some showing" of eligibility. That decision contravenes decisions of the Supreme Court and this Circuit, squarely conflicts with the decisions of other Circuits, and is at odds with the 2003 Amendments to Rule 23, which were aimed at ensuring heightened judicial scrutiny of class actions. The Chamber submits this brief in support of the Defendants-Appellants to highlight several of the lower court's errors of law.[1]

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[1] All parties have consented to the Chamber's filing of this brief.

INTRODUCTION AND SUMMARY OF ARGUMENT

In diluting the standard for certifying class actions from the "rigorous analysis" test established in *General Telephone Co.* v. *Falcon*, 457 U.S. 147, 161 (1982), to the decidedly more lenient "some showing" standard, the district court undermined the central purposes and protections of Rule 23. The court permitted plaintiffs to obtain certification of a massive class of institutional investors with little or no showing that the class met the essential requirements for certification. Instead, the district court permitted plaintiffs to proffer at most a modicum of proof – well below that required by any other court – as a basis for winning class certification.

The lower court thought its dramatic departure from the prevailing legal standard was justified by two of this Court's decisions: *Caridad* v. *Metro-North Commuter R.R.*, 191 F.3d 283, 293 (1999), and *In re Visa Check/MasterMoney Antitrust Litig.*, 280 F.3d 124, 134-35 (2001). Both cases, however, were decided before the 2003 Amendments to Rule 23. Moreover, neither decision supports the district court's misguided approach. *Caridad* cannot be read as modifying the "rigorous analysis" required by *Falcon*. *Visa Check* does not apply a "some showing" standard, nor does it suggest that *Caridad* adopted that standard of proof.

The district court seriously compounded these errors by erecting a *presumption of reliance* based on the notion that "some showing" of the underlying predicates to that presumption are all that is required. And the district court extended the presumption (based on the "fraud-on-the-market" doctrine) to claims against *non-issuer* defendants – and to *market manipulation* claims based on alleged tie-in agreements, compensation arrangements and analyst reports. It accomplished these extensions without requiring plaintiffs to provide *any* substantial evidence (as *Basic, Inc.* v. *Levinson* requires) that the market was efficient and that there was a causal connection between the market price and the alleged fraud.

Instead, the court relied solely on the submissions of a single, non-economist expert offered by the plaintiffs. That expert asserted a speculative theory for connecting the alleged tie-in scheme with an uptick in the price of securities at the outset of the class periods (of up to 18 months), while at the same time refusing to engage with the wealth of evidence offered by defendants that no such causal link could be established. The court justified its unwillingness to give any meaningful scrutiny to plaintiffs' expert on the ground that plaintiffs need only demonstrate that the expert's theory was not "fatally flawed." *In re Initial Pub. Offering Sec. Litig.*, 227 F.R.D. 65, 114

(S.D.N.Y. 2004). In other words, so long as the experts' opinion *might be admissible*, it was sufficient to prove compliance with Rule 23(b)(3). Nothing in *Caridad*, *Visa Check*, or any other legal precedent, supports such a toothless standard.

The court's certification decision, if upheld, will have far-reaching, adverse effects. Already, securities class actions often have become tools to extract large settlements from defendants who are unwilling to bear the risk of ruinous liability that even a weak claim poses. If the standard for deciding *whether* a class is certified is reduced to the cursory look given to plaintiffs' allegations in these sprawling cases, the result will be a proliferation of lawsuits not suitable for class-action treatment.

ARGUMENT

I. THE COURT MISAPPLIED ESTABLISHED LAW IN RULING THAT PLAINTIFFS SATISFIED THEIR BURDEN OF DEMONSTRATING COMPLIANCE WITH RULE 23

Class certification is appropriate only "if the trial court is satisfied, *after a rigorous analysis*," that the prerequisites of Rule 23 have been met. *Falcon*, 457 U.S. at 161 (emphasis added). Under Rule 23(b)(3), a district court must make "findings" that common questions "predominate over any questions affecting only individual members." Doing so requires that the

court take a "close look" at all matters relevant to predominance. *Amchem Prods., Inc.* v. *Windsor*, 521 U.S. 591, 615 (1997).

The district court entirely disregarded these mandates. It held that plaintiffs could satisfy Rule 23 by doing nothing more than making "some showing." 227 F.R.D. at 93. Equally pernicious was the court's announcement that its "*sole* job * * * in assessing expert evidence on a certification motion is to 'ensure that the basis of the [plaintiff's] expert opinion is not so flawed that it would be inadmissible as a matter of law.'" *Ibid.* (quoting *In re Visa Check/Mastermoney Antitrust Litig.*, 280 F.3d 124, 135 (2d Cir. 2001)). Those empty standards are not compelled by this Court's cases, are inconsistent with the approach followed in other Circuits, represent an abdication of the court's responsibilities under Rule 23, and warrant reversal.

