

**IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT**

Case No. 00-1586

KENNETH E. NEWTON; MLPF&S CUST. BRUCE ZAKHEIM
IRA FBO BRUCE ZAKHEIM

Plaintiffs-Appellants,

v.

MERRILL LYNCH, PIERCE, FENNER & SMITH INCORPORATED;
PAINWEBBER INCORPORATED; DEAN WITTER REYNOLDS, INC.
(D.C. No. 94-cv-05343)

Defendants-Appellees.

JEFFREY PHILLIP KRAVITZ

v.

DEAN WITTER REYNOLDS, INC.

(D.C. No. 95-cv-00213)

On Plaintiffs' Appeal From An Order Of The United
States District Court For the District of New Jersey
Denying Plaintiffs' Motion For Class Certification

**BRIEF FOR APPELLEES MERRILL LYNCH, PIERCE,
FENNER & SMITH INCORPORATED; PAINWEBBER INCORPORATED;
AND DEAN WITTER REYNOLDS, INC.**

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CORPORATE DISCLOSURE STATEMENT

The publicly-traded corporate parent of defendant Merrill Lynch, Pierce, Fenner & Smith Incorporated is Merrill Lynch & Co., Inc. The publicly-traded corporate parent of defendant PaineWebber Incorporated is PaineWebber Group, Inc. On July 12, 2000, PaineWebber Group, Inc. entered into an agreement and plan of merger with UBS AG. If the merger is consummated, UBS AG will become the publicly-traded parent of PaineWebber Incorporated. The publicly-traded corporate parent of defendant Dean Witter Reynolds Inc., doing business as Morgan Stanley Dean Witter, is Morgan Stanley Dean Witter & Co.

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COUNTER-STATEMENT OF JURISDICTION

The district court had jurisdiction over plaintiffs' federal securities law claims pursuant to 15 U.S.C. § 78aa. This Court has jurisdiction over this interlocutory appeal pursuant to 28 U.S.C. § 1292(e) and Fed. R. Civ. P. 23(f).

COUNTER-STATEMENT OF THE ISSUE PRESENTED

Did the district court (Debevoise, J.) abuse its broad discretion when it denied class certification under Rules 23(a) and 23(b)(3) on the ground that plaintiffs failed to show any of the following: that the putative class members suffered a common injury, *or* that putative class members each relied on defendants' alleged misrepresentations, *or* that class-wide issues predominate, *or* that the named plaintiffs' claims are typical of the claims of the class, *or* that the named plaintiffs can adequately represent the class, *or* that a class action is a superior method of adjudicating the controversy?

COUNTER-STATEMENT OF THE CASE AND FACTS

This is an appeal from the district court's denial of certification of a plaintiff class under Fed. R. Civ. P. 23(a) and 23(b)(3). See In re Merrill Lynch Sec. Litig., 191 F.R.D. 391 (D.N.J. 1999) ("Newton III"). The named plaintiffs are individual customers who placed "market orders" to buy or sell shares of over-the-counter ("OTC") stocks with the defendant securities firms, Merrill Lynch, PaineWebber, and Dean Witter.¹ Plaintiffs allege that defendants

¹ A "market order" is an instruction to buy or sell shares at the market price. Because market prices change, sometimes rapidly, a market order must be executed swiftly. Customers sometimes place a "limit order," which is an order to buy or sell shares but only at a specified price (or better). The customer instructs the broker to wait for that price because the customer is more concerned about price than immediate execution and would choose to forgo execution entirely if the requested price is not available. See In re Merrill Lynch Sec. Litig., 911 F. Supp. 754, 760 (D.N.J. 1995), rev'd, 135 F.3d 266 (3d Cir. 1998) ("Newton I").

violated SEC Rule 10b-5 in connection with these transactions. They seek to represent a class consisting of all entities and individuals that placed market orders to buy or sell OTC stocks with these firms between November 4, 1992, and August 28, 1996—a class of tens of thousands of persons and institutions that placed “hundreds of millions” of securities orders during the class period. JA765.

