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IN THE UNITED STATES COURT OF APPEALS  
FOR THE FOURTH CIRCUIT

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DEBRA GARIETY, et al.,	)	Appeal from the
Plaintiffs-Appellees,	)	United States District Court for the
v.	)	Southern District of West Virginia
	)	
GRANT THORNTON LLP, et al.,	)	
Defendants-Appellants,	)	
and	)	
	)	
THOMAS ALLEN,	)	
Plaintiff-Appellee,	)	
v.	)	Hon. David A. Faber,
	)	<i>Chief Judge</i> , Presiding
GRANT THORNTON LLP, et al.,	)	
Defendants-Appellants.	)	

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**REPLY BRIEF OF APPELLANT GRANT THORNTON LLP**

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## INTRODUCTION

For years, management at the First National Bank of Keystone conducted a fraudulent scheme to overstate the bank's assets. This went undetected despite nine examinations by federal regulators. Grant Thornton LLP ("Grant") had no involvement with Keystone until mid-1998, when Grant was retained to audit its financial statements. Grant issued just one audit report, dated April 19, 1999. Plaintiffs purchased Keystone's stock during the 4½ month period from April 19, 1999 until September 1, 1999, when the bank was closed by regulators. Plaintiffs sued Grant for securities fraud and five state common-law claims, and brought related claims against their own brokers and Keystone's management.

Grant's opening brief showed that the district court abused its discretion and erred as a matter of law in certifying the claims against Grant as a class action. First and foremost, plaintiffs' claims against Grant all require proof of reliance—that is, proof that plaintiffs justifiably relied on some statement by Grant in connection with purchasing Keystone's stock. As this Court recently reaffirmed in *Gunnells v. Healthplan Services Inc.*, 348 F.3d 417, 434 (4th Cir. 2003), such claims require "individual inquiry into the issue of reliance," which defeats Rule 23(b)'s commonality requirement and makes class certification inappropriate. Here the class relied on a wide mix of oral and written statements in purchasing Keystone's stock, but *not* on any statements made by Grant.

The district court did not directly disagree with this law. Instead, it decided that it need not conduct an individualized inquiry into plaintiffs' reliance on Grant because the court could presume that Keystone stock traded in an efficient market. But such a market simply could not exist here as a matter of law. Keystone's stock was *unlisted* for over half the class period, from April 19 until June 24, 1999, and the remaining two months of the class period was too short a time frame to develop an efficient market. The stock traded in this period only sporadically on two over-the-counter systems that should be presumed inefficient. Plaintiffs' complaint also shows there was no efficiency because it alleges that the so-called market consisted entirely of trading prices that were rigged by brokers and insiders. Finally, the efficient market theory requires reliance on public information, and yet many plaintiffs, including the class representatives, purchased in part based on *inside* information, in the form of tips that Keystone was "going to go public." Plaintiffs have no real answer to any of these points.

A second critical error by the district court was its finding that, under *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156 (1974), it could presume an efficient market based solely on the allegations in the complaint. In response, plaintiffs cited three out-of-circuit district court decisions that interpreted *Eisen* this way. Contrary to these few cases, this Court and most others *require* inquiry beyond the complaint in determining if class certification is appropriate.

The district court's third error was finding that common issues predominated in a class involving multiple state law claims where no presumption of reliance was available. This Court recently reaffirmed that the "efficient market" presumption of reliance in securities fraud cases does *not* apply to common-law causes of action. *Gunnells*, 348 F.3d at 435. Fourth Circuit law thus demands that certification be overturned on the state law claims. Plaintiffs also failed to rebut Grant's showing that numerous differences in the at least six states' laws that apply here defeat any prospect for commonality under Rule 23(b).

Instead of meeting Grant's arguments head-on, plaintiffs fall back on false accusations that Grant really *did* commit fraud. Plaintiffs also suggest that Grant can be held liable based on the legal theory that Grant participated in a "common scheme." But bare allegations of a scheme do not overcome plaintiffs' burden to prove reliance and establish that common questions predominate. Indeed, the district court did not even apply the "scheme" theory. In contrast to plaintiffs' unsupported accusations, the undisputed evidence presented by Grant establishes that Keystone was an unlisted stock for half the class period, and that most plaintiffs (and the class representatives in particular) never saw any statement by Grant, and relied instead on a wide mix of oral and written representations. Since Fourth Circuit law flatly prohibits class certification under these circumstances, Grant requests that the order below be reversed.

## ADDITIONAL FACTS

**A. Plaintiffs Falsely Accuse Grant Of Fraud.** Plaintiffs' response devotes several pages to accusing Grant of fraud, and claims that disputed facts about Grant's conduct require a trial. These purported facts have no bearing on whether class certification was correct. Nevertheless, Grant will briefly respond.

