

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.

REPLY BRIEF FOR DEFENDANT-APPELLANT UNDERWRITERS SEEKING REVERSAL OF CLASS CERTIFICATION PURSUANT TO FEDERAL RULE OF CIVIL PROCEDURE 23(f)

Pursuant to June 30, 2005 Order Granting Permission to Appeal

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

January 27, 2006

(Appearance list annexed)

Gandolfo V. DiBlasi
John L. Hardiman
Penny Shane
David M.J. Rein
Richard J.L. Lomuscio
Taleah E. Jennings
SULLIVAN & CROMWELL LLP
125 Broad Street
New York, New York 10004
(212) 558-4000

Attorneys for Goldman, Sachs & Co. in Engage Technologies, Inc. and Sycamore Networks, Inc. and Liaison Counsel for the Underwriter Defendants

Andrew B. Clubok
Richard A. Cordray
Brant W. Bishop
KIRKLAND & ELLIS LLP
655 Fifteenth Street, N.W.
Suite 1200
Washington, DC 20005
(202) 879-5000

Attorneys for Morgan Stanley & Co. Incorporated in Sycamore Networks, Inc. and iXL Enterprises, Inc.

Randy Mastro
Robert Serio
Mark Holton
GIBSON, DUNN & CRUTCHER
LLP
200 Park Avenue
New York, New York 10166
(212) 351-4000

Attorneys for Bear, Stearns & Co. Inc. and The Bear Stearns Companies Inc. in Engage Technologies, Inc. and iXL Enterprises, Inc.

Robert B. McCaw
Louis R. Cohen
Fraser L. Hunter, Jr.
Mark M. Oh
David S. Lesser
WILMER CUTLER PICKERING
HALE AND DORR LLP
399 Park Avenue
New York, New York 10022
(212) 230-8800

Attorneys for Credit Suisse Securities (USA) LLC (formerly known as Credit Suisse First Boston LLC) in Corvis Corp., VA Linux Systems, Inc., Engage Technologies, Inc., and Sycamore Networks, Inc.

Andrew J. Frackman
Brendan J. Dowd
Matthew J. Merrick
O'MELVENY & MYERS LLP
Times Square Tower
7 Times Square
New York, New York 10036
(212) 326-2000

Attorneys for Robertson Stephens, Inc., in Firepond, Inc., Corvis Corp., iXL Enterprises, Inc., and Sycamore Networks, Inc.

Barry R. Ostrager
David W. Ichel
Joseph M. McLaughlin
SIMPSON THACHER &
BARTLETT LLP
425 Lexington Avenue
New York, New York 10017
(212) 455-2000

Attorneys for J.P. Morgan Securities Inc., individually in Sycamore Networks, Inc. and as successor in interest to Hambrecht & Quist LLC in Engage Technologies, Inc.

Stephen M. Shapiro
Timothy S. Bishop
Joshua D. Yount
MAYER, BROWN, ROWE &
MAW LLP
71 South Wacker Drive
Chicago, Illinois 60606
(312) 782-0600

Attorneys for Merrill Lynch & Co., Inc. and Merrill Lynch, Pierce, Fenner & Smith Incorporated in iXL Enterprises, Inc., Sycamore Networks Inc., and Corvis Corp.

George A. Schieren
Mark Holland
Robert G. Houck
CLIFFORD CHANCE US LLP
31 West 52nd Street
New York, New York 10019
(212) 878-8000

Attorneys for Merrill Lynch & Co., Inc. and Merrill Lynch, Pierce, Fenner & Smith Incorporated in iXL Enterprises, Inc., Sycamore Networks, Inc., and Corvis Corp.

Moses Silverman
Philip Barber
PAUL, WEISS, RIFKIND,
WHARTON & GARRISON LLP
1285 Avenue of the Americas
New York, New York 10019
(212) 373-3000

Attorneys for Lehman Brothers Inc. in Corvis Corp. and Sycamore Networks, Inc.

A. Robert Pietrzak
Joel M. Mitnick
María D. Meléndez
SIDLEY AUSTIN LLP
787 Seventh Avenue
New York, New York 10019
(212) 839-5300

*Attorneys for Deutsche Bank
Securities Inc. (f/k/a Deutsche
Banc Alex. Brown Inc., DB Alex.
Brown LLC and BT Alex. Brown
Incorporated) in Engage
Technologies, Inc.*

Jay B. Kasner
Scott D. Musoff
SKADDEN, ARPS, SLATE,
MEAGHER & FLOM LLP
Four Times Square
New York, New York 10036
(212) 735-3000

*Attorneys for SG Cowen Securities
Corp. (n/k/a SG Cowen & Co.,
LLC) in Firepond, Inc.*

Stephen L. Ratner
Sarah S. Gold
PROSKAUER ROSE LLP
1585 Broadway
New York, New York 10036
(212) 969-3000

*Attorneys for Prudential Securities
Incorporated in Engage
Technologies, Inc.*

Stewart D. Aaron
ARNOLD & PORTER LLP
399 Park Avenue
New York, New York 10022
(212) 715-1000

*Attorneys for RBC Dain Rauscher,
Inc. (f/k/a Dain Rauscher, Inc.) in
Engage Technologies, Inc.,
Firepond, Inc. and Sycamore
Networks, Inc.*

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2005 IPO Allocations Release	<i>Commission Guidance Regarding Prohibited Conduct in Connection with IPO Allocations</i> , SEC Release Nos. 33-8,565, 34-51,500 (April 7, 2005)
A-__	Joint Appendix
Barry	Report of Christopher B. Barry in <i>In re iXL Enterprises, Inc. Initial Public Offering Securities Litigation</i> , dated February 23, 2004
CA-__	Confidential Appendix
Cornell	Report of Bradford Cornell in <i>In re Initial Public Offering Securities Litigation</i> , dated May 10, 2004
Ex.	Exhibit
Exchange Act	Securities Exchange Act of 1934, 48 Stat. 891, as amended
Fischel I	Report of Daniel R. Fischel, dated January 20, 2004
Fischel II	Rebuttal Report of Daniel R. Fischel, dated April 15, 2004
Fischel III	Supplemental Report of Daniel R. Fischel, dated July 12, 2004
IPO	Initial Public Offering
Kleidon	Report of Allan W. Kleidon in <i>In re Sycamore Networks, Inc., Initial Public Offering Securities Litigation</i> , dated February 24, 2004
MA	Master Allegations

O'Hara		Report of Professor Maureen O'Hara in <i>In re VA Linux, Inc. Initial Public Offering Securities Litigation</i> and <i>In re Corvis Corp., Inc. Initial Public Offering Securities Litigation</i> , dated February 23, 2004
O'Hara Supp.		Supplemental Expert Report of Professor Maureen O'Hara in <i>In re Initial Public Offering Securities Litigation</i> , dated July 23, 2004
PL-__		Brief for Plaintiffs-Appellees, dated December 19, 2005
Securities Act		Securities Act of 1933, 48 Stat. 74, as amended
September Report	2002	Report of the Judicial Conference Committee on Rules of Practice and Procedure, September 2002 (available at http://www.uscourts.gov/rules/jc09-2003/summreptjc.pdf)
Sirri		Report of Erik R. Sirri in <i>In re iXL Enterprises, Inc. Initial Public Offering Securities Litigation</i> , dated February 23, 2004
SPA-__		Special Appendix
Stulz		Report of René M. Stulz in <i>In re FirePond, Inc. Initial Public Offering Securities Litigation</i> , dated February 24, 2004
UD-__		Brief of Defendant-Appellant Underwriters Seeking Reversal of Class Certification Pursuant to Federal Rule of Civil Procedure 23(f), dated October 3, 2005

Underwriter
Defendants

The underwriters named as defendants in one or more of the 310 coordinated actions in *In re Initial Public Offering Securities Litigation*, 21 MC 92 (SAS)

Weiss

Declaration of Melvyn I. Weiss in Support of Motion for Judicial Notice, dated December 19, 2005

INTRODUCTION

In these extremely unusual securities fraud cases, Rule 23(b)(3)'s requirements for class certification cannot be met. Plaintiffs allege that dozens of underwriters, hundreds of IPO issuers, and *over 11,000 individual and institutional investors* engaged in a brazen market manipulation scheme that inflated share prices for years in otherwise “efficient” securities markets. These allegations of widespread knowledge of — and participation in — the alleged scheme raise individualized issues that predominate over the common ones for every element of a securities fraud claim:

- Knowledge negates deception and belies materiality.
- Knowledge is the antithesis of reliance and, when widespread, destroys the “common sense” rationale for presuming reliance under *Basic* or *Affiliated Ute*.
- Widespread knowledge by market professionals negates any loss causation theory predicated on long-lived price inflation, because if the market is “efficient,” market professionals eliminate inflation through arbitrage trading.

Plaintiffs cite no certified class action where assertions about the knowledge of so many potential claimants raise so many individualized issues.

Plaintiffs also cite no basis for extending a reliance presumption to the conduct alleged here. Plaintiffs brush aside concerns expressed in *Hevesi* about extending *Basic*'s “common sense” presumption beyond issuer

statements in well-developed markets, by arguing that the cases here center on omissions from issuers' prospectuses. But the allegedly misstated and omitted information here concerns allegedly manipulative *trading*. That trading was not engaged in by issuer "insiders," but by investors. It involved newly issued securities, in markets plaintiffs admit lacked key attributes of efficiency.