The central reason why the district court rejected certification of this sweeping nationwide class is that it would be necessary (even if plaintiffs’ disputed legal theories were ultimately accepted) to examine the facts and circumstances pertaining to each customer and each transaction to determine whether there was any violation of Rule 10b-5 with respect to that customer. See Newton III, 191 F.R.D. at 395. Every element of plaintiffs’ Rule 10b-5 claim—material misrepresentation, scienter, reasonable reliance, injury, and damages—depends on transaction-specific facts. See Newton v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 135 F.3d 266, 270-71 (3d Cir.), cert. denied, 525 U.S. 811 (1998) (“Newton II”). Understanding why each putative class member’s claim depends on transaction-specific facts requires a brief explanation of how the pertinent market works.

A. The Over-the-Counter Securities Market and the Duty of Best Execution

The OTC market in equity securities is a market created by securities firms’ buying and selling stocks for their own accounts, in transactions both with each other and with public customers. See Newton I, 911 F. Supp. at 758-59. OTC orders placed with brokers may be executed on either a principal or an agency basis. A principal transaction occurs when a customer places an order for a security in which the broker makes a market, and the broker itself acts as the customer’s counterparty (i.e., buys or sells the shares). An agency transaction occurs when the customer seeks to buy or sell stock in which the broker does not make a market or

when the customer chooses to have its order executed on an agency basis, and the broker receiving the order transmits it to another broker who makes a market in that security. During the class period, defendants in this case acted sometimes as principal and sometimes as agent, and plaintiffs' complaint sweeps in both principal and agency transactions. JA294-95, 387-88, 673-74. Thus, many other market makers that are not defendants in this lawsuit executed a significant number of the orders at issue here.²

The National Association of Securities Dealers ("NASD") requires each dealer that "makes a market" in a particular stock to publish both a "bid" price and an "offer" price for that stock and to state the largest lot size (e.g., "1,000 shares") at which it would be obligated to execute at its published bid and offer.³ Market makers are required to make a continuous two-sided market (i.e., stand ready to execute up to their displayed size at both their quoted bid and offer prices). In general, market making firms are compensated for the use of (and risk to) their capital by receiving the "spread" between the bid price at which they are willing to buy and the offer price at which they are willing to sell.

Market makers are linked by an electronic system, created at Congressional direction, originally called the NASD Automated Quotation System or "Nasdaq." See 15 U.S.C. § 78k-1. Nasdaq contains all market makers' bid and offer quotations (which are constantly changing), and it continuously displays the highest bid and lowest offer (as well as the associated lot sizes). This set of best bid and offer prices and associated lot sizes is referred to as the

² The district court determined that 10 of the 13 transactions subject to plaintiffs' original complaint were agency transactions. Newton I, 911 F. Supp. at 764-67.

³ See Newton I, 911 F. Supp. at 758-59. Although plaintiffs describe only the Nasdaq market, the class they have defined includes all persons who traded OTC stocks, a class that includes many persons who bought and sold stock not traded on Nasdaq. JA941.

“national best bid [and] offer” or “NBBO.” See 17 C.F.R. § 240.11AC1-4(b)(1)(i); see also id. at § 240.11AC1-1(b)(1)(ii).