Plaintiffs first claim that Grant "was aware" and "knew," prior to the issuance of its audit report dated April 19, 1999, that "Keystone had overstated its assets by at least \$236 million." Pl. Br. 6-7. The record does not support this charge. Plaintiffs' theory derives from a single e-mail, dated April 7, 1999, which on its face offers no evidence of fraud at all. It is hard to see how an e-mail from Keystone's loan servicer, confirming that Keystone had the loans it said it had, somehow shows fraud by Grant. App. 521-522.

Plaintiffs next accuse Grant's lead auditor, Stan Quay, of helping to falsify Keystone's Call Reports to the FDIC. Pl. Br. 7. The sole witness for this theory is Terry Church, a former Keystone employee and convicted felon, who implicated Stan Quay from prison in hopes that her "cooperation" with the FDIC would earn a reduced sentence. What plaintiffs fail to mention is that Church's testimony about errors in the Call Reports did *not* concern the alleged \$236 million overstatement of assets in the financial statements. Her testimony is unreliable for other reasons as well. *See* Grant's Response to FDIC's Surreply, 7/23/03 (dist. ct. docket 1246).

**B. Unrebutted Facts About the Class Period and Reliance.** It is not surprising that plaintiffs emphasize the merits, and falsely accuse Grant of fraud, because on the facts that matter to class certification, they have no real response. One key question is when Keystone was first listed for trading. It is *undisputed* that Keystone was an *unlisted stock* prior to June 24, 1999, and thereafter became listed for the first time on two “over-the-counter” trading systems. App. 387.

Another question is when insiders began their alleged “fraudulent scheme” to dump the stock. Grant asserted that the scheme began roughly in June 1999, two months after Grant issued its audit report. Grant’s source was the complaint, which asserts that the bank executive defendants “began aggressively dumping their stock through the Broker Defendants . . . on or about June 21, 1999.” App. 113. This coincides with June 24, 1999, when Keystone first became listed. Plaintiffs now retreat from this, stating without citation that “discovery confirmed that the insider stock dumping began as early as September 1998 . . .” Pl. Br. 8-9.

But nothing supports this attempt to “backdate” the dumping scheme to September. The earliest trade in the record was on February 18, 1999. App. 390. After that, there were *no trades* until April, two months later. App. 391. Trading was sporadic thereafter. For example, the data reflect 18 trades in May (less than 1 per trading day) and 68 in July. App. 395. Overall, the data cited by plaintiffs (Pl. Br. 11) reflect 244 trades during the entire class period, over 96 trading days. App.

390-397. This is about 2½ trades per day. And although there were trades before June 24, 1999, Keystone's stock was *unlisted* before that date. It is undisputed that “[p]rior to June 24, 1999, there was no formal market for Keystone stock and some broker-dealers simply reported some Keystone stock transactions to an OTCBB site which had no market maker Bid or Ask quotes.” App. 387.

Plaintiffs also have no rebuttal to the evidence about what, exactly, the class relied on. They extravagantly claim that “*all* the named Plaintiffs relied on the false *written* financial information provided by Grant (in its Audit Report) and/or taken *in haec verba* from Grant's audit report.” Pl. Br. 14. With all due respect, this is not what the depositions and interrogatory answers say. Three plaintiffs (Hanyzewski, Shannon and Overholser) relied only on oral statements and received nothing in writing. App. 450-453. The class representatives and two others (Cline and Overholser) bought in part based on false *inside* information that Keystone was “going to go public.” App. 267, 277, 453. The class representatives and most plaintiffs never saw Grant's audit report, Keystone's financial statements or the Call Reports. App. 237-240, 287, 450-454.

The only writing most plaintiffs saw was a single page on Keystone in *Walker's Manual of Unlisted Stocks*. App. 450-454. Even plaintiffs do not accuse Grant of drafting *Walker's*, and they do not explain their assertion that it was foreseeable to Grant that Keystone's financial results would appear in *Walker's*.

Plaintiffs also incorrectly assert that *Walker's* repeated Grant's audit report "*in haec verba*." Pl. Br. 14. *Walker's* summarized the financial statements. App. 430; 490-514. Grant's audit opinion, in contrast, cautioned that Keystone's financial statements "are the responsibility of the Bank's management," and that Grant's work was limited to performing tests, estimates and other audit techniques to arrive at an opinion. App. 489. The one-page listing in *Walker's* was also no substitute for the financial statements, which contained six pages of Assets, Liabilities, Net Earnings and Cash Flow, and 19 pages of Notes. App. 490-514.

Plaintiffs attempt to get around these problems by asserting, again without support, that their *brokers* relied on Grant's audit report and the Call Reports, and this is enough to hold Grant liable. Pl. Br. 35. But again, this is not borne out by the record. The class representatives and nearly all named plaintiffs purchased Keystone from brokers working for Michael Patterson's firms. App. 218, 276, 450-454. Plaintiffs presented *no* evidence as to what these brokers reviewed. (Patterson testified he did *not* review Grant's audit report, or Keystone's financial statements or Call Reports. All he had was *Walker's*.) In short, on the record that matters for class certification, plaintiffs cannot avoid the fact that the class representatives, their brokers and most of the other named plaintiffs never saw Grant's audit report, Keystone's financial statements or the Call Reports.