When it comes to loss causation, plaintiffs contradict their efficient market theory, and impermissibly assert that common proof can show that price inflation that started before trading began remained uncorrected for years thereafter. Plaintiffs identified no methodology to prove at trial, on a class-wide basis, that defendants' alleged conduct caused each class member's loss. As six prominent economists testified, the speculative theory plaintiffs' expert offered lacks any scientific basis, and is incapable of excluding "changed economic circumstances" or other non-fraudulent causes of price declines, such as fledgling companies proving unprofitable. *See Dura*, 125 S. Ct. at 1631-32.

Plaintiffs never attempt to reconcile the profound incongruities among their knowledge, reliance, and loss causation assertions. Instead, they urge the Court to overlook them, by endorsing the district court's ruling that plaintiffs need only make "some showing" that the requirements of Rule

23 are met. In *Heerwagen v. Clear Channel Communications*, --- F.3d ---, 2006 WL 45859 (2d Cir. Jan. 10, 2006), this Court joined the majority of Circuits in determining that Rule 23’s demand for “findings,” on an “informed basis” about how a case “actually will be tried,” can be satisfied only if plaintiffs prove the predominance of common issues *by a preponderance of the evidence*. The necessary predominance finding cannot be made in these cases because overwhelmingly individualized issues of knowledge, reliance, and loss causation flow directly from plaintiffs’ assertions.

ARGUMENT

I. TO SATISFY RULE 23 PLAINTIFFS MUST PROVE BY A PREPONDERANCE OF THE EVIDENCE THAT COMMON ISSUES PREDOMINATE.

In certifying the classes, the district court held that it was enough that plaintiffs made “some showing” that the classes satisfy Rule 23, 227 F.R.D. at 93 (SPA-68), and that plaintiffs “need not establish the elements of Rule 23 by a preponderance of the evidence.” *Id.* The district court held that it “is forbidden to weigh the evidence on class certification.” *Id.* Plaintiffs embrace that standard. (PL-11, 14, 18, 21.)

Since we filed our opening brief this Court has rejected the “some showing” standard. In *Heerwagen*, the Court rejected an antitrust

plaintiff's contention that the district court erred when it required her "to make a predominance showing . . . by a preponderance of the evidence" and "weigh[ed] the competing testimony of the experts on this issue." 2006 WL 45859, at *3, *9. "Complying with Rule 23(b)(3)'s predominance requirement," this Court held, "*cannot be shown by less than a preponderance of the evidence.*" *Id.* at *11 (emphasis added). The Court recognized that "[i]f plaintiff had a lesser burden" — like "some showing" — a class could be certified despite the "judge's belief that it is more likely than not that individual issues would predominate." *Id.* Certification in those circumstances "would contravene the express language" of the Rule requiring a court to make "findings" that common questions predominate, and would "undermin[e]" the "purpose of Rule 23(b)(3), to ensure that the class is 'sufficiently cohesive to warrant adjudication by representation.'" *Id.* (quoting *Amchem*, 521 U.S. at 623); *see also Falcon*, 457 U.S. at 160 ("actual, not presumed, conformance" with Rule 23 is required); Fed. R. Civ. P. Adv. Comm. Notes 2003 (the focus under Rule 23 is on evidence and issues "that actually will be presented at trial").

Heerwagen also held that the district court had properly "weigh[ed] the experts' testimony" bearing on "whether issues common to the class are likely to predominate," 2006 WL 45859, at *10 — something

Judge Scheindlin deemed prohibited. 227 F.R.D. at 114-15 (SPA-127-28). *Heerwagen* explains that nothing in *Eisen* or *Caridad* prohibits a “thorough predominance analysis that indirectly address[es] merits issues,” including a “comparison of the weight of the experts’ testimony.” 2006 WL 45859, at *11. Indeed, the Court observed that was precisely the type of analysis that this Court “affirm[ed] and favorably review[ed]” in *Visa Check*. (See also UD-45.)

“[W]eighing evidence in connection with Rule 23 determinations,” this Court explained, is impermissible only “to the extent those determinations are effectively *identical* to merits issues.” *Heerwagen*, 2006 WL 45859, at *11 (emphasis added). Such weighing is *required*, however, when necessary to resolve the “independent question of whether plaintiff had made a proper showing of predominance.” *Id.* *Heerwagen*, which flatly rejects the approach taken by the district court here, is binding precedent in this Circuit, and requires reversal. See *Nicholas v. Goord*, 430 F.3d 652, 659 (2d Cir. 2005).

Heerwagen is consistent with demanding standards for class certification articulated by other Circuits, the Supreme Court, and the amended Rule itself. Most recently, in *In re PolyMedica Corp. Securities Litigation*, 432 F.3d 1, 5-7 (1st Cir. 2005), the First Circuit, following “the

majority view,” held that while a court may not rule on “whether a plaintiff will prevail on the merits,” given “the high stakes in the class-certification decision” it must “evaluate . . . critically” the “competing evidence.” *Id.* at 6, 17, 5; *see* PL-22 n.10; UD-40-42 (collecting cases from other Circuits).

Here, the disputes now presented concern not “the probability of success on the merits” — whether an investor could establish the elements of Section 10(b) or Section 11 liability — but whether those elements, including lack of knowledge, reliance, and loss causation, “are susceptible to common proof.” *Heerwagen*, 2006 WL 45859, at *10. There is no need to resolve “the validity of plaintiffs['] claim[s],” only whether the plaintiffs could establish liability by common proof. *Id.* “Some overlap” between a merits and class certification inquiry is “an acceptable collateral consequence of the ‘rigorous analysis’ that courts must perform when determining whether Rule 23’s requirements have been met.” *Id.*¹

¹ *Amicus* NAACP’s argument fails to distinguish between ruling on who is likely to prevail at trial and whether the merits can be tried on a common basis. In a proper civil rights class suit brought under Rule 23(b)(3) — and NAACP concedes that most are brought under Rule 23(b)(2) (to which these requirements do not apply) — plaintiffs are readily able to support a finding that common issues predominate and the case is manageable. Otherwise, class proceedings are improper. *Falcon*, 457 U.S. at 155-61.

The 2003 Amendments to Rule 23 reinforce *Heerwagen's* approach. The Amendments permit time for “discovery into the ‘merits’” so that the district court has the “information necessary” to decide “on an informed basis” whether the issues “are susceptible to class-wide proof.” Fed. R. Civ. P. Adv. Comm. Notes 2003. Statements in the history of the 2003 Amendments that the Amendments concern the “process” and not the “standards” for class certification (PL-24-25) mean simply that they do not “change the criteria for class certification” — such as predominance, superiority, and manageability — “focus[ing] instead . . . on the process for applying current certification criteria” to ensure that a court has sufficient information to make a rigorous determination whether the case can be resolved with common evidence. Report of the Civil Rules Adv. Comm., May 20, 2002, at 125 (Weiss-7). Indeed, the amendment abolished conditional certification in order to “remove[] any suggestion that courts should . . . err on the side of certifying doubtful cases.” Mem. of Lee Rosenthal to Adv. Comm. on Civil Rules, Apr. 23, 2002, at 2 (Weiss-9). This is the opposite of the ruling below that ““when a court is in doubt as to whether or not to certify a class action, [it] should err in favor of allowing the class to go forward.”” 227 F.R.D at 90 (SPA-60-61); *see also* Civil Adv. Comm. Minutes, Oct. 22-23, 2001, at 3 (endorsing *Szabo's* insistence that a

court uncover “the substance of the dispute”); Civil Adv. Comm. Minutes, May 6-7, 2002, at 19 (approving Third and Seventh Circuit standards).

Plaintiffs suggest that the district court’s “actual analysis” was more “meaningful” than acceptance of “some showing” alone. (PL-11, 21.) The district court undoubtedly reviewed much evidence and wrote a lengthy opinion describing critical disputes and their importance. Its rulings, however, were that because plaintiffs had made “some showing” each dispute must be resolved at some “later stage.” 227 F.R.D. at 93, 99 (SPA-69, SPA-86). Thus, the court reserved for trial critical disputes over whether common proof could avoid individualized inquiry into each investor’s “actual knowledge of the alleged scheme,” whether plaintiffs would have to “make individual showings of reliance,” and whether loss causation from allegedly manipulative conduct could be proved on a class-wide basis without any trade-by-trade inquiries, over class periods of months or years. 227 F.R.D. at 103 & n.300, 107-108 & n.326, 115 (SPA-96, SPA-108-10, SPA-128-29). On each of these issues, as plaintiffs ultimately concede (PL-11, 21), all the district court found was that plaintiffs made “‘some’ threshold showing,” not a showing that could support a finding that the Rule 23 standards are met by a preponderance of the evidence. *Heerwagen*

squarely holds that a finding of less than a preponderance falls short of what Rule 23 requires.