NASDAQ, as designed and modified by Congress and the SEC, promotes the interest of customers—particularly customers with small market orders⁴—by permitting execution of their orders largely automatically (and therefore at minimum cost) and very swiftly (and therefore near the time the order was placed and near the price the customer expected). See Newton I, 911 F. Supp. at 758-60; Restatement (Second) of Agency, § 424 cmt. b (1958) (“a direction to a stockbroker to buy or sell ‘at the market’ is interpreted, under normal circumstances, as a direction to buy or sell immediately, irrespective of price and prospect”); Sanford J. Grossman, et al., Clustering and Competition in Asset Markets, 40 J.L. & Econ. 23, 38 (1997) (“an investor who wants to take a position immediately and with certainty will place a market order, not a limit order”). In 1984, long before the class period, the SEC publicly approved the NASD’s small order execution system, or “SOES,” which provided for *automatic* execution of small orders at the NBBO, without human intervention or searches for alternative buyers and sellers; all market makers were *required* to participate in SOES. See SOES, 49 Fed. Reg. 44042 (1984); Order Granting Accelerated Approval to Proposed Rule Change, 53 Fed. Reg. 22594 (1988) (“orders entered into SOES are automatically routed to the SOES market maker displaying the best bid or ask price”); see also SOES, 58 Fed. Reg. 69419, 69420 (1993). As recently as January 1994, well into the class period in this case, the SEC’s Division of Market Regulation stated: “[I]t is reasonable to accept quote-based executions of market orders based on

⁴ The SEC’s Market 2000 Report noted that “orders under 3,000 shares” qualify as small orders. See Securities and Exchange Comm’n, Div. Of Market Regulation, Market 2000, An Examination of Current Equity Market Development, at 7 (Jan. 1994), 1994 SEC Lexis 130, at *17 (discussing modernization and diversification of market execution options) (“Market 2000”), entire report available at 1994 SEC Lexis, at 130-45.

the Nasdaq best bid or offer [i.e., the NBBO] as consistent with best execution, absent customer instructions to the contrary.” Market 2000 at V-5, 1994 SEC Lexis 136, at *15. The district court commented that execution at the NBBO was commonplace in the industry and “no secret.” Newton I, 911 F. Supp. at 772.

Other sources of bids and offers, which were not reflected in the NBBO during the class period, have emerged and grown over time. As publicly reported by the SEC, these include the computer systems Instinet⁵ and SelectNet,⁶ which display particular securities offered or sought by particular sellers or buyers at particular prices. See Market 2000 at IV-6 to IV-8, 1994 SEC Lexis 135, at *21-26; id. at A IV-2 to A IV-4, 1994 SEC Lexis 142, at *6-10. Unlike Nasdaq, which ensures a ready market for all securities for which there are market makers, these “alternative sources of liquidity” merely offer a means by which particular institutions may post specific offers to buy or sell shares at specific prices, typically for limited periods of time.

Six points about these alternative sources of liquidity are central to the class certification issue. First, as the district court found, “in a large number of transactions there were no better prices from other sources.” Newton III, 191 F.R.D. at 396. In fact, the record shows that at all times during the class period these alternative-source bids and offers represented (and therefore could have been matched against) only a fraction—at most, roughly 27 percent—of the

⁵ Instinet is a proprietary communications network that permits subscribers to trade securities. See Proprietary Trading Systems, 54 Fed. Reg. 15429, 15430 & n.9 (1989); see also SOES, 58 Fed. Reg. at 69429 n.89 (noting that Instinet “permits institutional traders to limit their market activity to other institutions, thereby excluding customers represented by broker-dealers from their negotiations”); U.S. Equity Market Structure Study, 57 Fed. Reg. 32587, 32603 (1992) (“Proprietary trading systems such as [Instinet] * * * are designed to attract institutional, not individual customer, order flow”).

⁶ The SEC has noted that “SelectNet is an electronic, screen-based order routing system that allows market makers and order entry firms * * * to negotiate securities transactions in [Nasdaq] securities through computer communications rather than by telephone.” See SOES and SelectNet Service, 65 Fed. Reg. 3987, 3987 (2000).

transactions effected on Nasdaq.⁷ Second, the prices on these alternative sources were not necessarily better than the NBBO prices. *Id.* at 396-97. Third, the alternative sources have grown in availability and usefulness over time, including over the four-year class period.⁸ Fourth, these sources provided realistic alternatives only when the same security was offered at the same time and the same lot size: for example, a bid to buy 10,000 shares of Microsoft at \$70 a share could not ordinarily be executed in any other quantity and, of course, could not be used to satisfy *two* 10,000-share sell orders. Plaintiffs' expert and their affidavit evidence confirmed that many orders on alternative systems are available only on an "all or nothing" basis. JA347, 411, 578, 584, 619. Fifth, as Judge Debevoise recognized, agency orders and principal orders trigger quite different actions by the securities firms and pose quite different questions about the firms'