A. This Court's Precedents Do Not Establish A "Some Showing" Standard, Which Is Fundamentally Misguided

In certifying the class, Judge Scheindlin purported to follow the Supreme Court's mandate in *Falcon*, 457 U.S. at 161, to "undertake a 'rigorous analysis' that the requirements of Rule 23 have been satisfied." *In re Initial Pub. Offering Sec. Litig.*, 227 F.R.D. at 90. But her inquiry was anything but "rigorous." See WEBSTER'S NEW DICTIONARY OF AMERICAN

ENGLISH 1156 (3d College ed. 1988) (defining "rigorous" as "very strict" or "thoroughly accurate or exact"). Although she acknowledged that "at least two Courts of Appeal" have concluded that plaintiffs must satisfy the requirements of Rule 23 by a preponderance of the evidence, Judge Scheindlin concluded that this Circuit's decisions mandate a far less rigorous "some showing" test for two reasons. First, citing decisions that mostly antedate *Falcon*, Judge Scheindlin suggested that this Court "requires a 'liberal' construction of Rule 23." 227 F.R.D. at 90 & nn.211-213. Second, she held that this Court's decisions in *Caridad* and *In re Visa Check* establish the lenient "some showing" test. Neither rationale withstands analysis.

1. The district court got off on the wrong foot by suggesting that, if a certification question is close, "the court should err in favor of allowing the class to go forward." 227 F.R.D. at 90 (internal quotations omitted). There is simply no basis for putting such a thumb on the scale in the plaintiffs' favor. Doing so is inconsistent with the rule that it is the *plaintiffs'* burden to establish the prerequisites to class certification. Nor is Judge Scheindlin's remarkable proposition supported by this Court's statement, which originally appeared in *Lundquist* v. *Security Pacific Automotive Financial*

Services Corp., 993 F.2d 11, 15 (2d Cir. 1993), that the Second Circuit is "noticeably less deferential to the district court when that court has denied class status than when it has certified a class." See 227 F.R.D. at 90 n.213 (internal quotation marks omitted). The only case that *Lundquist* cited was *Robidoux* v. *Celani*, 987 F.2d 931 (2d Cir. 1993), which said something quite different: "abuse of discretion can be found more readily on appeals from the denial of class status *than in other areas*, for the courts have built a body of case law with respect to class action status." *Id.* at 935 (emphasis added). The point is not that abuse of discretion is more readily found in *denials* of certification as compared with *grants*, but rather in certification decisions generally (because the standards governing the exercise of discretion in this setting have been articulated in the case law). This is confirmed by *Abrams* v. *Interco, Inc.*, 719 F.2d 23 (2d Cir. 1983), the sole case cited in *Robidoux*: "Abuse of discretion can be found far more readily on appeals from the denial *or grant* of class action status than where the issue is, for example, the curtailment of cross-examination or the grant or denial of a continuance." *Id.* at 28 (emphasis added).

2. The district court was equally wrong to say that this Court adopted a "some showing" standard of proof for Rule 23 determinations in either *Caridad* or *In re Visa Check*.

Caridad involved Title VII claims of race discrimination by a group of African-American employees. The district court denied class certification but this Court reversed, concluding that the requirements for commonality and typicality had been satisfied. On appeal, the employer argued that class certification was inappropriate because the alleged employment discrimination had been caused by subjective employment practices. The employees, in turn, argued that it was precisely the employer's "policy" of "delegat[ing] to supervisors, pursuant to company-wide policies, of discretionary authority without sufficient oversight" that gave rise to common questions of fact warranting certification of a class action. 191 F.3d at 291. In siding with the employees, this Court pointed out that in *Falcon* the Supreme Court had acknowledged that, "under certain circumstances, disparate treatment cases challenging subjective decision-making processes could be certified as class actions." 191 F.3d at 292. This Court added that, "[o]f course, class certification would not be warranted absent *some showing* that the challenged practice is causally related to a pattern of disparate treatment or

has a disparate impact on African-American employees." *Ibid.* (emphasis added).

As context makes clear, *Caridad* certainly did *not* hold that a plaintiff "is only required to make 'some showing.'" 227 F.R.D. at 93. To the contrary, the Court held that a plaintiff *must* make some showing, *i.e.*, must put forward actual evidence *rather than bare allegations*, that the prerequisites to class certification exist. *Caridad* thus stands only for the proposition that a plaintiff cannot satisfy the requirements of Rule 23 merely by *alleging* that they have been met. A ruling that "some" showing is *necessary* for class certification does not mean that *any* showing is therefore *sufficient*. Had this Court in *Caridad* actually intended to establish for this Circuit the plaintiff's burden of proof for class certifications under Rule 23, one would have expected at least some discussion of the alternatives and some justification for the standard adopted. The opinion contains neither.