II. CERTIFICATION IS IMPROPER BECAUSE WIDESPREAD INVESTOR KNOWLEDGE MAKES INDIVIDUAL ISSUES PREDOMINATE.

Plaintiffs never deal with the key difference between these 310 cases and any other securities class action: plaintiffs' repeated admissions that there was *widespread investor knowledge of and direct involvement in* the alleged "industry-wide" fraud. During the period of this appeal alone, plaintiffs' own list of alleged *participants* in improper trading has jumped from 500 to *over 11,000* investors.² If so many knew about the alleged

² After we filed our opening brief, and pursuant to orders of the district court dated October 30 and December 15, 2003, plaintiffs served supplemental responses to the Underwriters' interrogatories. Whereas plaintiffs' earlier interrogatory responses had identified approximately 500 investors who purportedly participated in the allegedly improper trading (*see, e.g.*, UD-6, 10; CA-431-442), plaintiffs' most recent responses identify over 11,000 such investors. (This figure reflects a highly conservative count by defendants, in which similar, though not clearly related, account names identified by plaintiffs are counted as only one account. If each distinct account were instead counted as a distinct investor, the number of identified participants is more than 21,000.) This Court may take judicial notice of plaintiffs' interrogatory responses. *See* Fed. R. Evid. 201(b) & (f); *Rothman v. Gregor*, 220 F.3d 81, 92 (2d Cir. 2000). Copies of those responses, which comprise over 5,000 printed pages, are available to this Court upon request.

fraud, common proof cannot establish reliance or any other element of plaintiffs' claims.

A. Plaintiffs Concede That Knowledge And Participation Issues Require Over 500 Mini-Trials Per Case.

Plaintiffs seek to minimize the problem of investors' knowledge, calling it "entirely speculative." (PL-70.) Like the district court, they treat investor knowledge as a relatively unimportant component of reliance and class definition issues. (PL-65-70, 82-88.) According to plaintiffs (PL-86), they merely allege that "*certain* institutional investors stated that receipt of allocations was conditioned on payment of undisclosed compensation and commitments to order in the aftermarket." (PL-86 (emphasis in original).)

Plaintiffs' "Master Allegations" read differently. There, plaintiffs allege the broadest possible knowledge and participation, without any of the limitations they now assert. They say the alleged arrangements gave rise to "industry-wide understanding," which was "invariably communicated" to investors of all kinds and sizes directly, by oral communications with Underwriters whenever investors sought or obtained any of thousands of IPO allocations; and indirectly, by communications with a broader population of market participants and market watchers, and from internet postings, chat rooms, and the like. (MA ¶¶ 30, 31, 33 (A-1137-38);

see UD-10-11, 16-17, 29, 50.) The pleadings also assert, and the record confirms, that print and broadcast media publications, including financial news services and SEC pronouncements, provided another source of information about the alleged misconduct during the class period. (UD-16-18, 50-51.) And the record includes plaintiffs’ assertion that in the six focus cases alone at least 667 investors entered into or placed purchase orders pursuant to “tie-in” arrangements. *See* Fischel III ¶¶ 4, 6-8, 13-14, Ex. A (CA-813-15, CA-817, CA-825-26).

After repeated discovery orders required plaintiffs to list the institutional investors allegedly “required or induced” to enter into improper trading arrangements, plaintiffs identified 500. (CA-68-442.) While this appeal was pending, plaintiffs expanded that list to include over *11,000 institutions and individuals*, including federal agencies, dozens of states, universities, pension funds, and many of the biggest financial institutions, money managers, and corporations in the world.

To downplay these admissions, plaintiffs present some new math. They now say that the universe of investors who may be subject to exclusion based on direct communications with Underwriters is “not more than a few hundred” per issue, corresponding to the number of institutional “allocants” per issue. (PL-86-87.) By limiting the count to institutions that

actually *received* allocations, plaintiffs would have the Court overlook their claim that anyone who *sought* an allocation knew of the alleged scheme, making it “common knowledge” even among those who received no allocation. (MA ¶¶ 30, 33 (A-1137, A-1138).) Plaintiffs’ count excludes, as well, *thousands* of “retail” allocants per issue, contrary to plaintiffs’ Master Allegations that tie-in arrangements were “invariably” communicated to these prospective allocants, and contrary to plaintiffs’ interrogatory responses. (MA ¶ 30 (A-1137).) Even so, plaintiffs concede that knowledge and participation inquiries in these cases may warrant *more than 500 mini-trials in each of the 310 cases*. (PL-86-87 & n.56.)

Plaintiffs do not dispute that it would be economically rational for the parties to engage in intensive litigation over knowledge in more than 500 mini-trials in each of 310 cases. Institutional investors accounted for the overwhelming majority of the *shares allocated* in these offerings, as well as for a substantial volume of *shares bought and sold* in the aftermarket and, consequently, would have significant economic interest in any recovery. *See* 227 F.R.D. at 112 (SPA-121); PL-86, 87 n.56; UD-57; Fischel III ¶¶ 8, 13 (CA-815, CA-817). These institutions, as fiduciaries to millions of investors, would have every incentive to testify at a mini-trial that they invested as they saw fit, not as participants in an alleged market

manipulation scheme, and each would have had every reason to arbitrage or hedge any stock purchased at an inflated price. (CA-5-66, CA-68-442.)

Plaintiffs' argument that participants and others who learned about allegedly improper trading could still recover if they lacked "knowledge of the entire scheme" or its "total distortions in market price," underscores the potential complexity of individual inquiries in each mini-trial. (PL-85-86.) Plaintiffs cite no case holding that fraud claims are barred only for claimants who knew about "the entire scheme" and its "total" price impact. This Court has held the opposite: plaintiffs asserting manipulation claims must have traded "in ignorance of the fact that the price was affected by the alleged manipulation." *Gurary*, 190 F.3d at 45.³ The same principle — that knowledge of or access to key facts defeats recovery for fraud — is widely applied. UD-51-52 (citing cases); *see also Shah v. Meeker*, --- F.3d ---, 2006 WL 147503, at *7 (2d Cir. Jan. 20, 2006). It also precludes class treatment of plaintiffs' Section 11 claims, since an investor

³ Contrary to plaintiffs' view (PL-40-41), the investor's claims in *Gurary* were barred not because he was told of the manipulation in its entirety or understood its total price impact, but because he had enough facts to form a "belief" that the price he paid reflected *some* of the short selling that allegedly constituted *part* of the manipulation scheme. 190 F.3d at 45; *see id.* at 41-42 (describing "scheme," including short selling, misstatements, and omissions).

has no claim if defendants prove that “he knew of [the alleged] untruth or omission.” 15 U.S.C. § 77k(a); *see DeMaria*, 318 F.3d at 175; *Akerman*, 810 F.2d at 340.⁴ Because there is no *legal* basis for a *class-wide* ruling that could render investors’ knowledge irrelevant, extensive investor-by-investor inquiries are inevitable.

B. The Need For Thousands Of Complex Inquiries Into Allocants’ State Of Mind Precludes Class Certification As A Matter Of Law.

Plaintiffs cite *no* case approving class certification where thousands of individualized and fact-intensive inquiries will be required. Instead, plaintiffs (PL-66) rely on standard issuer-disclosure cases where “few” if any individualized questions typically arise, such as *Blackie*, 524 F.2d at 906 n.22, and *Kennedy*, 710 F.2d at 717. By contrast, a long line of authority from this and other Circuits deems class treatment improper where the nature of plaintiffs’ allegations makes numerous individualized inquiries foreseeable. *See Moore*, 306 F.3d at 1253-56 (collecting cases); *Broussard*,

⁴ Plaintiffs incorrectly claim that the underwriters “do not challenge the propriety of certification with respect to Plaintiffs’ 1933 Act claims.” (PL-10 n.5.) We contested Section 11 class certification below, and in the Rule 23(f) petition we sought review of all certified classes. *See* 227 F.R.D. at 93 n.236, 117-21 (SPA-70, SPA-135-45). As permitted by this Court’s Rule 23(f) order (A-4694), we raised this issue throughout our opening brief. (*See* UD-3, 52 n.14, 91 n.27, 108.)

155 F.3d at 340-42 (collecting earlier cases); UD-52 (citing cases). As here, many of those cases involved claims arising out of varied direct dealings between putative class members and the defendants.

Plaintiffs brush aside these cases, including this Court's decision in *Moore*, claiming that "there could be no class-wide proof that each class member received the same communication in the first place," whereas here there is a prospectus-based claim, so "the fraudulent acts are uniform class-wide, and reliance is presumed." (PL-69.) The claimed distinction is false: in each case cited, plaintiffs tried to proceed based on uniform written materials that allegedly constituted the *initial* misleading communication. In *Moore* and *Johnston*, those materials were offering documents for securities or similar investments, analogous to the prospectuses on which plaintiffs rely here. *Moore*, 306 F.3d at 1250-51; *Johnston*, 265 F.3d at 189-90. In *Broussard*, they were largely contracts. 155 F.3d at 340. For their ERISA claims in *Sprague*, plaintiffs relied on retirement plans and other documents. 133 F.3d at 398. In deeming class certification inappropriate, these courts did not find that common communication was lacking "in the first place" (PL-69), but found that the claims ultimately depended on a mix of *both* common and distinct communications, giving rise to individualized issues. *E.g.*, *Moore*, 306 F.3d

at 1252-56. As this Court reiterated in *Heerwagen*, “a common course of conduct is not enough to show predominance, because a common course of conduct is not sufficient to establish liability of the defendant to any particular plaintiff.” 2006 WL 45859, at *7 (quoting *Moore*, 306 F.3d at 1255).

The same is true here: even if the prospectuses and registration statements contained uniform misstatements or omissions, plaintiffs allege that what made them misleading and manipulated the markets were direct communications and trading arrangements between the Underwriters and countless customers. *See* 227 F.R.D. at 101 (SPA-92-93); MA ¶ 31 (A-1137-38). Plaintiffs cannot contend that these alleged direct communications and trading arrangements were uniform, or are susceptible to class-wide proof. To the contrary, they assert that the substance of communications and terms of the arrangements varied from investor to investor. (*See* PL-2, 6-7; MA ¶¶ 14-15, 34 (A-1134, A-1138); Fischel III ¶ 4 (CA-813).)