⁷ SEC studies demonstrate that in 1993—the first full year of the class period—all electronic communications networks (including Instinet and SelectNet) accounted for only 13% of the share volume in Nasdaq securities. Securities and Exchange Comm'n, Div. Of Market Regulation, Electronic Communication Networks and After-Hours Trading, at 5 & n.5, 2000 WL 731754 (June 7, 2000) (citing Market 2000, at II-13, 1994 SEC Lexis 133, at *43-44). Plaintiffs' expert's statistics (JA410-13) showed that even later in the class period, the volume of Instinet trades in Nasdaq securities was only 15 to 20 percent of Nasdaq volume (JA411), while SelectNet's volume was 5 to 7 percent of Nasdaq's (JA413). These figures, moreover, greatly overstate the percentage of Nasdaq trades that could actually have been executed through alternative sources. Execution would have been possible only when the time, price, and quantity of a non-Nasdaq bid or offer matched an opposing market order simultaneously placed with one of the defendants.

The same considerations apply to claims that class members could have obtained better execution if defendants crossed plaintiffs' orders with in-house market or limit orders. Plaintiffs must show that defendants held opposing or limit orders for particular securities at the exact time they executed plaintiffs' market orders at the NBBO. Plaintiffs have never shown that limit orders accounted for any appreciable fraction of defendants' trading in Nasdaq securities or that defendants held offsetting market orders when they executed plaintiffs' transactions. Judge Debevoise's examination of the original plaintiffs' 13 trades during the summary judgment proceeding revealed only *one instance* of actual injury and no instance in which a defendant held opposing limit and market orders for the same security at the same time. *Newton I*, 911 F. Supp. at 765.

⁸ See generally Market 2000 at 7-11, 1994 SEC Lexis 130, at *19-31; *id.* at II-11 to II-13, 1994 SEC Lexis 133, at *36-44.

responsibilities; indeed, most of plaintiffs’ theories are wholly inapplicable to agency transactions. See Newton I, 911 F. Supp. at 764. Sixth, when a firm received a customer’s market order to buy or sell a particular stock, checking alternative sources of liquidity would have taken time—precious seconds during which the NBBO price could move in a direction adverse to the customer.⁹

At all relevant times, defendants have had a “duty of best execution,” an obligation to get the most “favorable terms reasonably available under the circumstances.” See Newton II, 135 F.3d at 270-71 & nn. 1, 2. That duty, which is at the heart of this case, “has evolved over time with changes in technology and transformation of the structure of financial markets.” Id. at 271. Moreover, “best execution” has never meant solely “best price”; it has always encompassed many other factors, “including, for example, the opportunity for price improvement, the likelihood of execution * * *, the speed of execution, the trading characteristics of the security, and any guaranteed minimum size of execution.” Disclosure of Routing Practices, 65 Fed. Reg. 48406, 48428 (2000); see Newton II, 135 F.3d at 271 n.2; In re Certain Market Making Activities on NASDAQ, 1998 WL 919673, at *5 (S.E.C. 1999) (the duty of best execution has generally been defined as the obligation of the broker-dealer to “obtain the most favorable terms reasonably available under the circumstances for a customer’s order”). The key point is this: *to determine whether a broker has breached the “duty of best execution,” the finder of fact must assess all the facts and circumstances pertaining to the customer and the particular trade.*

B. The Complaint and the Putative Class

⁹ Market 2000 at V-3 to V-5, 1994 SEC Lexis 136, at *11-12. The record shows, for example, that the NBBO for U.S. Healthcare changed 71 times on June 7, 1994, the day that plaintiff Zakheim sought to purchase that stock. JA348.