## ARGUMENT

### **I. The District Court Erred In Certifying The Class Based On A Presumption That Keystone Traded In An Efficient Market.**

The class certification decision below rested entirely on the district court's erroneous presumption that Keystone traded in an efficient market. App. 476-480. Plaintiffs do not offer any adequate defenses of this error.

#### **A. Keystone's Stock Did Not Trade In An Efficient Market.**

For the first half of the alleged class period there was, quite literally, no "market" for Keystone at all, much less an "efficient" one: it is undisputed that there was no exchange, listing service or other forum that provided a daily listing of buy and sell prices for Keystone's stock. App. 387. Plaintiffs make no effort to explain how the presumption of efficiency for publicly-held and widely-traded stocks outlined in *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988), can be applied to an unlisted stock. By definition, an unlisted stock is not being traded in an "open and developed" securities market "involving millions of shares changing hands daily," which is how *Basic* describes the kind of market that supports application of the efficient market presumption. *Id.* at 244. As a matter of law, there is no way "the reliance of individual plaintiffs on the integrity of the market price may be presumed" during the first half of the class period. *Id.* at 247.

For the second half of the class period—June 25, 1999 to September 1, 1999—Keystone traded sporadically on two over-the-counter systems. Plaintiffs

did not answer Grant's contention that a stock trading over-the-counter for only two months has not had sufficient *time* to become efficient. *O'Neil v. Appel*, 165 F.R.D. 479, 501 (W.D. Mich. 1996). Nor did plaintiffs address the scholarship illustrating how stocks on major exchanges can take months to reflect new public information, and over-the-counter stocks exhibit even greater delay. Grant Br. 15.

Plaintiffs also have little to say about Grant's point that the Pink Sheets and Bulletin Board systems do not resemble the efficient market described in *Basic*. True, some courts have refused to adopt a "*per se*" rule that over-the-counter stocks are not efficient. Pl. Br. 18. But these cases are wrong. Quite simply, given the scholarship questioning the efficiency of even large publicly-held stocks traded on major exchanges, there is no basis to hold that over-the-counter markets perform, in *Basic*'s words, "a substantial part of the valuation process performed by the investor in a face-to-face transaction." 485 U.S. at 244; Grant Br. 15-16.

Grant also argued that a market consisting solely of sales prices rigged by brokers who are colluding with insiders cannot be efficient. In response, plaintiffs said that the cases do not require brokers to be unknowing. That misses the point. Here, plaintiffs alleged that *all* the sales were made at rigged prices, and that *all* the brokers were in on the fraud. That is far different from, for example, a few brokers having silent knowledge of misstatements that might affect a company's stock, and selling it anyway. According to *Basic*, an efficient market is one in which reliance

is presumed because the stock price is set by *publicly available information*. Fairly read, plaintiffs' complaint does not allege that Keystone's price had anything to do with Grant's audit report, Keystone's Call Reports, or any other publicly available information about Keystone. Instead, insiders and brokers dumped the stock for as much as they could persuade the unsuspecting purchasers to pay. The stock's price was not set based on public information (whether true or false) it was set by a small group of fraudfeasors bent on victimizing the buyers.

Grant also showed that no presumption of an efficient market is possible where the purchaser trades on non-public information. *West v. Prudential Sec. Inc.*, 282 F.3d 935, 936 (7th Cir. 2002). Here, class representatives Bischoff and Gariety both bought Keystone's stock partly in reliance on their brokers' tip conveying false inside information that the bank was "going to go public." App. 267, 277. Plaintiffs did not put forward any evidence that, at the time of these purchases, the press or other sources were reporting that Keystone would "go public." Thus, because plaintiffs "thought that they were receiving and acting on non-public information," this Court should not "exten[d] ... the fraud-on-the-market doctrine to the [broker's] non-public statements." *West*, 282 F.3d at 937, 940. Plaintiffs' attempt to brush off this issue as a statement about "the anticipated stock price of Keystone," Pl. Br. 30 n.26, is unpersuasive. In mid-1999, near the height of the stock market "bubble," the chance to buy a company's stock before it

went public was considered a ticket to instant riches. The brokers' "going public" representation was a crucial part of the "mix of information" relied on by the plaintiffs who heard it.

**B. It Was Error To Presume Efficiency Based On The Complaint.**

The district court also erred by relying on the allegations of plaintiffs' complaint to presume that an efficient market existed at the class certification stage. In this regard, the court cited *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156, 177-178 (1974), which held that a court should not consider "the merits" in ruling on class certification. App. 479. Interestingly, plaintiffs begin by ignoring this proposition. They tout the district court's experience with "extensive pre-trial fact discovery" and its having "presided over several Keystone criminal trials," and then state that "there is no basis to conclude that the certification order was not fully informed by the district court's awareness of that record." Pl. Br. 21-22.