Nor can plaintiffs distinguish these cases by arguing that a reliance presumption solves the predominance problem. (PL-84.) Not only does no such presumption properly apply here, but knowledge of an alleged fraud is an absolute bar to recovery even where plaintiffs seek to rely on the

fraud-on-the-market theory. *See* Point III *infra*; *see also Basic*, 485 U.S. at 249; *Zlotnick*, 836 F.2d at 822. In any event, each distinct element of a securities fraud claim requires separate scrutiny, both on the merits and, for class certification purposes, to determine the manner in which the merits must be proved. *See* 485 U.S. at 231-42, 248 & n.28.⁵

Other decisions confirm that investors' access to allegedly withheld information affects the nature of proof not only on reliance but on virtually every element of any securities fraud claim. In *Moore*, this Court specifically held that uniform misrepresentations are required in order for “*any element of the fraud*” to be susceptible to “generalized proof.” 306 F.3d at 1255 (emphasis added); *see also West*, 282 F.3d at 937 (“[O]ral frauds have not been allowed to proceed as class actions, for the details of the deceit differ from victim to victim, and the nature of the loss also may be statement-specific.”). In *Johnston*, the elements of misrepresentation, reliance, and loss causation required individual proof because investors'

⁵ Besides *Basic*, plaintiffs cite two cases, neither of which says that *Basic*'s presumption makes members' knowledge a reliance-rebuttal issue only. *Black*, 418 F.3d at 209, was an individual action, where the jury decided after trial that the investor in fact relied on market pricing, not other factors. *In re Ames*, 991 F.2d at 967, addressed the “in connection with” requirement. It did not mention investor knowledge.

discussions with brokers informed their views on the offering materials. 265 F.3d at 189. In *Broussard*, not only reliance but also falsity and materiality required individual proof because of each class member's potential access to alternative sources of information. 155 F.3d at 341-42. In *Zimmerman*, diverse media coverage meant both that "the extent of knowledge of the omitted facts or reliance on misrepresented facts will vary from shareholder to shareholder," *and* that "the question of whether the omission was material might require an individual inquiry for each shareholder." 800 F.2d at 390. And in *Newton*, where "some class members likely knew" of the challenged trade execution practices, issues including "the state of mind of each investor" meant that "individual questions of economic loss" predominated. 259 F.3d at 176, 187, 192-93.⁶ Accordingly,

⁶ Plaintiffs' citations are not to the contrary. Each involved just a handful of class members with individual timeliness or damage calculation issues, rather than thousands with individualized liability issues. See *Visa Check*, 280 F.3d at 139 (determination of liability left only "some individualized damage issues"); *Waste Mgmt.*, 208 F.3d at 296 (limitations defense involved thirteen transactions); *Thiessen*, 267 F.3d at 1101, 1107 (individual defenses manageable with only 23 class members); *Linerboard*, 305 F.3d at 157, 163 (relatively small number of transactions and primarily common issues on limitations defense); *NASDAQ*, 169 F.R.D. at 520 (limitations defense not dependent on "significant reference to individual differences in knowledge").

many cases hold that proposed class representatives who had access to allegedly misstated or omitted information cannot assert their own claims, let alone those of a class, because their knowledge creates individualized issues not only of reliance, but also on deceit and other “unique defenses,” such as the statute of limitations. *See, e.g., Gary Plastic*, 903 F.2d at 179-80.

Denial of class certification is particularly appropriate where significant individualized liability issues or defenses flow from *plaintiffs'* own allegations. This Court has long recognized the significance of judicial admissions, through which a litigant “plead[s] himself out of court.” *E.g., Official Comm. Unsecured Creditors of Color Tile, Inc. v. Coopers & Lybrand, LLP*, 322 F.3d 147, 167 (2d Cir. 2003); *see also Pegram v. Herdrich*, 530 U.S. 211, 230 & n.10 (2000). Assertions of fact in pleadings and interrogatory responses bind parties “throughout the course of the proceeding.” *E.g., Bellefonte Re Ins. v. Argonaut Ins.*, 757 F.2d 523, 528 (2d Cir. 1985); *accord Bell v. A-Leet Leasing Corp.*, 863 F.2d 257, 259 (2d Cir. 1988) (interrogatories constitute admissions, subject to further evidence.) In *Heerwagen*, this Court emphasized the importance of plaintiff’s admissions, including in pleadings, deposition testimony and expert reports. 2006 WL 45859, at *3, *13. Indeed, those admissions

persuaded the Court that no further discovery or proceedings could remedy the predominance failure that flowed from plaintiff's admissions. *Id.* at *13.

C. Plaintiffs Do Not Dispute That The “Overinclusive” Class Definition Uses Undefined Terms And Subjective Criteria.

Our opening brief (UD-55-61) identified fatal flaws in the class definition fashioned by the district court to exclude with “broad strokes” certain class members whose “full participation,” 227 F.R.D. at 99, 103 (SPA-86, SPA-97), in the alleged scheme precludes them from asserting any claim:

- Thousands allegedly knew about improper agreements, but the definition aims to exclude only “full” participants.
- The definition requires subjective analysis of each investor's trading history, trading intentions, and the complex interrelationships among investors' trading accounts.
- Putative class members and defendants lack reasonable notice of who is in or out of any class.
- Class membership in any one case could not be finally ascertained until after trial not only in that case, but in up to 310 separate cases.

Plaintiffs concede several of these points and fail to mention the rest. Plaintiffs confirm (PL-2, 7) that because the difference between an allegedly proper and improper aftermarket order turns on whether the order was “induced,” finding out which investors participated would require detailed examination of the communications incident to legitimate

bookbuilding between thousands of sales representatives and their institutional customers. (See MA ¶¶ 1, 16, 17 (A-1131, A-1134-35).) Likewise, plaintiffs confirm that many aftermarket trading participants could not be excluded from the class based solely on trading records, because trading records do not reflect whether a trade was induced or voluntary. (PL-2, 42 n.22, 47 n.24; MA ¶ 15 (A-1134).)

Plaintiffs also concede that institutional investors “overlap” from case to case, and that disqualification in one case based on knowledge or participation warrants disqualification in others. (PL-82, 87.) If so, then even if some investors’ trading and other conduct in a certain offering looked unremarkable, their eligibility to recover on that offering would be subject to challenge through mini-trials about their activities in other offerings. The management of such interlocking, multi-factfinder proceedings presents significant Seventh Amendment issues, and any solution to those issues is likely to compound already intractable manageability problems. See *Blyden v. Mancusi*, 186 F.3d 252, 268-69 (2d Cir. 1999); see also *Robinson v. Metro-North Commuter R.R.*, 267 F.3d 147, 170 (2d Cir. 2001).

With respect to “Undisclosed Compensation,” plaintiffs do not deny that the pleadings’ definition depends on subjective investment

purposes and on departures from an undefined benchmark of customary commission rates. Instead, plaintiffs (PL-7) selectively paraphrase the pleadings, omitting words that most clearly convey subjectivity and relativism.⁷ Plaintiffs then declare (PL-1, 10, 13, 82, 83) the paraphrased rather than the pled conduct “objective,” or “objectively determinable.”

Plaintiffs incorrectly assert that ascertainability can await “judgment” (PL-83), but courts recognize that some precision is needed long before judgment to permit all parties to “identify the stakes,” and choose their litigation strategies accordingly. *See, e.g., Bieneman v. City of Chicago*, 838 F.2d 962, 964 (7th Cir. 1988) (per curiam). This Court’s decision in *Gary Plastic*, which plaintiffs say approves greater delay (PL-83), never mentions ascertainability, class membership, or any timing issue at all. It holds that certification must be denied where the named plaintiff had notice of the alleged fraud. 903 F.2d at 179.

⁷ For example, plaintiffs drop from their definition of “inflated brokerage commissions” the reference to rates “in excess of the ordinary and customary commission rates for these accounts.” They likewise drop any reference to investors’ “primary purpose” in generating commissions, and to the “undesired” securities that allegedly “would not be purchased but for the [] unlawful scheme.” (MA ¶¶ 17, 39, 41-43 (A-1134-35, A-1210-12).)

Plaintiffs fail to mention, let alone address, the many cases prohibiting subjective class definitions (*see* UD-60-67 (citing authorities)), rejecting class definitions that include individuals who would not be entitled to relief, *e.g.*, *Newton*, 259 F.3d at 178, 180-81, and recognizing the due process rights of putative class members to receive fair notice of their litigation status. (*See* UD-61 n.15 (citing cases)). Plaintiffs incorrectly contend instead (PL-84; *see* PL-13), citing two inapposite cases, that the class definition here is just “slightly overinclusive” and therefore not an abuse of discretion. In the first, the court refused to extend *Affiliated Ute* to purchasers who had no direct dealings with the defendants; the case was not brought as a class action, and the court did not address any class definition’s inclusiveness. *Fridrich*, 542 F.2d at 320. Plaintiffs rely (PL-84-85) on a footnote in a concurring opinion about hypothetically aggrieved investors, called a “class” not in the “class action” sense but in ordinary English usage. *Id.* at 326 & n.11. The other cited case says nothing about the propriety of an overinclusive class, merely noting that in typical issuer-disclosure cases, “few” investors are subject to challenge based on knowledge of the alleged fraud. *Blackie*, 524 F.2d at 906 n.22. By contrast, other courts have consistently rejected overinclusive class definitions. *See, e.g., Vaszlavik v. Storage Tech.*, 175 F.R.D. 672, 684 (D. Colo. 1997); *see also Newton*, 259

F.3d at 178, 180-81 (class may not include members who were not harmed). No case supports the assertion that classes with thousands of potentially ineligible members are only “slightly overinclusive” or are otherwise permissible.