The gravamen of the complaint is that defendants violated the Rule 10b-5 prohibition against material misrepresentations made with scienter and injured plaintiffs in doing so. Plaintiffs' principal theory can be fairly summarized as follows: (1) By accepting customer orders, defendants implicitly "represented" that they would obtain "best execution." (2) Plaintiffs placed market orders with defendants in reliance on that implied representation. (3) When defendants represented that they would provide "best execution," they actually intended either to execute market orders automatically in a principal transaction at the NBBO—rather than seek better prices from alternative sources or in-house limit orders—or to direct the agency order to another market maker without assuring that it would seek better-than-NBBO prices. (4) Plaintiffs and other class members whose orders were executed at the NBBO were therefore defrauded and injured when better prices were available. (5) The measure of each class member's damages is the difference between the NBBO and a better price at which the same transaction could actually have been executed. JA1297-98.

Although plaintiffs' principal claims assert the availability of better prices on alternative execution sources, their complaint also asserts a multitude of other claims. They allege that defendants obtained "unlawful profits" by trading out of inventory (JA948) or in proprietary accounts (JA951). They allege that defendants should have crossed market and limit orders. *Id.* They allege that defendants received payment for order flow in connection with agency orders. JA952. All these claims involve highly individualized questions of fact (for example, about the content of inventories), see, e.g., JA294-96, 347, 386-90, 559, 620, and of applicable regulatory requirements, which changed during the class period, see Order Execution Obligations, 61 Fed. Reg. 48290 (1996); NASD Notice to Members 94-62 (Aug. 1994). They also assert a variety of state law fiduciary duty and unjust enrichment claims, raising questions of

individual fact and implicating the substantive law of fifty different states. JA954-56. With respect to each such claim, agency transactions give rise to different factual and legal issues than principal transactions. Newton I, 911 F. Supp. at 764.

This is not the appropriate place to argue the merits of plaintiffs' claims and defendants' numerous affirmative defenses, which a jury would be required to resolve under the standards set forth by this Court in Newton II. But for purposes of assessment of the class action allegations,¹⁰ it is essential to understand that defendants contest plaintiffs' claims in the following respects, among others (JA1640-89):

First, there could be no possible material misrepresentation with respect to any transaction that was actually executed on the best available terms, and as plaintiffs' expert has admitted, *very few* of the transactions could in fact have been executed at better-than-NBBO prices. See p. 8 n.7, supra; Newton I, 911 F. Supp. at 764-67; JA411-13, 757; Order Execution Obligations, 61 Fed. Reg. 48290, 48291 (1996) (despite growth, alternative execution sources accounted for only a small fraction of trades in Nasdaq securities); see also JA1360 (plaintiff Binder stating that she did not allege that PaineWebber had injured her in every transaction).

Second, showing that a better price was available for a class member's specific order is necessary—though not sufficient—to prove that the class member was injured and that one of the defendants is liable for that injury. See Newton II, 135 F.3d at 270-71.

Third, even in instances where it may appear in hindsight that a marginally better price might have been available from another source, many customers preferred execution at the NBBO in the interest of speed and to avoid the risk of adverse market movement during a

¹⁰ See Coopers & Lybrand v. Livesay, 437 U.S. 463, 469 (1978) (“class determination generally involves considerations that are ‘enmeshed in the factual and legal issues comprising the plaintiff’s cause of action’”).

possibly fruitless search. JA1343 (summary of deposition testimony reflecting numerous plaintiffs' interest in speedy execution of orders). Given the risk inherent in taking time to review alternative sources, execution at the NBBO was best execution of most orders. See Market 2000 at V-3 to V-5, 1994 SEC Lexis 136, at *13.

Fourth, all sophisticated customers, and any other customer who wished to inquire into the operation of the market, knew that small orders were automatically executed and cannot properly claim "reasonable reliance" on any inconsistent understanding. See, e.g., Market 2000 at II-11 to II-13, 1994 SEC Lexis 133, at *36-44.