But there *is* a basis to conclude the district court's order was not informed by its experience with discovery. The order states, "[t]his Court *declines* to make a detailed examination here of the efficiency of the market in which Keystone shares were traded." App. 479. The court then held, "the fact that plaintiffs have asserted that the Keystone market was efficient is enough at the certification stage to find the market efficient." App. 480. The opinion below must be reviewed as having presumed an efficient market based solely on the complaint.

Plaintiffs next argue that the district court had the discretion not to look past the complaint. Yet plaintiffs' cases indicate strict limits on that discretion: a class "may only be certified if the trial court is satisfied, after a rigorous analysis, that the prerequisites of Rule 23(a) have been satisfied." *General Telephone v. Falcon*, 457 U.S. 147, 160-161 (1982). Plaintiffs also concede that those seeking class certification must "provide sufficient evidence which would allow the court to make an informed judgment on the satisfaction of Rule 23 requirements." Pl. Br. 23-24, citing *Doctor v. Seaboard CoastLine R.R.*, 540 F.2d 699 (4th Cir. 1976).

On the dispositive question of an efficient market, there can be no denying that the district court failed to conduct a "rigorous analysis" and make "an informed judgment." It decided to conduct no analysis, and said so in its opinion. Plaintiffs, for their part, did not tender even the most rudimentary evidence on crucial questions such as how an unlisted stock could possibly trade in an efficient market. Thus, class certification on that basis was erroneous.

Plaintiffs conclude by arguing the district court was not required to conduct a detailed inquiry into *all* the factors bearing on an efficient market or conduct a hearing. Pl. Br. 28. But this actually argues for reversal of class certification. Here, a detailed analysis of all the efficiency factors was not necessary. All the court had to do was consider the basic structure of the class period and the market: 2½ months of an unlisted stock, followed by 2 months' listing on marginal OTC

systems, with less than three trades per day on average during the class period. These facts alone were enough to conclude the market could not be efficient.

**C. Keystone Exhibited No Traits Of Efficiency.**

In any event, the district court was presented with persuasive evidence that the market for Keystone's stock exhibited *no* characteristics of efficiency. *Freeman v. Laventhol & Horwath*, 915 F.2d 193, 199 (6th Cir. 1990).

**Volume.** Plaintiffs claim that up to 145,000 shares of Keystone were sold during the class period, leading to a turnover ratio in excess of 1%. This statistic is unsupported, and also irrelevant in the face of evidence showing that there were, at most, 244 trades over roughly 96 trading days in the class period. App. 390-397. That comes to about 2½ trades per day. Plaintiffs do not cite—and we are not aware of—a single case where an efficient market has been found on trading volume this low. Grant's opening brief cited four cases involving similar or higher volumes where the courts found no efficient market. Grant Br. 20-21.

**Analyst Coverage.** There is no evidence that any stock analysts covered Keystone. Plaintiffs point to Keystone's mention in three trade journals (*American Banker*, *Walker's* and *Sheshunoff's*). Pl. Br. 32. But notice in three publications—even prominent ones like *Moody's* or the *Wall Street Journal*—"cannot substitute for serious attention to stock by professional securities analysts." *O'Neil*, 165 F.R.D. at 501; *Krogman v. Sterritt*, 202 F.R.D. 467, 474 (N.D. Tex. 2001).

**Market Makers.** On the question of market makers, plaintiffs again ignore the undisputed record. Grant claimed there were *no* market makers prior to June 24, 1999, when E.E. Powell’s application to open an over-the-counter market for Keystone on the Bulletin Board was granted. App. 387. Grant also contended that *all* purported market makers were alleged participants in the fraud. In response, plaintiffs were unable to *name* any market makers besides E.E. Powell, Scott & Stringfellow and Ferris Baker Watts. All were sued in this matter as defendants, and plaintiffs do not provide any evidence suggesting that any of them functioned as market makers before June 24, 1999. Pl. Br. 32.

Three market makers is far short of a number that might suggest efficiency—especially when all three allegedly joined in the fraud. *Serafty v. Int’l Automated Sys.*, 180 F.R.D. 418, 422 (D. Utah 1998). Plaintiffs also have not provided evidence of *how* the firms functioned as market makers, when they began trading, in what volume, and on what exchange. Absent such information, names of market makers are “virtually meaningless.” *O’Neil*, 165 F.R.D. at 501-502; *Krogman*, 202 F.R.D. at 475.

**Registration Statements.** It is also undisputed that Keystone did not file public registration statements, which “weighs heavily” against efficiency. *O’Neil*, 165 F.R.D. at 502. Plaintiffs cite no case to support their rebuttal that this factor does not apply to bank stocks. In any event, nothing here argues for efficiency.