Finally, plaintiffs argue (PL-87) that under the Supreme Court’s *Amchem* analysis and this Court’s ruling in *Kern*, 393 F.3d 120, “inventive” class certification decisions should only be set aside if they “entirely disregarded current law.” Even if that were the standard of review (which it is not, *see Parker*, 331 F.3d at 18 (de novo review of conclusions of law)), certification of these classes despite the knowledge, participation, and definition issues discussed here “entirely disregarded” Rule 23(a)’s requirements for timely “findings,” Rule 23(c)’s notice requirements, the due process rights of both absent class members and of the Underwriters, and Seventh Amendment concerns about inconsistent determinations by multiple factfinders. Because plaintiffs themselves assert that there was widespread investor knowledge of the alleged manipulative scheme, class certification is legal error.

III. THE *BASIC* AND *AFFILIATED UTE* PRESUMPTIONS DO NOT APPLY HERE, AND INDIVIDUAL RELIANCE ISSUES PREDOMINATE.

The district court found only that some sort of presumption “may” be available to plaintiffs in these cases. 227 F.R.D. at 105-06 (SPA-101-06). Neither the district court’s decision nor plaintiffs’ brief ever deals with the likelihood that a presumption does not apply or would remain subject to extensive individual inquiries.

A. Widespread Investor Knowledge Of The Alleged Fraudulent Conduct Negates Any Reliance Presumption.

If a reliance presumption were extended here, it would be negated by “[a]ny showing that severs the link between” the alleged misconduct and plaintiffs’ “decision to trade at a fair market price.” *Basic*, 485 U.S. at 248. That link would be severed if “the ‘market makers’ were privy to the truth” or “if news . . . credibly entered the market and dissipated the effects of the misstatements.” *Id.* It would also be severed where investors traded for reasons other than their belief in value relative to price, including trades made because of perceived “pressure” or for other reasons. *Id.* Plaintiffs’ response (PL-65, 68-70) echoes the district court’s erroneous holding that defendants’ evidence would be limited to “publications” a court might treat as having “credibly entered the market,” and would be resolvable on a class-wide basis. 227 F.R.D. at 110 (SPA-114-16). But *Basic* teaches

that there cannot be a “fraud on the market” when — independent of published disclosures — thousands of market participants knew about the alleged scheme.

B. *Basic’s* Fraud-On-The-Market Presumption Cannot Be Stretched To Encompass These Very Different Facts.

In *Basic*, the Court applied the presumption to misstatements about a merger, because generally accepted economic research had established a link between market price and information about major corporate events. 485 U.S. at 240-41, 246-47 & n.24. This Court recognized in *Hevesi* that the trial court had an obligation to determine, prior to certification, whether the *Basic* presumption should be extended beyond “uniquely authoritative” statements by issuers, to reach “opinions expressed by research analysts.” 366 F.3d at 79-80. Courts require a factual demonstration linking conduct to market price movements before extending the *Basic* presumption. *See id.* at 77; *West*, 282 F.3d at 938-39; *DeMarco*, 222 F.R.D. at 247; *see also* UD-68-79.

The allegations here range far from *Basic* or any prior application of the fraud-on-the-market doctrine, and go well beyond issuer misstatements about plainly material facts. Closely held information about prospective mergers is unquestionably important to shareholders, and public disclosure of such company-specific information can be presumed to affect

share prices significantly. *See Basic*, 485 U.S. at 248-50. By contrast, alleged trading agreements, underwriter compensation, and analyst reports involve no inside business information about the issuer. *See* UD-20-22, 93-94 (citing evaluations of six expert economists). Plaintiffs cite no case in which *Basic*'s presumption was extended to such varied conduct or to any of its trading-based components. In *West*, which this Court cited with approval in *Hevesi*, even a minor extension of *Basic*, to a stockbroker's statements that a company-control transaction was imminent, was found unwarranted. *See West*, 282 F.3d at 938-39 (holding class certification improper without need for a remand).

Plaintiffs try (PL-47-48) to distinguish *West*, on the ground that it involved only "a lone stockbroker" who "privately counseled a handful of clients," and no "mechanism explains how prices would respond to non-public information." In fact, merger rumors like those in *West* are more likely to affect market price than tangential events like unexecuted buy orders or disparate analyst reports.

Just as in *West*, plaintiffs presented and can point to no record evidence that the alleged conduct actually affected stock prices.⁸ Rather, as plaintiffs concede (PL-54), their expert merely *assumed* that tie-in trades had the claimed impact on market price and did not address alternative explanations for any price increases. Plaintiffs rely (PL-42-47) on SEC criticism of an extreme form of “tie-in” agreement *not at issue* in this case, but even as to this plaintiffs acknowledge (PL-42 n.22) that stock purchases could affect stock prices only “if accomplished on a material scale.” Plaintiffs acknowledge (PL-53-54) that they have not identified *any* tie-in agreement, even as more loosely defined. With respect to underwriter compensation, which involves only trading in *unrelated* securities, plaintiffs presented no link to price movements and did not dispute that such third-

⁸ Plaintiffs suggest (PL-53) that we “only specifically dispute Mr. Fischel’s iXL analysis.” But that example (along with Sycamore, which followed) was illustrative, not exhaustive. Moreover, plaintiffs fail to come to grips with the many problems inherent in the iXL example that affect the other IPOs. As we showed in detail (UD-73-74), institutional allocants there purchased only 2.7% of the shares traded in the first week, actually *sold* vastly more shares than they bought, and made no significant purchases over the next five months, while the stock received heavy media coverage. In response, plaintiffs simply complain about the discovery process and offer data-free speculation about what else may have happened. (PL-53.)

party compensation arrangements are generally understood to “bea[r] no relationship” to an investment’s value. *Castillo*, 1998 WL 342050, at *5.

Plaintiffs chiefly argue (PL-35-38) that market impact from a prospectus or registration statement that does not *disclose* these alleged tie-in and other arrangements is properly presumed in these cases. However, plaintiffs rely (PL-37) only on cases involving misstatements or omissions pertaining to the issuer’s business or financial results.⁹ Such data have bottom-line dollars-and-cents importance to shareholders and can be known accurately only by insiders. Prospectus misstatements cannot be presumed to have had an effect on market price unless they concerned a subject that tends to have such an effect. *See Basic*, 485 U.S. at 246 (presumption extended when it is a matter of “common sense and probability” that misstatements affected share prices).

Moreover, the prospectuses here disclosed such extensive and meaningful risks about these issuers’ businesses that it would make no sense

⁹ In *Shaw*, the company failed to disclose “unexpectedly large losses for that quarter,” 82 F.3d at 1207; in *Kaplan*, the company misrepresented the success of clinical trials of an important medical device it produced, 49 F.3d at 1371-73; and in *CINAR*, the company inflated its financial reports by claiming improper tax credits and excluding investments, 186 F. Supp. 2d at 285.

to presume the materiality of alleged omissions about potential stock-buying arrangements, underwriter compensation or analyst coverage. Plaintiffs assert (PL-71 n.42, 32-33) that the alleged omissions “made it appear as though the companies were stronger than they were.” In fact, each prospectus vividly disclosed the considerable risks associated with investing in such an unproven, unprofitable venture, including the fact that Internet and technology stocks prices had been exceedingly volatile and could collapse entirely. (A-2814-15.)¹⁰ And, to the extent that the omissions could be said to relate to *why* the underwriters were “selecting new issues” (PL-33), this is simply another way of referring to an outsider’s opinions about the insider.

Basic created only a limited “departure in securities law,” which Justice White cautioned courts must be vigilant “to control as it proceeds.” 485 U.S. at 263 (White, J., dissenting) (opinion cited in *Dura*, 125 S. Ct. at 1633-34). As *Hevesi* recognizes, the *Basic* presumption should

¹⁰ Plaintiffs suggest (PL-34 n.17) that because the district court “found” materiality at the motion to dismiss stage, it will not be an individual issue at trial. At that threshold stage, the district court was permitted to, and did, accept all allegations as true. At the class certification stage, by contrast, the court must determine whether such hotly disputed issues can actually be tried on a common basis.

not be extended to fundamentally different contexts without a clear demonstration that its underlying rationale fits. The sundry conduct alleged here far exceeds *Basic*'s common sense boundaries.

C. Plaintiffs Cannot Show That The Markets For These Newly Issued Stocks Were Efficient, Which Also Defeats The *Basic* Presumption.

Courts have recognized that, because market efficiency is a linchpin of the *Basic* presumption, it cannot simply be assumed at the class certification stage. *See, e.g., Unger*, 401 F.3d at 323; *West*, 282 F.3d at 937-40. Market efficiency is precisely the sort of “independent fact question concerning the expected forms of proof” that this Court held should be “resolved” as part of the class certification inquiry. *Heerwagen*, 2006 WL 45859, at *10; *see Bell*, 422 F.3d at 314.