Fifth, in view of the highly limited availability of bids and offers through alternative sources,¹¹ a particular class member would be able to show injury only if he assumed that orders would have been executed in one manner rather than another (e.g., matching Instinet bids or offers strictly on a first-come, first-served basis versus splitting the Instinet bids or offers pro rata over a set of approximately contemporaneous customer orders), and different members of the putative class would benefit from different and conflicting assumptions.

Sixth, each class member's damages, if any, would ultimately depend on the precise alternative bid or offer that would have been available to fill the particular class member's order when it was entered. See Schaffner v. Chemical Bank, 339 F. Supp. 329, 334 (S.D.N.Y. 1972) (Pollack, J.) (resolving a "complaint of poor executions * * * will require a comparison of every transaction * * * with other executions obtained at the same time").

¹¹ Plaintiffs argue that this Court has already determined that availability of alternative execution sources could be determined class-wide. Br. 15. Plaintiffs misdescribe Newton II, which held only that there was a material dispute of fact regarding the feasibility of executing plaintiffs' orders on alternative systems. See Newton II, 135 F.3d at 269-70 & n.2. Plaintiffs' arguments in favor of class-wide adjudication of "feasibility" issues ignore numerous relevant factual differences, including differences in the feasibility of executing small orders in an actively traded stock and large orders in a thinly traded stock.

The putative nationwide class that Judge Debevoise rejected includes entities and individuals with vastly different levels of knowledge regarding the operations of the market. It includes investors who were either aware that small orders were routinely executed at the NBBO or on notice of these facts through SEC disclosures and the well-publicized filing of the original complaint in this litigation. It includes individual investors who placed both limit orders and market orders, showing that they distinguished between transactions they considered primarily price-sensitive (limit orders) and those they considered primarily time-sensitive (market orders). It includes securities industry professionals who were aware both that defendants were executing trades automatically at the NBBO and that securities trades could be consummated through alternative systems. The putative class also includes huge institutions, such as mutual funds whose managers not only knew about alternative sources of bids and offers but in many cases had their own Instinet terminals and nevertheless chose to bring particular transactions to defendants. See Br. 20. During the class period, institutions held roughly 47 percent of Nasdaq stocks by market value (Nasdaq website, www.marketdata.nasdaq.com/asp/SEC4_mktval.asp) and accounted for nearly 70 percent of Nasdaq volume. In re NASDAQ Market Makers Antitrust Litig., 172 F.R.D. 119, 130 (S.D.N.Y. 1997). Finally, the class as defined includes all persons who entered market orders for OTC stock during the relevant period, whether or not those orders were executed at the NBBO, and thus includes persons whose trades were not, in fact, executed at the NBBO. See Market 2000 at 19-20, 1994 SEC Lexis 130, at *56; JA1635.

Plaintiffs' deposition testimony confirms that even the named plaintiffs had different trading objectives and expectations.¹² For instance, some plaintiffs were primarily

¹² Plaintiffs' testimony concerning their interest in price versus speed and their understanding of trading practices is summarized at JA1341-44, with copies of pertinent deposition pages attached.

interested in price and others were primarily interested in swift execution.¹³ Some placed limit orders when price was the paramount concern.¹⁴ Different plaintiffs had different understandings as to how quickly their orders would be executed some—expected immediate execution of trades,¹⁵ while others had no expectation as to when their trades would be executed.¹⁶ Still other plaintiffs testified that they might have been willing to delay execution if there had been a chance that they might have garnered a better price, but the amount of time individual plaintiffs would have been willing to wait for possible price improvement varied substantially.¹⁷

PRIOR PROCEEDINGS

Three plaintiffs, all individual investors, brought this case in 1994 against Merrill Lynch, PaineWebber, and Dean Witter. They identified 13 transactions they said were affected by defendants' allegedly fraudulent conduct.

Defendants moved to dismiss. The district court converted the motion into a motion for summary judgment and directed the parties to submit detailed information concerning (1) each plaintiff's own transactions, (2) the NBBO and alternative sources of execution

¹³ JA1342, 1404 (Finger Dep. 51-54); JA1342, 1417 (Lupica Dep. 68) (exact price of stock was not a factor in deciding whether to make a purchase).