Immediately after the reference to "some showing" in *Caridad*, this Court reasoned that "the statistical report *and* anecdotal evidence submitted by the Class Plaintiffs are sufficient to *demonstrate* common questions of fact regarding the discriminatory implementation and effects of [the employer's] company-wide policies." 191 F.3d at 292; see also *id.* at 293

(emphasizing that "th[e] report, *in conjunction with the anecdotal evidence*, satisfies" the plaintiffs' burden of "*demonstrating* commonality") (emphasis added). Had this Circuit only required "some showing," there would have been no reason to go beyond the expert report submitted by the plaintiff employees, which by itself indisputably constituted "some showing." Yet this Court carefully analyzed the plaintiffs' expert's submission and found her "multiple regression analyses" more persuasive than the employer's rebuttal evidence, which "[s]ignificantly * * * did not" include "any regression analyses." 191 F.3d at 286, 288-89. None of this would have been necessary if the plaintiff need only have submitted "some showing" as the district court interpreted that phrase.[2]

Visa Check likewise does not support the court's novel establishment of a "some showing" standard. Indeed, the only mention in the Court's opinion of "some showing" is in a footnote reciting the substantive elements

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[2] *Caridad*, by its express terms, involved only the commonality and typicality requirements of Rule 23(a). 191 F.3d at 291 ("Here, we are concerned with the commonality and typicality criteria."). Yet, as the district court has acknowledged, the predominance standard of Rule 23(b)(3), is "'more stringent' and 'far more demanding than' the commonality requirement of Rule 23(a)." 227 F.R.D. at 89 (internal quotation marks omitted). Thus, even if *Caridad* could somehow be construed as establishing a "some showing" test for the commonality and typicality requirements, it has no bearing on the proper standard for satisfaction of the more stringent predominance requirement.

of the plaintiffs' antitrust claims, which require "some showing" of antitrust injury. 280 F.3d at 133 n.5. The district court's inexplicable conclusion that in *Visa Check* this Circuit "reiterated the 'some showing' standard," 227 F.R.D. at 93, is thus utterly without merit.

3. The district court's "some showing" standard is also misguided. For one thing, it is the functional equivalent of the deferential "some evidence" standard, which is met if there is "any evidence in the record that could support the conclusion." See *Hamdi* v. *Rumsfeld*, 124 S. Ct. 2633, 2645 (2004). Following that approach would make class certification virtually automatic, "frustrating the district court's responsibilities for taking a 'close look' at relevant matters." *Gariety* v. *Grant Thornton, LLP*, 368 F.3d 356, 365 (4th Cir. 2004). Setting such a low bar may be appropriate where overriding policy concerns counsel against more serious scrutiny. *E.g.*, *Superintendent, Mass. Correctional Inst.* v. *Hill*, 472 U.S. 445, 455-56 (1985) (challenges to prison discipline). In light of the high costs to defendants and to society from erroneously certified class actions, however, this is not such a context. There is no justification for converting Rule 23, which requires analytic rigor, into little more than a rubber stamp.

Not surprisingly, use of the "some showing" standard contradicts the approach followed in other circuits. See *West* v. *Prudential Sec., Inc.*, 282 F.3d 935, 938 (7th Cir. 2002) ("A district judge may not duck hard questions by observing that each side has some support * * *. Tough questions must be faced and squarely decided, if necessary by holding evidentiary hearings and choosing between competing perspectives."); *Johnston* v. *HBO Film Mgmt., Inc.*, 265 F.3d 178, 186-190 (3d Cir. 2001) (carefully evaluating record evidence to reject plaintiffs' class certification allegations). Those courts have recognized that Rule 23's requirement of *findings* and the importance of class certification make it vital that robust procedural safeguards attend such decisions. See *Szabo* v. *Bridgeport Machs., Inc.*, 249 F.3d 672, 677 (7th Cir. 2001). This means that at the certification stage courts must engage in careful scrutiny to ensure – based on the facts as they actually are, not merely as plaintiffs want them to be – that the requirements of Rule 23 are satisfied. The "some showing" standard fails to do so.

B. The "Some Showing" Standard Is Incompatible With Recent Supreme Court Precedent

The district court's analysis is reminiscent of a pre-*Falcon* regime in which judges gave only limited review to class certification requests based on the Supreme Court's statement, in *Eisen* v. *Carlisle & Jacquelin*, 417 U.S

156, 177 (1974), that "nothing in either the language or history of Rule 23 * * * gives a court any authority to conduct a preliminary inquiry into the merits of a suit in order to determine whether it may be maintained as a class action." While Judge Scheindlin recognized that this aspect of *Eisen* "is no longer the prevailing view" (227 F.R.D. at 91), her lenient standard effectively rubber-stamps the plaintiffs' class certification application without adequate examination of whether the class claims satisfy Rule 23.

Since *Eisen*, the Supreme Court has gone to great lengths to make clear that stricter scrutiny of class certification applications is necessary to ensure that litigants and courts are not subjected to unwieldy and unmeritorious class actions. In *Coopers & Lybrand* v. *Livesay*, 437 U.S. 463, 469 n.12 (1978), for instance, the Court recognized that "[e]valuation of many of the questions entering into [the] determination of class action questions is intimately involved with the merits of the claims." *See id.* at 469 (quoting *Mercantile Nat. Bank* v. *Langdeau*, 371 U.S. 555, 558 (1963)).