Plaintiffs counter with a novel argument that they say flows from the First Circuit's recent decision in *PolyMedica*. It is a curious choice, for there the First Circuit *vacated* a class certification order based on the district court's failure to consider whether the evidence had demonstrated the efficiency of that market so as to justify the *Basic* presumption. *See* 432 F.3d at 5-7. Plaintiffs contend that in contrast to the lower court's efficiency ruling in *PolyMedica*, the ruling here suffices because in manipulation cases the “efficiency inquiry” only concerns

whether “investors justifiably relied upon stock prices,” not whether the prices reflected material information. (PL-59.) *PolyMedica* did not involve manipulation claims, and drew no such distinction. Offering no other case support for their argument, plaintiffs effectively concede that they cannot show the baseline attribute of an efficient market: that the market price of the stock rapidly reflects all publicly-available information. *PolyMedica*, 432 F.3d at 5-7; *see also West*, 282 F.3d at 938 (“[F]ew propositions in economics are better established than the quick adjustment of securities prices to public information.”); *In re Merck & Co. Sec. Litig.*, 432 F.3d 261, 269 (3d Cir. 2005) (efficient markets process information “immediately,” not over months).

Indeed, plaintiffs’ allegations directly contradict market efficiency. For loss causation purposes, plaintiffs insist (PL-72, 81) that inflation that allegedly began in 1998 and 1999 uniformly lasted past December 6, 2000 (the date they chose to end all class periods for unexplained “legal and practical reasons”). Plaintiffs also assert that long-lived inflation came about because analysts and other market professionals were in on the fraud, so they did not do their usual job of identifying inflation or trading against it. (PL-75.) If market prices remained inflated for months or even years, uncorrected by knowing market-makers and a

constant stream of public information about the companies and the market, then clearly these were *inefficient* markets. As the court explained in *West*, “in an efficient market, how could [the alleged misconduct] cause a long-term rise in price? Professional investors would notice the inexplicable rise and either investigate for themselves (discovering the truth) or sell short immediately, driving the price back down.” 282 F.3d at 940. “In an efficient market” such price distortions “will self-destruct long before eight months have passed.” *Id.*; *see also Basic*, 485 U.S. at 249 n.29.

Similar incongruity recently led the Third Circuit to dismiss securities claims that depended on the same contradictory pair of assertions made here: (1) that the fraud-on-the-market presumption should apply for purposes of establishing reliance, based on the market’s efficiency; and (2) the price effect of alleged misrepresentations or omissions occurred not immediately, but over a period of two months, for purposes of showing loss causation and materiality. *Merck*, 432 F.3d at 270-71 n.8. Here, of course, because the period of alleged dissipation was even greater, so is the contradiction of the efficient market hypothesis.

More incongruity arises out of plaintiffs’ allegations that not only “aftermarket” but also IPO *offering* and *opening prices* were and remained inflated. Many courts observe that the presumption of efficient

markets cannot “logically apply when plaintiffs allege fraud in connection with an IPO, because in an IPO there is no well-developed market in the offered securities.” *Berwecky*, 197 F.R.D. at 68-69 n.5; *see also Freeman*, 915 F.2d at 199. Plaintiffs concede (PL-60) that these cases rule out a presumption of reliance on “offering prices” but argue that investors justifiably believe in opening prices as a true indicator of “demand” because a 15- or 30-minute “pre-open” period precedes the opening of trading, and at opening many IPO stocks trade at heavy volume. However, the “pre-open” period is “quotation-only,” indicating market makers’ tentative, non-binding *price* quotations, without regard to the *quantity* of demand. SEC Release No. 34-40968, 1999 WL 26891, at *1 (Jan. 22, 1999). During the proposed class periods, the NASD found “excessive volatility” in the pre-open, associated with *retail investor demand* for Internet and technology IPO stocks.¹¹ *See id.* at *1, *4. Plaintiffs cite no authority for the proposition that pre-open quotations and heavy volume at the opening of an IPO stock are sufficient predicates for a finding of market efficiency. There is no basis for an assumption that during the “bubble” investors — especially

¹¹ Neither the SEC nor NASD has ever suggested that manipulation by underwriters or anyone else contributed to this volatility.

“aftermarket” purchasers months and years after the IPO — justifiably relied on volatile price movements and heavy trading volumes immediately before and after IPO openings as true indicators of any fundamental economic value.

Plaintiffs grudgingly admit (PL-56-57) that not “all” the factors cited in the case law as indicating market efficiency can be met here. *See Cammer*, 711 F. Supp. at 1286-87. About the factor that is arguably most critical — whether the SEC recognizes the stock’s efficiency by permitting short-form “S-3” registration — plaintiffs (PL-52 n.29) say nothing except that this factor should not “matter.” Plaintiffs likewise gloss over the “irrational exuberance,” including rampant day- and momentum-trading, that bloated share prices during the relevant periods. Plaintiffs provide not a shred of support for their market efficiency assertions, and the district court wrongly determined they all should remain untested until “trial.” 227 F.R.D. at 107 (SPA-108-09).

D. The *Affiliated Ute* Presumption Cannot Apply Because These Cases Do Not Primarily Involve Omissions.

Plaintiffs attempt to invoke the *Affiliated Ute* presumption, but it has no proper role in this case. Plaintiffs recast their claims (PL-39-41) as focused on material *omissions*, despite their repeated assertions (PL-55 n.28, 59, 70, 82), credited by the court on the motion to dismiss, 241 F. Supp. 2d

at 381-83 (A-1854-55), that their claims are all about market manipulation. Similarly, for *Affiliated Ute* purposes plaintiffs say (PL-39) there was “an absence of information,” but for liability and loss causation purposes plaintiffs say there were no fewer than eight affirmative prospectus misstatements and widespread investor participation and knowledge. *See* 241 F. Supp. 2d at 310-13 (A-1798-1800).

No *Affiliated Ute* presumption can apply here. That presumption was carefully designed for a limited set of circumstances, where a bank violated its fiduciary duty by completely failing to disclose not only the available market prices but the existence of a secondary market to the bank’s customers when they sold their shares. The Court held that in “the circumstances of this case, involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery.” 406 U.S. at 153. Here, by contrast, plaintiffs allege that many people in the class were told about the alleged scheme and traded anyway. Plaintiffs even assert (PL-5) that many of those customers were involved, through the bookbuilding process, in helping to determine IPO prices, in a two-sided market. Where investors trade for reasons or at prices unrelated to the alleged material omission, the rationale for the *Affiliated Ute* presumption does not apply. *See duPont*, 828 F.2d at 78; *Gochnauer v. A.G. Edwards & Sons*, 810 F.2d

1042, 1047 n.8 (11th Cir. 1987); *Rifkin v. Crow*, 574 F.2d 256, 263 (5th Cir. 1978).

Moreover, the *Affiliated Ute* presumption does not apply to cases that primarily involve market manipulation claims because its reach would grossly outstrip its rationale. Manipulation claims *always* involve some conduct that is undisclosed. See *Schreiber v. Burlington Northern, Inc.*, 472 U.S. 1, 6-8 (1985); *Santa Fe Indus. v. Green*, 430 U.S. 462, 477 (1977). If undisclosed manipulation were enough to obtain the *Affiliated Ute* presumption, then plaintiffs alleging market manipulation claims would *never* have to prove reliance. But this Court’s decision in *Gurary* squarely holds that plaintiffs must prove reliance in manipulation cases, even though the alleged manipulation — by definition — was concealed at least in part. See 190 F.3d at 44-45; see also *Joseph*, 223 F.3d at 1163 (concealment cannot “transform [an] alleged malfeasance into an omission” under *Affiliated Ute* without “swallow[ing] the reliance requirement” entirely).

For like reasons, the Circuits have uniformly held that *Affiliated Ute* excuses positive proof of reliance only in cases primarily or exclusively involving omissions. If misstatements *and* omissions are alleged, the presumption applies only to cases that “primarily” involve nondisclosure.

See UD-88 & 81 n.22 (citing cases). Plaintiffs do not contend that these cases meet that requirement.

Instead, plaintiffs attempt (PL-39) to argue that here there was concealment of “conflicting incentives,” which was “independent of the manipulations.” However, elsewhere (PL-33) plaintiffs describe the alleged “conflicting incentives” as the product of Underwriters “rig[ging] prices in the aftermarket.” *See also* 297 F. Supp. 2d at 675 (A-2074) (“gravamen of plaintiffs’ complaint is that the Underwriters manipulated the IPO market”); 10/7/03 Tr. at 20 (A-2762) (“[t]he allegations are” “manipulative schemes” and “manipulative conduct”); 10/7/03 Tr. at 25 (A-2764) (class members “bought at the inflated price because of the manipulation”). Because the distinction plaintiffs suggest between market manipulation and “concealment” claims is meaningless, manipulation claims regularly stand or fall based on a showing of actual reliance. *See Piper*, 430 U.S. at 48-53 & n.2 (Blackmun, J., concurring). *Affiliated Ute* does “not even enter the case,” *id.*, because any omission “did nothing more than conceal the Underwriters’ alleged market manipulation.” 227 F.R.D. at 111-12 n.351 (SPA-119) (quoting 297 F. Supp. 2d at 675 (A-2074)).