**Price Movement in Response to Disclosures.** A history of stock price movements in response to news about a company is yet another factor courts have used to test for a efficiency. Grant argued that Keystone's stock price exhibited unexplained volatility, and cited cases holding that this weighs against efficiency. Grant Br. 23. Plaintiffs make no effort to explain the price data cited in their own complaint, which included a \$55 per share trading range (approximately 18%) over three trades on July 12, 1999, and 30% bid/ask spread during the same time frame. App. 136, 424. Plaintiffs instead argue that a *lack* of price movement need not be fatal to finding efficiency, which was not Grant's point. Pl. Br. 34. In any event, the only affirmative price movement evidence cited by plaintiffs is that trading stopped after Keystone was closed by regulators. Pl. Br. 35. But "a period of only four months of substantial trading, followed by a crash, cannot be viewed as evidence of a developed or efficient market." *O'Neil*, 165 F.R.D. at 501. In toto, the *Freeman* factors show Keystone did not trade in an efficient market.

**D. Grant Did Not Make A Public Misstatement.**

Grant's audit report was never made public because the bank's financial statements were not publicly filed, inasmuch as Keystone was not an S-3 reporting company. The court held nevertheless that plaintiffs met their burden to show a "public misrepresentation" by Grant because of *Walker's* listing on Keystone, and because of allegations that Grant helped falsify the bank's Call Reports. App. 477.

Grant argued that it could not be liable for *Walker's* or the Call Reports because it was not the author of those materials. Grant Br. 24. Since *Central Bank of Denver, N.A. v. First Interstate Bank of Denver*, 511 U.S. 164 (1994), it has been clear that private plaintiffs cannot sue a defendant for aiding and abetting another's securities fraud. One line of cases following *Central Bank* holds that "a defendant must actually make a false or misleading statement in order to be held liable under Section 10(b)." *Wright v. Ernst & Young LLP*, 152 F.3d 169, 175 (2d Cir. 1998); *Ziamba v. Cascade Int'l*, 256 F.3d 1194, 1205 (11th Cir. 2001) (requiring statement "publicly attributable" to defendant); *Anixter v. Home-Stake Products*, 77 F.3d 1215, 1226 (10th Cir. 1996). Grant cannot be liable because it was not the author of (or credited with authoring) *Walker's* or the Call Reports. Grant urges this Court to follow these cases as compelled by *Central Bank*.

Plaintiffs rely on a contrary minority line of cases adopted by only one circuit, *In Re Software Toolworks Inc. Sec. Lit.*, 50 F.3d 615 (9th Cir. 1994), which hold that a secondary actor can be held liable if it "substantially participated" in making a public statement. Pl. Br. 36. In *Software Toolworks*, the accountant helped draft the allegedly misleading statement to the SEC. These cases are contrary to *Central Bank* and should not be followed by this Court. They also do not apply here: it is undisputed that Grant had nothing to do with *Walker's*; that the class representatives and most plaintiffs never even saw the Call Reports; and

that the alleged errors in the Call Reports did *not* concern Keystone's alleged \$236 million overstatement of assets. It would be perverse to hold Grant liable as a primary violator based on client statements which, even if Grant's assistance were proven, nobody relied on, and were not connected to the financial statement fraud.

*In re Enron Corp. Sec. Derivative and ERISA Litig.*, 235 F. Supp. 549 (S.D. Tex. 2002), is wrong and inapposite for the same reasons. Further, as plaintiffs concede, it applies only to statements "on which the investor plaintiffs relied." Pl. Br. 37; see *Tricontinental Indus. Ltd. v. Anixter*, 256 F.Supp.2d 806 (N.D. Ill. 2003) (*Enron* limited to alleged "creators" of misleading statement; *Central Bank* controls where professional "reviewed and provided assurance"). Plaintiffs suggest that they need only show Grant "knew or should have known that the representation would be communicated to investors," Pl. Br. 38, but this does not help them. At the time Grant performed its audit work, Keystone was an *unlisted* company. Its stock was not publicly available for purchase or sale, and Grant had no reason to think that Keystone had public "investors" at all. Accountants cannot be held liable to third parties simply because their private audit report is summarized in a journal like *Walker's*. See *Raritan River Steel Co. v. Cherry, Bekaert & Holland*, 407 S.E.2d 178 (N.C. Sup. Ct. 1991) (no liability to lender for audit report reviewed and reported without attribution by *Dun & Bradstreet*). Plaintiffs cannot show a "public misrepresentation."

## **II. The Class Certification Order Cannot Stand In The Absence Of An Efficient Market.**

Plaintiffs next argue that class certification was appropriate, regardless of whether the market was efficient, under a “common scheme” theory or the “fraud created the market” theory of reliance. Neither theory applies here.

### **A. Grant’s Conduct Has No Connection To The Dumping Scheme.**

Plaintiffs claim that this is a “scheme” or “market manipulation case,” where “an allegation of a common course of conduct” means that “individual questions of reliance do not defeat predominance.” Pl. Br. 42. The first problem with this is that Grant was not part of any “common course of conduct” with the persons who carried out the alleged dumping scheme. The evidence necessary to prove the dumping scheme would focus on whether Keystone’s executives contacted the brokers; persuaded them to get in on the fraud; set artificial, rigged prices to sell their stock; and found purchasers who could be duped into buying. In contrast, Grant’s liability would turn on whether Grant knowingly or negligently gave an opinion on the financial statements or reviewed false Call Reports. So trial would not involve a single, common scheme—quite the contrary.