Then, in *Falcon*, the Court resolved any lingering doubt that judges should blithely accept requests for class certification by mandating that courts must subject such requests to a "rigorous analysis" to determine whether the stringent requirements of Rule 23 have been met. 457 U.S. at

161. As the Court acknowledged, "sometimes it may be necessary for the court to *probe behind* the pleadings before coming to rest on the certification question * * * [A]ctual, not presumed, conformance with Rule 23(a) remains * * * indispensable." *Id.* at 160 (emphasis added). In *Falcon*, the Court also observed that "significant proof" of classwide unlawful practices could satisfy class certification. *Id.* at 159-61 & n.15. "*Significant*" proof is hardly the same as "some" – or any – admissible evidence, the standard applied by Judge Scheindlin.

The Court's decision to decertify a class in *Amchem Prods., Inc.* v. *Windsor*, 521 U.S. 591 (1997), underscores the lower court's failure to apply a sufficiently rigorous standard to the class-certification inquiry. Unlike the district court in this case, the Supreme Court in *Amchem* looked critically at the ability of plaintiffs to litigate their claims based on classwide proof, and concluded that common exposure to asbestos could not overcome the "sprawling" nature of the class and the disparities among class members as to the individual nature of the harm caused by exposure.[3] See *id.* at 624. The Court carefully examined, and found wanting, the district court's con-

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[3] The Court's holding in *Amchem* is not limited to settlement classes but applies as well to litigation classes. See *Amchem*, 521 U.S. at 619, 622.

clusion that "predominance was satisfied based on two factors: class members' shared experience of asbestos exposure and their common 'interest in receiving prompt and fair compensation for their claims.'" *Id.* at 622 (citation omitted). Likewise, the Court carefully examined whether the class satisfied Rule 23(a)(4)'s requirement that the named parties "'will fairly and adequately protect the interests of the class'" – and determined the class did not meet that standard. *Id.* at 625.

The rigorous mode of analysis applied in *Amchem* to test whether the requirements of Rule 23 had been satisfied is clearly at odds with the lenient "some showing" test.

C. The "Some Showing" Test Is Inconsistent With The 2003 Amendments to Rule 23

Even if the district court correctly interpreted this Court's decisions in *Caridad* and *In re Visa Check*, those decisions have been superseded by the 2003 Amendments to Rule 23. Those amendments, which substantially changed the procedures for certifying and managing class actions, were the first major changes in Rule 23 since its adoption in 1966. See Summary of the Report of the Judicial Conference Committee on Rules of Practice and Procedure, September 2002 ("Judicial Conference Report"), at 8 (available at http://www.uscourts.gov/rules/jc09-2002/Report.pdf).

The amendments were expressly designed, among other things, to "enhance judicial oversight" of the process of class certification. *Id.* at 9. Toward that end, amended Rule 23 makes clear that courts should have sufficient time to scrutinize class certification requests to ensure full compliance with the requirements for class certification. Specifically, Rule 23(c)(1)(A) now requires that the court "at an early practicable time" determine "whether to certify the action as a class action." In contrast, the previous rule, promulgated in 1966, provided that a court should make the certification decision "'as soon as practicable'" after the commencement of the action. Judicial Conference Report, at 9. The 2003 amendments were designed to correct judicial confusion over the scrutiny courts may give to a certification request. As the Judicial Conference Committee noted, "[t]he current [pre-2003] rule's emphasis on dispatch in making the certification decision has, in some circumstances, led courts to believe that they are overly constrained in the period before certification." *Id.* at 10. The Judicial Conference Committee therefore urged that the language be changed to emphasize that courts should provide ample time to allow for careful consideration of certification decisions.

In particular, both defendants and plaintiffs may engage in certification discovery on "merits issues" to clarify the issues bearing on certification since "[a] certain amount of discovery may be appropriate during this period to illuminate issues bearing on certification, including the nature of the issues that will be tried; whether the evidence on the merits is common to the members of the proposed class; whether the issues are susceptible to class-wide proof; and what trial-management problems the case will present." *Id.* at 10-11. The Judicial Conference Committee made clear that such language is "consistent with the practice of authorizing discovery on the nature of the merits issues, which may be necessary for certification decisions, while postponing discovery pertaining to the probable outcome on the merits until after the certification decision has been made." *Id.* at 11.