IV. LOSS CAUSATION CANNOT BE PROVEN ON A COMMON BASIS FOR INVESTORS OVER THE CLASS PERIODS.

As the Third Circuit held in *Newton*, a class may not be certified where proving that “a class member suffered economic loss from a given securities transaction would require proof of the circumstances surrounding each trade.” 259 F.3d at 180, 187, 189. The record here establishes that trade-by-trade inquiry will be required before any investor’s economic loss could be blamed on alleged misconduct in these cases. Plaintiffs plead for lenience (PL-77), arguing that the parties’ differences reflect “battles of experts,” which should be reserved for trial. *Heerwagen* makes clear, however, that whether common proof can establish loss causation must be resolved at the class certification stage even if that inquiry involves “[s]ome overlap with the ultimate review of the merits” and a weighing of expert testimony. 2006 WL 45859, at *10; Point I *supra*. Because the district court could not find by a preponderance of the evidence that plaintiffs’ expert’s loss causation methodology would avoid the need for trade-by-trade inquiries at trial, class certification was improper as a matter of law. *See* 227 F.R.D. at 114-15 (SPA-127-28).

A. The District Court Erred By “Assuming” Plaintiffs’ Ability To Prove Loss Causation On A Common Basis, Contrary To Legal Precedent And Settled Economic Theory.

We have demonstrated (UD-89-105) that the multitude of forces at work on the markets during these sprawling class periods, together with the (at most) weak and transient price effect of alleged tie-in agreements, analyst reports, and commission payments, mean that proof of loss causation requires time- and trade-specific inquiries that will differ from plaintiff to plaintiff and are therefore incompatible with class adjudication. How long did the alleged manipulative act inflate the price? How quickly did any such inflation dissipate? Was that inflation still present when a given plaintiff purchased and sold? Will a plaintiff who bought in the immediate aftermarket rely on the same evidence of manipulation as a plaintiff who bought months, if not years, later in the class period? Because different plaintiffs buying and selling at different times will need to present individualized proof at trial about the specific causative act that allegedly injured them, predominance is lacking. *See Newton*, 259 F.3d at 189.

Plaintiffs identify no case, and we have found none, where a class was certified based on allegations that practices like trading stocks, reporting opinions, and receiving compensation created uniform and lingering distortions in efficient securities markets for months or even years.

Instead, courts have certified classes for manipulation claims in efficient markets only where the time period is short, a distinctive pricing effect can be ascertained, and all investors suffered similar harm from the supposed scheme upon a discernibly related price drop. (UD-97 n.29.) Only in those circumstances can plaintiffs prove with common evidence that it was defendants' alleged conduct, rather than "changed economic circumstances, changed investor expectations, new industry-specific or firm-specific facts, conditions, or other events, which taken separately or together account for some or all of that lower price." *Dura*, 125 S. Ct. at 1631-32; *see Lentell*, 396 F.3d at 176; *Emergent Capital*, 343 F.3d at 197.

To give proper effect to *Dura*, a court at the class certification stage may not presume that evidence of inflation by itself is enough to demonstrate that loss causation may be proved on a class-wide basis. *Dura*, 125 S. Ct. at 1631 ("an inflated purchase price will not itself constitute or proximately cause the relevant economic loss"); *Emergent Capital*, 343 F.3d at 197-98 (same). Instead, each class member must establish that at the moment of purchase the defendants' misconduct was causing price inflation *and* that at the moment of sale some measurable amount of that price inflation had been eliminated from the price, causing the loss.

Plaintiffs insist (PL-72-73) that they can satisfy both requirements through common proof over lengthy class periods, using their expert's "plausible" hypothesis that inflation was wrongfully generated by bids based on tie-in orders during the short pre-open period, and thereafter dissipated gradually, without vanishing, for many months and years. The district court deemed Mr. Fischel's theory "not fatally flawed" because each of the focus stocks opened at a price higher than the offer price and each "ultimately plummeted in value to levels far below their offering prices," so that "[s]ome loss causation may be *inferred* simply from the disappearance of the original inflation." 227 F.R.D. at 114 (SPA-125) (emphasis added). According to the court, "when an artificially inflated stock tumbles to a fraction of its offering price, it is logical to *assume* that the artificial inflation has dissipated." *Id.* at 114-115 & n.370 (SPA-125-126) (emphasis added); *see also* 297 F. Supp. 2d at 674-75 (A-2073-74).

Defendants' expert economists explained that this is an unscientific approach and that no recognized scientific methodology exists that could determine the inflationary effects, if any, of pre-open "tie-in" bids in the circumstances of these cases or segregate any remaining price impact they might have in the aftermarket. (O'Hara ¶ 13 (A-2251-52); O'Hara II ¶¶ 7-36 (A-4601-13); Cornell ¶¶ 2-3, 7-8 (A-4349-51).) This Court has

rejected as a basis for class certification expert opinions about causation that, like Fischel's, are untethered to economic theory. *See Heerwagen*, 2006 WL 45859, at *13. Six economists here testified that trial of loss causation would involve individualized inquiries for “hundreds of millions of transactions,” that Fischel's proposed method of avoiding such proof had no scientific support (*see* UD-98-105 (summarizing testimony of defendants' expert economists)), and that accurate evaluation “would require intensive trade-by-trade analysis and be characterized by instantaneous dissipation of artificial inflation.” 227 F.R.D. at 115 n.375 (SPA-127-28).

The district court ruled that criticisms of Mr. Fischel's methodology go to its weight and not its admissibility. 227 F.R.D. at 114-15 (SPA-127-28). The court then explicitly declined to weigh the competing submissions to determine whether common proof would predominate. *Id.* at 114 n.375 (SPA-127-28). The court refused to consider defendants' experts' showing that any loss causation trial would require a trade-specific inquiry into the circumstances of the purchase or sale to determine the impact, if any, of any purportedly manipulative trade. But *Heerwagen* makes clear that at the certification stage, the district court must weigh competing expert submissions that speak to whether an element of the plaintiff's claim can be

proved on a class-wide basis, and may not simply put this task off until trial. 2006 WL 45859, at *11.¹²

Moreover, the district court's *assumptions* about dissipation, if generally applied, would gut *Dura* and *Emergent Capital*. Under the court's approach, merely showing inflation followed by any price decline would be enough to prove dissipation and loss causation — the very proposition rejected by the Supreme Court just last Term. *See Dura*, 125 S. Ct. at 1631-32. The district court compounded that error by assuming an unquantified but continual and gradual dissipation of inflation throughout the class periods, a theory directly at odds with the very concept of efficient securities markets relied on elsewhere in the opinion.

Plaintiffs fall back on the contention (PL-76-77, 81-82) that they should not be held, at the class certification stage, to the *legal* standards set forth by this Court and the Supreme Court for proof of loss causation.

¹² In *Ruggiero*, which plaintiffs cannot distinguish, this Court reaffirmed that “when an expert opinion is based on data, a methodology, or studies that are simply inadequate to support the conclusions reached, *Daubert* and Rule 702 mandate the exclusion of that unreliable opinion testimony” on causation. 424 F.3d at 253 (quotation omitted). Regardless of whether the issue is one of weight (as in *Heerwagen*) or admissibility (as in *Ruggiero*), the result is the same: Fischel's speculations are not a proper basis for class certification.

But the Rule 23 inquiry focuses on how the case would actually be tried. At trial, plaintiffs must prove, for each class member, that their investment losses were *specifically attributable* to defendants' alleged wrongful conduct. *See* 15 U.S.C. § 78u-4(b)(4). At the class certification stage, plaintiffs must show, by a preponderance of the evidence, that they can present common proof of causation at trial without the need for individualized inquiry. Because plaintiffs have failed to do so, class certification is improper. *See Heerwagen*, 2006 WL 45859, at *7 (citing *Blades*, 400 F.3d at 566); *see also Newton*, 259 F.3d at 187.

B. Plaintiffs Cannot Establish Loss Causation Through Class-Wide Proof.

Plaintiffs' proposal for proving loss causation is also wholly impractical. First, plaintiffs incorrectly contend (PL-79-80) that only the price effect of the whole "scheme" counts. Even if plaintiffs could show a common scheme, that would "not [be] enough to show predominance, because a common course of conduct is not sufficient to establish liability of the defendant to any particular plaintiff," as this Court has repeatedly held. *Heerwagen*, 2006 WL 45859, at *7 (quoting *Moore*, 306 F.3d at 1255). That defect is particularly glaring here. With pre-open price indications coming from many different market participants, aftermarket tie-in purchases occurring in different quantities and at different times in different

market settings, many alleged tie-in purchases being reversed by those same investors' sales, multiple analyst reports with different contents and recommendations, and commission payments on unrelated transactions, there is no simple answer to the question whether these events had any price impact, and, if so, when and for how long. For loss causation purposes, if the "scheme" had any price effect over a period of months or years, it would still be necessary (in order to show loss for any given plaintiff who bought and sold at particular times) to untangle the separate and distinct effects, if any, of each of the numerous alleged events.

Nothing in Mr. Fischel's abstract method — using index comparisons to show inflation and its dissipation — would obviate the need for such individualized inquiry at trial. As the district court recognized, such comparisons "assume[] loss causation rather than detect[] it." 227 F.R.D. at 113 (SPA-124-25); *see also* Cornell ¶¶ 2-4 (A-4349-50) (author of comparative index method explains it measures damages only). They also fail to take account of the sector- and firm-specific factors that *Dura* requires be considered. Index comparisons have been rejected by this Court because they fail to "control for relevant variables to permit reliable inferences." *Ackerman*, 810 F.2d at 343; *see also Elkind*, 635 F.2d at 171; *Lentell*, 396 F.3d at 176.