Plaintiffs also cite a dozen or more district court cases with no discussion. These do not change the requirements of securities fraud: plaintiffs must have relied on a material misstatement by the defendant made in connection with the purchase or sale of a security. Indeed, some of these cases expressly held that the

“scheme” occurred in an efficient market. *Walco Investments, Inc. v. Thenen*, 168 F.R.D. 315, 333 (S.D. Fla. 1996); *Hanon v. Dataproducts Corp.*, 976 F.2d 497 (9th Cir. 1992). These cannot support the argument that a “scheme” obviates the need to prove reliance. Other cases held that employees who carried out a company’s fraud cannot escape liability by saying that they personally did not make the misstatement. None of the cases held accountants liable as members of a scheme.

Equally inapposite are “market manipulation” cases such as *In re Blech Sec. Litig.*, 187 F.R.D. 97 (S.D.N.Y. 1999), and *Berwecky v. Bear Stearns & Co.*, 197 F.R.D. 65 (S.D.N.Y. 2000). *Blech* and *Berwecky* involved schemes by brokers who conspired to trade in various securities at pre-arranged times, quantities and prices, in order to manipulate the stocks’ prices, secure improper commissions and artificially support their firm’s apparent asset position. Plaintiffs’ claim against Grant, in contrast, pleads classic allegations that an accounting firm rendered a negligent or reckless opinion on its client’s financial statements. The broker-dealer “market manipulation” cases’ treatment of reliance does not apply. Plaintiffs’ theory that a “common scheme” avoids their burden to prove reliance is wrong.

**B. The “Fraud Created The Market” Presumption Does Not Apply.**

Plaintiffs’ second attempted end-run around the lack of an efficient market is the so-called “fraud created the market” theory. A few courts have held that an alternate presumption of reliance may be available when purchasers rely, not on a

particular stock's publicly-traded price, but on the bare fact that a security is being offered for sale in the market. Pl. Br. 41, citing *Shores v. Sklar*, 647 F.2d 462 (5th Cir. 1981). The district court held this presumption was "inapplicable." App. 477.

This theory has never been approved by the Supreme Court, and has been criticized by several courts of appeal. *In re NationsMart Corp. Sec. Litig.*, 130 F.3d 309, 321 (8th Cir. 1997); *Ockerman v. May Zima & Co.*, 27 F.3d 1151, 1160 (6th Cir. 1994). The Seventh Circuit has rejected the theory outright, calling its premise "simply false." *Eckstein Balcov Film Investors*, 8 F.3d 1121, 1131 (7th Cir. 1993). As that court explained, there is no reason to infer a causal link between the *fact* that a security is being offered for sale and the truth or falsity of available information: "the *existence* of a security does not depend on, or warrant, the adequacy of disclosure." *Id.* Based on the foregoing, this Court should decline plaintiffs' invitation to apply the "fraud created the market" theory to this case.

In any event, even on its own terms the theory does not apply here, for it is limited to situations where plaintiffs bought newly issued securities. *Shores*, 647 F.2d at 464 n.2 (theory applies when fraud is so pervasive that "without it the issuer would not have issued" the stock in question); *Ockerman*, 27 F.3d at 1159; *Joseph v. Wiles*, 223 F.3d 1155, 1163 n.2 (10th Cir. 2000). Keystone was not a new issue; to the contrary, plaintiffs purchased *previously* issued stock held by insiders. The "fraud created the market" theory does not fit these facts.

### **III. The District Court Abused Its Discretion In Certifying The Class Because Individual Issues Predominate Over Common Issues.**

For other reasons having nothing to with the efficient market theory, this Circuit's class certification precedents require reversal of the district court's order.

#### **A. The Varying Mix Of Representations Destroys Commonality.**

It was error to certify a class because plaintiffs relied on a wide mix of oral and written representations, making this matter inappropriate for class treatment. Grant Br. 26-28. Plaintiffs respond by arguing that *Walker's*, the broker's oral representations and *American Banker* somehow conveyed the same information included in Grant's audit report. Pl. Br. 43. But as Grant demonstrated, this is not true. *Walker's* was only a single page, App. 430, different in substance and detail from Grant's audit report or Keystone's 20-plus page financial statements. App. 489-514. *American Banker* had even less information—Keystone appears as a single line among 75 other banks. App. 15. Some plaintiffs purchased in reliance only on *oral* representations. App. 450-454. Plaintiffs' brokers made varying oral representations, including that Keystone was "going to go public," had "guaranteed earnings," and was "very safe." *Id.* Finally, there is no evidence that the brokers on whom the class representatives relied saw Grant's audit report, or the financial statements or Call Reports. Based on this, plaintiffs' bald-faced claim that "*all* the named plaintiffs ... relied on the same written document" must be rejected. Pl. Br. 43. It was an abuse of discretion to find that common issues predominated.