In addition, under amended Rule 23(c)(1)(C), a court can no longer grant conditional class certification (although it may later alter or amend a certification). Under the old rule, courts could issue a "conditional" certification order that could be altered or amended 'at any time up to 'final judgment.'" *Ibid.* Under the new rule, a putative class cannot proceed under a tentative certification if it is otherwise unclear whether the class satisfies the requirements for class certification. As the Judicial Conference Commit-

tee indicated, "[t]he provision for conditional class certification is deleted to avoid the unintended suggestion, which some courts have adopted, that class certification may be granted on a tentative basis, even if it is unclear that the rule requirements are satisfied." *Id.* at 12. See also Report of the Civil Rules Advisory Committee 38 (May 20, 2002) (recommending deletion of "any reference to the 'conditional' nature of certification" and noting that public comments "expressed fear that emphasis on the conditional nature of a certification order will encourage some courts to grant certification *without searching inquiry*, relying on later developments to determine whether certification is in fact appropriate.") (emphasis added). If the "some showing" standard ever had any justification at all, it stemmed from the fact that a court could later revisit a class certification decision reached on the basis of less than the full "findings" Rule 23 has always required, but now the rulemakers have disapproved of ready resort to that practice.

Taken together, these changes to Rule 23 enhance the court's supervisory role by increasing judicial scrutiny before a class is certified, as well as providing appellate courts an adequate basis for reviewing certification orders. As one commentator has correctly pointed out, after the 2003 Amendments "[v]aguely defined classes can no longer receive certification

in hopes of establishing their qualifications in merit discovery." Mohsen Manesh, "*The New Class Action Rule Procedural Reforms In An Ethical Vacuum*," 18 GEO. J. LEGAL ETHICS 923, 929 (2005). "Because certification creates leverage for class counsel to push the defendants into a settlement, the new rule screens out improper and unmeritorious class certifications that could be used to extort defendants." *Ibid.*

In light of the clear intent underlying the 2003 Amendments – to enhance scrutiny of class certification orders as well as to eliminate conditional certification of classes that may not satisfy Rule 23 – any possible support for a "some showing" standard in pre-2003 authorities is simply no longer relevant.[4]

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[4] The Class Action Fairness Act, Pub. L. No. 109-2 (Feb. 18, 2005) (CAFA), confirms that a "some showing" standard is insufficiently rigorous. CAFA expanded federal jurisdiction to cover many class actions previously filed in state courts precisely because state courts had been "lax" about following "the strict requirements" for certification. S. Rep. 108-123 at 15, 52 (2003); see 151 Cong. Rec. H729 (2005). Congress in CAFA disapproved rulings "readily certifying classes" that give plaintiffs "unbounded leverage" to force ransom settlements. S. Rep. 108-123 at 6, 18. See *id.* at 20-21 (this "'laissez faire' attitude" results in "blatant forum shopping"). It would thwart CAFA if the many additional suits that will be adjudicated in federal court in this Circuit are governed by "lax" standards that "render virtually any controversy subject to class action treatment." H. R. Rep. 108-144, at 12 (2003), 151 Cong. Rec. E136 (Feb. 2, 2005).

II. THE COURT'S APPLICATION OF THE "SOME SHOWING" TEST TO ERECT A PRESUMPTION OF RELIANCE UNDER *BASIC* WAS ERRONEOUS

The district court also mistakenly ruled that plaintiffs were entitled to a presumption of reliance under *Basic, Inc.* v. *Levinson*, 485 U.S. 224 (1988), "for claims arising from alleged misrepresentations and market manipulation." 227 F.R.D. at 106. That ruling allowed the court to conclude that common issues predominated over individualized issues of reliance, as required by Rule 23(b)(3). 227 F.R.D. at 105.

In Section 10(b) securities actions, plaintiffs ordinarily must prove reliance as an element of the cause of action. See *Basic*, 485 U.S. at 243. "Reliance provides the requisite causal connection between a defendant's misrepresentation and a plaintiff's injury." *Ibid.* The Supreme Court has created several narrow exceptions to the requirement of proof of individualized reliance, however. Those exceptions include situations where "a duty to disclose material information had been breached," *ibid.* (citing *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 153-54 (1972)), and where misleading material information created a "fraud on the market" by affecting the integrity of the market price. *Id.* at 243-44. Those exceptions permit a rebuttable presumption of reliance, rather than actual proof of

reliance. See *ibid.* The district court held that the plaintiffs in this case could avail themselves of the *Basic* and *Affiliated Ute* presumptions. 227 F.R.D. at 105-106. That holding, in turn, allowed the court to conclude that common issues predominated over individual issues, in conformity with Rule 23(b)(3).

The district court's application of the "some showing" standard to extend *Basic*'s presumption of reliance resulted in two grave errors. First, it relieved plaintiffs of their burden of demonstrating that the stocks in question traded in an efficient market – a prerequisite for invoking the *Basic* presumption. Second, plaintiffs were excused from showing the necessary causal connection between the alleged fraud and the price of securities. Both errors allowed the district court to reach the further erroneous conclusion that common issues predominated over individual issues, when in fact plaintiffs' claims are fraught with individualized issues that simply cannot be resolved on a classwide basis.