Plaintiffs insist (PL-76-77) that correlation is enough to infer causation for purposes of class certification, but showing mere correlation tells a court *nothing* about whether loss causation can be proved class-wide with common evidence. *See Heerwagen*, 2006 WL 45859, at *13 (rejecting as basis for class certification expert’s opinion that tandem price movements in different locations demonstrate a national market, when commentators recognize that “[c]orrelations in price movements can be spurious” because they may have many different causes). Contrary to plaintiffs’ suggestion (PL-77), we do not argue that plaintiffs must rule out non-manipulative causes of price changes, but that they must present a methodology that shows they can do so at trial with common evidence. This plaintiffs concede (PL-76-77) they have *not* done.

Plaintiffs seem to think (PL-49-52) that their belated allegations of manipulation in the pre-open can solve all these problems.¹³ Contrary to plaintiffs’ argument (PL-50), “whether the pre-open bid sessions were

¹³ A pre-open bidding period exists only on NASDAQ-listed stocks. Plaintiffs have offered no theory to explain the opening price increases of the five securities in this litigation that were not traded on NASDAQ, or to explain why many other non-NASDAQ IPOs experienced comparable increases in their opening price above their offering price.

manipulated” is not “common to all class members” because, as plaintiffs concede (PL-6) and the district court acknowledged, 227 F.R.D. at 112 (SPA-119-22), the allegedly manipulative pre-open bids and asks reflected an aggregation of buy and sell orders from customers — including class members who could not lawfully assert injury arising out of their own wrongdoing. But even more critically, plaintiffs offered no scientific model to separate out, on an objectively determinable basis, proper and improper bids and their respective price effects, the role of other market-makers in the bidding process, the differences between executed and unexecuted orders, limit and market orders, and orders at lower or higher prices, or the alleged contribution of fraud from the pre-open period to any inflation in the ensuing years.¹⁴ (O’Hara ¶ 13 (A-2251); O’Hara II ¶¶ 7-36 (A-4601-13); Cornell ¶¶ 2-3, 7-8 (4349-50, A-4351). The Third Circuit, facing much the same problem, held that loss causation may not be proved on a common basis

¹⁴ Plaintiffs do not dispute (PL-51) that the vast majority of the bid increases in the pre-open periods came not from the lead underwriter and its syndicate members, but from entirely unaffiliated market-makers. (See Kleidon ¶¶ 86-87 & Ex. 5 (A-3855-56, A-3887) (during Sycamore pre-open, lead underwriter was inside bidder only once, for just 17 seconds and long before the stock opened; other syndicate members improved bid in only 2 of 36 instances); Sirri ¶¶ 14-20 & Ex. F (A-3778-80, A-3813-14) (iXL); A-2157-63 (Corvis); A-4097-4106 (VA Linux).)

where “economic loss” depends on “bids” (and asks), after a sampling of actual trades showed that in some instances defendants could not have obtained a better price. *Newton*, 259 F.3d at 178-79 & n.20.

Moreover, plaintiffs’ pre-open theory could never support loss causation findings over the lengthy class periods alleged here. In an allegedly efficient market, how could upticks observed during one 15- or 30-minute pre-open bidding session have “infected” (PL-50) stock prices for days, months, and even years after real trading began? In an efficient market, the proof would have to detail the price impact of each specific alleged manipulative order. The proof would have to address the effects of specific allocant sales, and the market effects of a constant barrage of information, the impact of widespread knowledge of alleged tie-ins, and actual gains and losses for each class member.

In deciding the predominance issue in the loss causation context, the district court made no findings on any of these questions. For damages purposes, however, the district court properly recognized that minute-by-minute calculations of inflation and its duration would be required for each claimant, but suggested separate, individualized damages trials could solve the problem. 227 F.R.D. at 117 & n.392 (SPA-134-35). This same “laborious and time consuming task” would already have been

required to determine loss causation at any liability trial. *See id.*; *see also Blyden*, 186 F.3d at 268-69. As in *Heerwagen*, plaintiffs cannot manufacture predominance: each plaintiff would have to “rely on market specific evidence” at the time of each trade, and this evidence “will vary from one putative class member to another.” *See* 2006 WL 45859, at *8, *13 (affirming denial of further discovery in aid of predominance inquiry).

CONCLUSION

The order granting certification of Section 10(b) and Section 11 classes in each focus case should be set aside and the case remanded with instructions to deny plaintiffs’ motion for class certification.

Respectfully submitted,

SULLIVAN & CROMWELL LLP

By _____
Gandolfo V. DiBlasi
John L. Hardiman
Penny Shane
David M.J. Rein
Richard J.L. Lomuscio
Taleah E. Jennings
125 Broad Street
New York, New York 10004
(212) 558-4000

*Attorneys for Goldman, Sachs & Co. in
Engage Technologies, Inc. and Sycamore
Networks, Inc. and Liaison Counsel for
the Underwriter Defendants*

MAYER, BROWN, ROWE &
MAW LLP

By _____
Stephen M. Shapiro
Timothy S. Bishop
Joshua D. Yount
71 South Wacker Drive
Chicago, Illinois 60606
(312) 782-0600

*Attorneys for Merrill Lynch & Co., Inc.
and Merrill Lynch, Pierce, Fenner &
Smith Incorporated in iXL Enterprises,
Inc., Sycamore Networks, Inc., and*

WILMER CUTLER PICKERING
HALE AND DORR LLP

By _____
Robert B. McCaw
Louis R. Cohen
Fraser L. Hunter, Jr.
Mark M. Oh
David S. Lesser
399 Park Avenue
New York, New York 10022
(212) 230-8800

*Attorneys for Credit Suisse Securities
(USA) LLC (formerly known as Credit
Suisse First Boston LLC) in Corvis
Corp., VA Linux Systems, Inc., Engage
Technologies, Inc., and Sycamore
Networks, Inc.*

KIRKLAND & ELLIS LLP

By _____
Andrew B. Clubok
Richard A. Cordray
Brant W. Bishop
655 Fifteenth Street, N.W.
Suite 1200
Washington, DC 20005
(202) 879-5000

*Attorneys for Morgan Stanley & Co.
Incorporated in Sycamore Networks,
Inc. and iXL Enterprises, Inc.*

Corvis Corp.
O'MELVENY & MYERS LLP

By _____
Andrew J. Frackman
Brendan J. Dowd
Matthew J. Merrick
Times Square Tower
7 Times Square
New York, New York 10036
(212) 326-2000

*Attorneys for Robertson Stephens, Inc., in
Firepond, Inc., Corvis Corp., iXL
Enterprises, Inc. and Sycamore Networks,
Inc.*

GIBSON, DUNN & CRUTCHER LLP

By _____
Randy Mastro
Robert Serio
Mark Holton
200 Park Avenue
New York, New York 10166
(212) 351-4000

*Attorneys for Bear, Stearns & Co. Inc.
and The Bear Stearns Companies Inc.
in Engage Technologies, Inc. and iXL
Enterprises, Inc.*

CLIFFORD CHANCE US LLP

By _____
George A. Schieren
Mark Holland
Robert G. Houck
31 West 52nd Street
New York, New York 10019
(212) 878-8000

*Attorneys for Merrill Lynch & Co., Inc.
and Merrill Lynch, Pierce, Fenner &
Smith Incorporated in iXL Enterprises,
Inc., Sycamore Networks, Inc., and
Corvis Corp.*

SIMPSON THACHER & BARTLETT
LLP

By _____
Barry R. Ostrager
David W. Ichel
Joseph M. McLaughlin
425 Lexington Avenue
New York, New York 10017
(212) 455-2000

*Attorneys for J.P. Morgan Securities
Inc., individually in Sycamore Networks,
Inc. and as successor in interest to
Hambrecht & Quist LLC in Engage
Technologies, Inc.*

PAUL, WEISS, RIFKIND, WHARTON
& GARRISON LLP

By _____
Moses Silverman
Philip Barber
1285 Avenue of the Americas
New York, New York 10019-6064
(212) 373-3000

*Attorneys for Lehman Brothers Inc. in
Corvis Corp. and Sycamore Networks,
Inc.*

SKADDEN, ARPS, SLATE,
MEAGHER & FLOM LLP

By _____
Jay B. Kasner
Scott D. Musoff
Four Times Square
New York, New York 10036
(212) 735-3000

*Attorneys for SG Cowen Securities
Corp. (n/k/a SG Cowen & Co., LLC) in
Firepond, Inc.*

SIDLEY AUSTIN LLP

By _____
A. Robert Pietrzak
Joel M. Mitnick
María D. Meléndez
787 Seventh Avenue
New York, New York 10019
(212) 839-5300

*Attorneys for Deutsche Bank Securities
Inc. (f/k/a Deutsche Banc Alex. Brown
Inc., DB Alex. Brown LLC and BT
Alex. Brown Incorporated) in Engage
Technologies, Inc.*

PROSKAUER ROSE LLP

By _____
Stephen L. Ratner
Sarah S. Gold
1585 Broadway
New York, New York 10036-8299
(212) 969-3000

*Attorneys for Prudential Securities
Incorporated in Engage Technologies,
Inc.*

ARNOLD & PORTER LLP

By _____
Stewart D. Aaron
399 Park Avenue
New York, New York 10022
(212) 715-1000

*Attorneys for RBC Dain Rauscher, Inc.
(f/k/a Dain Rauscher, Inc.) in Engage
Technologies, Inc., Firepond, Inc. and
Sycamore Networks, Inc.*