¹⁴ JA1419 (Lupica Dep. 74) (placed limit orders during class period; would place market orders when "I wanted the stock now, instead of waiting"); JA1376-77 (I. Braun Dep. 68-72).

¹⁵ JA1343, 1364 (Blatt Dep. 68) (expected immediate execution); JA1343, 1369, 1372-1373 (Bracey Dep. 50-51, 124-26) (would wait on the phone for confirmation); JA1343, 1418 (Lupica Dep. 70-71); JA1343, 1378 (I. Braun Dep. 73).

¹⁶ JA1343, 1404 (Finger Dep. 52-53) (had no expectation that orders would be executed same day trade was placed); JA1343, 1397 (Daly Dep. 115) ("I didn't have an expectation of when that stock was going to be bought"); JA1343, 1420 (Lupica Dep. 78); JA1343, 1413 (LoForte Dep. 74-75).

¹⁷ JA1344, 1398 (Daly Dep. 126-28); JA1344, 1421 (Lupica Dep. 88).

potentially available for each of the 13 transactions, and (3) general market practices and applicable regulatory requirements. JA846. Upon consideration of these and other materials, the district court granted summary judgment. See Newton I, 911 F. Supp. 754.

In his opinion on summary judgment, Judge Debevoise made findings that are highly pertinent to the present question. He examined each of the 13 orders (together with information regarding contemporaneous bids and offers available on alternative execution sources) and found on the record before him that only one order was executed at the NBBO at the same time that a potential counterparty was offering a (slightly) better price, on the same quantity of the same stock, through an identified alternative source. See Newton I, 911 F. Supp. at 764-67. Although plaintiffs could show no injury resulting from any of the other 12 transactions, Judge Debevoise assumed, in plaintiffs' favor for purposes of summary judgment, that additional information might reveal "some damage in a sufficient number of transactions to surmount defendants' challenge to plaintiffs' standing." Id. at 767. He nevertheless granted summary judgment on the ground that plaintiffs failed to identify any disputed issue of fact regarding two of the elements of their securities fraud claim: misrepresentation and scienter.

At the summary judgment stage, plaintiffs *agreed* that trial of this case would require examination of facts and circumstances surrounding each transaction. Indeed, they opposed summary judgment on the ground, among others, that they needed to develop evidence that "prices superior to the NBBO were available * * * *when* defendants executed plaintiffs' market orders [at the NBBO]." Plaintiffs' Supplemental Opposition to Motion for Summary Judgment at 2 (Newton I) (emphasis added). Pursuant to Rule 56(f), they requested discovery concerning the availability of alternative executions "*when plaintiffs' orders were executed.*" JA597 (emphasis added).

After a panel of this Court affirmed the district court's decision, the en banc Court granted rehearing and reversed, in part because it agreed that liability could be determined only in the factual context of particular trades. Newton II, 135 F.3d at 270-72. The en banc Court held that the "duty of best execution" could be determined only trade-by-trade:

While ascertaining what prices are reasonably available in any particular situation may require *a factual inquiry into all of the surrounding circumstances*, the existence of a broker-dealer's duty to execute at the best of those prices that are reasonably available is well-established and is not so vague as to be without ascertainable content *in the context of a particular trade or trades*.

Id. at 270-71 (emphasis added). The numerous factors that this Court identified (id. at 270 n.2) as relevant to best execution (price, order size, trading characteristics of the security, speed of execution, and clearing costs) can be assessed only by reviewing each individual transaction. For example, any delay required to consult alternative execution sources or to negotiate a more advantageous price risks an adverse market movement in the interim. This Court therefore noted that the fact-finder would need to "evaluat[e] * * * price as well as all of the other relevant terms [to determine whether] the trade would be better executed through a source of liquidity other than the NBBO" (id. at 270 n.2), an examination of broker performance that considers "all of the surrounding circumstances" (id. at 270).