A. The District Court Improperly Assumed The Market Was Efficient

The fraud-on-the market presumption depends on the existence of an efficient market, for only such markets can be expected to reflect "all publicly available information, and, hence, any material misrepresentations."

Basic, 485 U.S. at 246. In *Gariety* v. *Grant Thornton, LLP*, 368 F.3d 356, 364 & n* (2004), the Fourth Circuit recently reversed a class certification decision that relied on the plaintiffs' allegations and on very limited evidence of an efficient market. In concluding that the district court had "failed to comply adequately with the procedural requirements of Rule 23," the Fourth Circuit explained that the fact that the stock price had dropped in response to the alleged fraud, "standing alone," was insufficient "evidence that the plaintiffs in this case purchased their shares * * * in an efficient market." *Id.* at 368. After a rigorous analysis of plaintiffs' claims, the appellate court instructed the district court to make an actual *finding* of market efficiency. *Ibid.*

Judge Scheindlin expressly rejected the Fourth Circuit's analysis, concluding that "[u]ltimately, whether the relevant markets were efficient is a question of fact to be resolved at trial." 227 F.R.D. at 107. She added: "The present finding – that plaintiffs have made 'some showing' that the focus markets were efficient – is solely for the purposes of adjudicating the pending motion for class certification, and is not binding on the finder of fact." *Id.* at 107-08. Judge Scheindlin went on to observe that the finder of fact could "conclude that one or more of the relevant markets was inefficient, in

which case those plaintiffs who traded in such markets would be required to make individual showings of reliance." *Id.* at 108.

The district court's willingness to delay until *after* class certification the question whether an efficient market exists, and to permit plaintiffs to proffer only "some showing" of efficiency, was mistaken. The court's holding grants plaintiffs access to the *Basic* presumption of reliance at a critical stage of the litigation even though, in fact, they may not be entitled to it if a crucial condition precedent – the presence of an efficient market – is not met.[5]

Delaying resolution of whether an efficient market exists thus unfairly skews the court's analysis in favor of class certification. As a plurality of the Supreme Court recognized in *Basic*, 485 U.S. at 242, "[r]equiring proof of individualized reliance from each member of the proposed plaintiff class effectively would have prevented respondents from proceeding with a class action * * * since individual issues then would have overwhelmed the common ones." See also *Hevesi* v. *Citigroup Inc.*, 366 F.3d 70, 78 (2d Cir.

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[5] Defendants set out reasons why an efficient market for the six securities at issue did not always exist during the relevant period. See Def. Br. 79-85. The "Internet bubble" (or, in Chairman Greenspan's phrase, "irrational exuberance") market of the late 1990s is probably the worst candidate in decades to be characterized as an "efficient market."

2004) ("if plaintiffs are not entitled to the *Basic* presumption because they cannot plead fraud on the market, reliance *must be proved separately* as to each class member, and common issues may not predominate over individual issues.") (emphasis added). By deferring close scrutiny of whether market efficiency existed until a later date, the district court effectively granted plaintiffs a conditional certification – in direct contravention to the 2003 Amendments to Rule 23.

B. The Court Improperly Extended *Basic*'s Fraud-On-The-Market Doctrine

Equally mistaken was the trial court's failure to require plaintiffs to make more than a cursory showing that there was any causal connection between the alleged fraud and the price of securities. *Basic*'s presumption of reliance applies only where, as a matter of "common sense and probability," the alleged fraud affected the security's market price. See *Basic*, 485 U.S. at 246. Such a causal connection requires classwide evidence both that orchestrated purchases of the target stocks immediately after an IPO had an inflationary effect on share prices and that this effect persisted throughout the extremely long class periods. The district court failed to give any meaningful scrutiny to plaintiffs' expert's theory of a connection between the alleged fraud and the price of the securities.

Indeed, plaintiffs relied entirely on the report of a single non-economist expert, Daniel Fischel. Fischel asserted that the tie-in scheme, in which underwriters allegedly required IPO allocants to purchase shares in the aftermarket, artificially affected the prices of the securities and that plaintiffs relied on such prices. As even the district court recognized, class certification is inappropriate unless plaintiffs provide a mechanism that explains that inflation – as well as its extremely slow dissipation – on a classwide basis. 227 F.R.D. at 116-117.

Because Judge Scheindlin viewed this case through the prism of her lenient "some showing" standard, she required plaintiffs only to proffer a theory of causal connection that was "'not so flawed that it would be inadmissible as a matter of law.'" *Id.* at 111 (quoting *Visa Check*, 280 F.3d at 135). As a result, she refused even to consider the wealth of evidence that Fischel's approach was incapable of providing a common mechanism for connecting the tie-in scheme with movements in the price of securities across the class period. *Id.* at 111 & nn.346-348. The district court cited no evidence at all that any of the alleged practices had any effect on prices of stocks, let alone did so over the entire class period.[6]

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[6] The need for evidence of price impact before the presumption may apply is

Failure to subject the plaintiffs' expert to any meaningful scrutiny on such a critical issue flatly contravenes the rigorous analysis required by *Falcon*, as well as the 2003 Amendments to Rule 23. As the Seventh Circuit has recognized, the failure to scrutinize expert evidence at the class certification stage "amounts to a delegation of judicial power to the plaintiffs, who can obtain class certification just by hiring a competent expert." *West*, 282 F.3d at 938.