**B. No Presumption Of Reliance Is Available For State Law Claims.**

This Court's precedents also make clear that the certification of plaintiffs' state common-law claims was an abuse of discretion. Under the laws of at least six states applicable to plaintiffs' common law claims, there is no presumption of reliance, and plaintiffs thus are required to prove individual reliance against Grant. Grant Br. 27-28. This defeats commonality as to all plaintiffs' state law claims. *Broussard v. Meineke Discount Muffler Shops*, 155 F.3d 331, 341-342 (4th Cir. 1998); *Zimmerman v. Bell*, 800 F.2d 386, 390 (4th Cir. 1986).

Shortly before plaintiffs filed their response brief, this Court reaffirmed "the need for individual inquiry into the issue of reliance" in cases involving "negligent misrepresentation and fraud." *Gunnells*, 348 F.3d at 434. The *Gunnells* panel reviewed certification of fraud, negligent misrepresentation, negligent undertaking and breach of contract claims against numerous individual brokers who sold and marketed a health insurance plan that failed to pay claims and was closed by state regulators. This Court made clear that the efficient market presumption of reliance in *Basic v. Levinson* could *not* be applied to state common law claims. *Id.*, citing *Broussard, supra*. This confirms that class treatment was inappropriate.

**C. Multiple State Law Issues Defeat Commonality.**

Plaintiffs have also failed to rebut Grant's opening argument that common questions do not predominate on plaintiffs' state law claims. Grant Br. 30-50.

**1. The laws of multiple states will apply.**

Plaintiffs acknowledge the district court's holding that under West Virginia's "traditional[]" *lex loci delicti* choice-of-law rule "the substantive law of at least six states apply" to their claims. App. 481. And plaintiffs do not dispute that under this rule, their state law claims are governed by the law of the state in which each plaintiff lives. But plaintiffs contend that the district court erred in determining that *lex loci delicti* applies. They assert that West Virginia "likely" would apply its own law if applying other states' laws "would result in fraudulent financial reporting going unpunished." Pl. Br. 48.

This argument—the only one plaintiffs make for applying West Virginia law—is meritless. First, they do not cite any case in which a West Virginia court has used this rationale to refuse to apply another state's laws. Second, the district court reached no conclusions about West Virginia's interest in financial reporting. In denying Grant's motion to dismiss, the court merely noted (without citing any cases) that "Plaintiffs point to a strong public interest in accurate financial reporting." Docket no. 462, at 10. The truncated quotation in plaintiffs' brief on appeal (at 48) omits the first three words.

Third, West Virginia deviates from the doctrine of *lex loci delicti*—which "has long been the cornerstone of our conflict of laws doctrine," *Armor v. Lantz*, 535 S.E.2d 737, 741 n.8 (W. Va. 2000)—only when "the substantive law of a

foreign state . . . contravenes the public policy of [West Virginia],” such as when another state’s law precludes recovery entirely because it has immunity doctrines that West Virginia does not follow, or the other state adheres to complete defenses of contributory negligence and assumption of risk that West Virginia has abolished. *Mills v. Quality Supplier Trucking*, 510 S.E.2d 280, 282 (W. Va. 1998). There is nothing like that here. Plaintiffs do not—and cannot—identify any aspect of other states’ laws that would preclude recovery or violate West Virginia’s public policy in any way. Accordingly, there is no basis for their contention that West Virginia would reject its longstanding *lex loci delicti* rule.

**2. The applicable law varies considerably from state to state.**

Grant’s opening brief (at 31-33) explained that plaintiffs did not satisfy their obligation to identify all of the states’ laws that apply to their claims because they have never even identified the states in which approximately 135 class members live. Plaintiffs do not dispute that they have this obligation—one of their cases notes that the law “require[s] that the plaintiffs demonstrate that the law of the different states either will not apply or will not vary significantly.” *Grace v. Perception Technology*, 128 F.R.D. 165, 171 (D. Mass. 1989). Yet plaintiffs remain silent on where the other class members live (and thus on which states’ laws apply to their claims). The logical inference to be drawn is that the remaining 135 class members live in states other than the six already identified.

Plaintiffs’ complete failure to even identify which states’ laws apply to those 135 class members, much less demonstrate that common questions predominate under those laws, is enough by itself to overturn certification of the state law claims. But even limiting consideration to the six states identified in our opening brief and the five state law claims that plaintiffs assert, it is evident that individual issues predominate.

Plaintiffs do not seriously contend otherwise. Their conclusory assertion that “the elements of the state common law claims . . . are substantially the same” (Pl. Br. 44) is refuted by even a cursory look at the cases we cited. For example, as Grant pointed out (Grant Br. 34), the six states have either three, five, or six elements for a fraud claim. Plaintiffs do not respond to those cases. Likewise, plaintiffs assert—without citing a case—that each state requires materiality for a fraud claim (Pl. Br. 51), but Maryland and Florida do not (Grant Br. 34-35). Plaintiffs’ contention that the intent element is the same in every state (Pl. Br. 51) is similarly contradicted by the cases (Grant Br. 35). And plaintiffs blithely assert that whether reliance must be “justifiable” or “reasonable” is immaterial (Pl. Br. 51)—although the Fifth Circuit has ruled just the opposite. *Castano v. American Tobacco*, 84 F.3d 734, 743 n.15 (5th Cir. 1996). Moreover, Florida requires only “reliance” (Grant Br. 34), which plaintiffs do not mention.