Judge Scheindlin's suggestion that her ruling was compelled by *Visa Check* and *Caridad* is wrong for the reasons set forth above. As this Court's more recent opinion in *Hevesi* suggests, the fraud-on-the-market doctrine may not be so lightly expanded. In *Hevesi*, the district court certified a class by extending the fraud-on-the-market doctrine to opinions by research

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particularly important here because economists have shown that the conduct alleged here has no lasting effect on stock prices. Anup Agrawal & Mark A. Chen, *Do Analyst Conflicts Matter? Evidence from Stock Recommendations* 1 (AFA 2006 Boston Meetings Paper, Sept. 2005), *available at* http://ssrn.com/abstract=654281 (finding that "the market recognizes analyst conflicts and properly discounts analyst opinions"); Qi Chen, Jennifer Francis, & Katherine Schipper, *The Applicability of the Fraud on the Market Presumption to Analysts' Forecasts* 1-4 (working paper, Sept. 2005), *available at* http://faculty.fuqua.duke.edu/%7Ejfrancis/bio/working_papers.htm (finding that analyst reports do not reliably result in statistically significant price changes); *West*, 282 F.3d at 939 (trading alone has only fleeting, if any, price impact).

analysts. As in this case, the district court had "declined to 'wade into th[e] battle of experts'" concerning whether any connection existed between the alleged fraud and the price of securities. *Hevesi*, 366 F.3d at 78 (citation omitted). The district court accordingly declined to subject plaintiffs' expert to any rigorous testing as to whether a causal link between the alleged fraud and the price of securities had been established.

This Court granted review under Rule 23(f), holding that the lower court's approach in *Hevesi* raised serious questions worthy of immediate appellate attention. Without mentioning *Visa Check* or *Caridad*, the Court cited with approval the Seventh Circuit's observation in *West*, 292 F.3d at 938, that "'a district judge may not duck hard questions [at the certification stage] by observing that each side has some support.'" *Hevesi*, 366 F.3d at 78. This Court then faulted the district court for extending the fraud-on-the-market doctrine "without identifying a causal link between the statements at issue and the price of securities." *Id.* at 78-79. This is exactly what Judge Scheindlin did, and it is no less troublesome in this case than it was in *Hevesi*.

In *Falcon*, the Supreme Court explained that "[c]onceptually, there is a wide gap between * * * an individual's claim that he has been denied a

promotion on discriminatory grounds, and his otherwise unsupported allegation that the company has a policy of discrimination," which could be demonstrated on a classwide basis. 457 U.S. at 157. Similarly, here there is an enormous gap between plaintiffs' allegation that the price they paid for a security was caused by alleged misrepresentations, and market manipulations by underwriters that is susceptible to classwide proof. By permitting plaintiffs to gain class certification simply by proffering expert testimony the court deemed "not fatally flawed," the court effectively relieved plaintiffs of their burden of demonstrating entitlement to the *Basic* presumption or compliance with Rule 23. In this case, as in *Falcon*, there is "nothing in the statute to indicate that Congress intended to authorize such a wholesale expansion of class-action litigation." *Id.* at 159.

III. ADOPTION OF THE "SOME SHOWING" TEST BY THIS CIRCUIT WILL HAVE SERIOUS ADVERSE EFFECTS

If upheld, the district court's certification decision under a "some showing" standard will have troublesome and far-ranging effects. If plaintiffs can win class certification simply by making the modest evidentiary showings the district court required, plaintiffs' lawyers can be expected to file hundreds of class actions – no matter how tenuous – in the district courts within this Circuit in an effort to exploit a certification standard that would

be substantially lower than in other jurisdictions. Armed with those certifications, plaintiffs' counsel will be able to pressure defendants to reach financial settlements to avoid the huge costs and uncertainties associated with defending a class action.

As many courts and commentators have recognized, class certification "places inordinate or hydraulic pressure on defendants to settle." *Newton* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 259 F.3d 154, 164 (3d Cir. 2001). "Certification of a large class may so increase the defendant's potential damages liability and litigation costs that he may find it economically prudent to settle and abandon a meritorious defense." *Coopers & Lybrand*, 437 U.S. at 476. See also *West*, 282 F.3d at 937 (class action settlements "reflect [a] high risk of catastrophic loss" and force "defendants to pay substantial sums even when the plaintiffs have weak positions"); *In re Bridgestone/Firestone, Inc.*, 288 F.3d 1012, 1016 (7th Cir. 2002) (aggregating millions of claims in a class action lawsuit "makes the case so unwieldy, and the stakes so large, that settlement becomes almost inevitable – and at a price that reflects the risk of a catastrophic judgment as much as, if not more than, the actual merit of the claims"); Bone & Evans, *Class Certification and the Substantive Merits*, 51 DUKE L.J. 1251, 1292 (2002) ("[A]lmost all class

actions settle, and the class obtains substantial settlement leverage from a favorable certification decision.").

The federal courts already are experiencing a glut of cases that illustrate the ramifications of inadequate application of the Rule 23 standards. Investors have filed hundreds of Section 10(b) damages suits in the aftermath of the stock market bubble to recover losses incurred on speculative investments in unproven internet and technology companies. A record 503 private federal securities law class actions were filed in 2001, the year after the bubble burst. NERA, RECENT TRENDS IN SECURITIES CLASS ACTION LITIGATION: 2003 EARLY UPDATE 2 (Feb. 2004). Settlements of securities fraud claims totaled $6.6 billion in 2001-2003. CORNERSTONE, POST-REFORM ACT SECURITIES LAWSUITS 1 (2004). Congress and the courts have recognized that plaintiffs' lawyers often go after the deepest pocket, no matter how tangentially related. See S. Rep. No.104-98 at 9 (1995) (noting that "[u]nderwriters" and "other professionals are prime targets of abusive securities lawsuits" and that "[t]he deeper the pocket, the greater the likelihood that a marginal party will be named as a defendant"). When such "peripheral defendants are sued, the pressure to settle is overwhelming – regardless of the defendant's culpability." *Id.* at 21.

An improperly certified class also causes "potential unfairness to the class members bound by the judgment if the framing of the class is overbroad." *Falcon*, 457 U.S. at 161. As the Fourth Circuit has recognized: "We must not lose sight of the fact that when a district court considers whether to certify a class action, it performs the public function of determining whether the representative parties should be allowed to prosecute the claims of absent class members." *Gariety*, 368 F.3d at 366-67. The court of appeals went on to note that, "[w]ere the court to defer to the representative parties on this responsibility by merely accepting their assertions, the court would be defaulting on the important responsibility conferred on the courts by Rule 23 of carefully determining the class action issues and supervising the conduct of any class action certified." *Id.* at 367; see also *Szabo* v. *Bridgeport Machs., Inc.*, 249 F.3d at 677 ("[c]ertifying classes on the basis of incontestable allegations in the complaint moves the court's discretion to the plaintiff's attorneys – who may use it in ways injurious to other class members, as well as ways injurious to defendants").

In addition, a class certification decision that results in a settlement also gives a single judge extraordinary power since the decision is never subjected to appellate review. See *Blair* v. *Equifax Check Servs., Inc.*, 181

F.3d 832, 834 (7th Cir. 1999). Those are some of the reasons why the requirements of Rule 23 are stringent. The Supreme Court has admonished judges to respect the rule's rigor: "Rule 23 * * * must be interpreted with fidelity to the Rules Enabling Act. * * * [T]he rulemakers' prescriptions for class actions may be endangered by 'those who embrace [Rule 23] too enthusiastically just as [by] those who approach [it] with distaste." *Amchem*, 521 U.S. at 629.

As the Supreme Court stated in *Amchem*, 521 U.S. at 622, "[f]ederal courts * * * lack authority to substitute for Rule 23's certification criteria a standard never adopted." That is precisely the error made by the court below, and its certification order should be reversed.[7]

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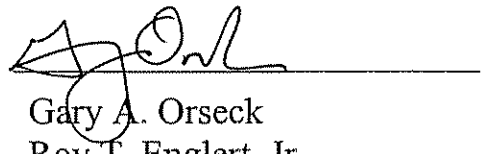
[7] There is no reason to believe that the institutional investors who comprise significant parts of the classes in these cases have any need for class actions to bring suits in cases such as these.

CONCLUSION

For the foregoing reasons, and those set forth in Defendants-Appellants' brief, the order granting certification should be reversed.

Respectfully submitted,



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CERTIFICATE OF COMPLIANCE

Undersigned counsel certifies on this 13th day of October, 2005, that this brief complies with the type-volume limitation of FED. R. APP. P. 29(d) because it contains 7,000 words, excluding the parts of the brief exempted by FED. R. APP. P. 32(a)(7)(b)(iii). Undersigned counsel further certifies that this brief complies with the typeface requirements of FED. R. APP. P. 32(a)(5) because this brief has been prepared using Word Perfect 12.0 for Windows in 14-point typeface, Times New Roman style.

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CERTIFICATE OF SERVICE

I hereby certify that an original and ten copies of this brief have been filed with the court, and two copies served on counsel for each party, this 13th day of October, 2005. All counsel listed on , via United States mail, as permitted by FED. R. APP. P. 25(a)(2)(B)(i) and FED. R. APP. P. 25(c)(1)(B). The counsel who have been so served are as follows:

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