For negligent misrepresentation claims, the six states follow markedly different standards (Grant Br. 38-43)—yet plaintiffs pretend the states can be “easily divided into two categories.” Pl. Br. 51 (citing no cases and not discussing ours). Similarly, plaintiffs assert that the claim for aiding and abetting tortious conduct can be handled simply by creating two subclasses: one for states “that allow such a cause of action” and one for “those that do not.” Pl. Br. 52 (citing no cases). That is one difference between the states, but there are many others, as we pointed out (Grant Br. 47-49) but which plaintiffs ignore. And the contention that the states “essentially require the same elements” for conspiracy (Pl. Br. 52, citing no cases) is false—as we demonstrated (Grant Br. 43-46) in an extensive summary of cases that plaintiffs do not deign to discuss.

Constructive fraud is the only claim for which plaintiffs bother to cite cases (Pl. Br. 52 n.35), but even there the differences among the six states are readily apparent. For example, plaintiffs lump West Virginia and New York together, but the cases they cite show unequivocally that the elements of a constructive fraud claim are very different in the two states. Compare *State v. Morgan Stanley & Co.*, 459 S.E.2d 906, 913 (W. Va. 1995), with *Abbate v. Abbate*, 441 N.Y.S.2d 506, 512 (App. Div. 1981). Plaintiffs cite several cases to show that there is no scienter element for constructive fraud in any of the six states—but we never said there was. And plaintiffs say nothing about our showing (Grant Br. 37) that (a) the

states differ in their standards for establishing a fiduciary duty, which is part of a constructive fraud claim; (b) the states' differences for fraud claims are relevant in those states where constructive fraud shares some elements with fraud; and (c) New Jersey bars damages for constructive fraud.

Plaintiffs' strategy is clear: ignore the pertinent case law. But sticking one's head in the sand will not make precedent go away, and plaintiffs' failure to come to grips with the cases we cited is telling. Plaintiffs' approach here is in striking contrast to cases that they cite in which courts certified state law classes: in *LaFata v. Raytheon Co.*, 207 F.R.D. 35, 48 (E.D. Pa. 2002), plaintiffs submitted "state-by-state comparisons of each element of each state law claim," while in *In re Prudential Ins. Co. Sales Practices Litig.*, 962 F.Supp. 450, 525 (D.N.J. 1997), the plaintiffs "submitted a series of charts setting forth comprehensive analyses of the various states' laws potentially applicable." Not only have the plaintiffs here not even attempted such a showing, but they have persistently ignored Grant's demonstration that the causes of action differ significantly in the six states (to say nothing of the unknown states' laws that apply to the other 135 class members).

Plaintiffs also rely heavily on *In re Telectronics Pacing Systems*, 172 F.R.D. 271 (S.D. Ohio 1997), which certified a nationwide class action involving the laws of all 50 states, but that district court decision is squarely inconsistent with the law in at least three circuits. *Telectronics* itself stated that it "strongly disagree[d]" (*id.*

at 275-76) with the Fifth Circuit’s decision in *Castano*, 84 F.3d 734, and Chief Judge Posner’s opinion in *In re Rhone-Poulenc Rorer Inc.*, 51 F.3d 1293 (7th Cir. 1995). And the Ninth Circuit refused to follow *Telectronics* in *Zinser v. Accufix Research Institute*, 253 F.3d 1180, 1189-90 (9th Cir. 2001). Moreover, after the district court in *Telectronics* certified a mandatory, non-opt-out class and approved a settlement, the Sixth Circuit reversed, noting that “we do not decide if . . . any type of class certification, can work in this case.” *In re Telectronics Pacing Systems*, 221 F.3d 870, 882 (6th Cir. 2000).

In the end, plaintiffs’ position rests on their conclusory assertion that the various claims are essentially the same in each state. But as then-Judge Ruth Bader Ginsburg wrote, “[a] court cannot accept such an assertion ‘on faith.’” *Walsh v. Ford Motor Co.*, 807 F.2d 1000, 1016 (D.C. Cir. 1986). And because plaintiffs have utterly failed to meet their burden to demonstrate that common legal issues predominate, class certification of the state law claims cannot stand.<sup>1</sup>

## CONCLUSION

The class certification order should be reversed.

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<sup>1</sup> Regarding Grant’s argument that Bischoff and Gariety are inadequate class representatives, Grant generally stands on its opening brief, but points out that the class representatives are also inadequate because they, unlike most named plaintiffs, relied on false inside information, in the form of brokers’ tips that Keystone was “going public.” App. 267, 277.

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Respectfully submitted,

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