In so ruling, this Court accepted *plaintiffs'* argument that their implied misrepresentation claims turn on transaction specific facts:

The ultimate determination of whether Defendants satisfied their duty of best execution turns on the factual issue of whether execution prices superior to the NBBO were available to Defendants from alternative sources *when Plaintiffs' orders were executed, and whether it would have been reasonable for Defendants to refer to those sources*.

Brief for Appellants, 30 (Newton II) (emphasis added). Plaintiffs further conceded that this determination "requires a factual analysis involving the reasonableness of Defendants'

conduct under particular circumstances.” Id. at 31. Plaintiffs asked for a remand to conduct that “fact-intensive inquiry.” JA747, 723. Plaintiffs’ expert, in fact, attempted the very transaction-specific factual inquiry required (on plaintiffs’ legal theory) to resolve this controversy:

Proving * * * violations [of defendants’ best execution obligations] requires additional data regarding available liquidity and execution sources, including Instinet quotes, SelectNet orders, available limit orders, and other market orders placed with the brokers *between the time Defendants accepted the market orders and their execution.*

JA419 (emphasis added). That inquiry—and any other effort to determine whether any potential plaintiff was injured—can only be performed one trade at a time.

This Court’s en banc opinion also addressed the reliance element of plaintiffs’ cause of action. Notwithstanding contrary implications in plaintiffs’ brief in this appeal (Br. 44-46), the Court did not hold or imply that any of the elements of a Rule 10b-5 claim could be “presumed” in the present case. On the contrary, the Court expressly held that “plaintiffs must demonstrate” each element of a 10b-5 case before the finder of fact: material misrepresentation, scienter, reliance, and injury and amount of damages. See Newton II, 135 F.3d at 269.

In view of the fact-specific nature of each class member’s claim, Judge Greenberg made the following pointed observation during oral argument before the en banc court: “I didn’t see how you could try this as a class action because it seemed to me there were too many variables with respect to the individuals involved as the plaintiffs and also with respect to the large number of transactions.” JA764. Plaintiffs did not deny this factual diversity. See generally JA769 (“the very notion under the law is that it’s the judicial system that’s supposed to do that fact intensive inquiry”).

After remand to the district court, plaintiffs moved to amend the definition of the class in two critical respects: First, although this Court had just held that plaintiffs had to prove injury caused by defendants' misrepresentation, plaintiffs broadened the class to include persons who had *not* been injured.¹⁸ The deletion of the injury element from the class definition made it possible to determine membership in the class without a pre-litigation inquiry into individual circumstances, but it also expanded the class to include persons *who, by plaintiffs' own definition, suffered no injury and possessed no best execution claim at all.* Second, plaintiffs added 18 additional class representatives (all individual investors) and extended the end of the class period to August 28, 1996, a date approximately 22 months *after* they filed their well-publicized initial class action complaint—even though the gravamen of both complaints was a “misrepresentation” that the initial complaint itself dispelled. Remarkably, plaintiff Gloria Binder alleged that she *continued* to rely on PaineWebber's misrepresentation of best execution in her own trading with PaineWebber *after she filed the initial complaint alleging the same misrepresentation.* JA882, 940, 954.¹⁹

¹⁸ The original class included all persons who placed market orders for OTC stock with defendants between November 4, 1992 and November 4, 1994 “and were damaged by the conduct alleged herein.” JA34 (emphasis added). The new complaint broadened the class to include all persons who placed market orders for OTC stock with defendants between November 4, 1992 and August 26, 1996, irrespective of injury. JA941.

¹⁹ This amendment, permitted over defendants' objections, more than doubled the size of the class and nearly tripled the number of transactions covered (see Defendants' Memorandum in Opposition to Plaintiffs' Motion for Leave to File a Supplemented and Second Amended and Consolidated Class Action Complaint at 1 & n.1, In re Merrill Lynch, et al., No. 94-5343 (DRD) (D.N.J. June 26, 1998); Defendant PaineWebber Incorporated's Opposition to Plaintiff's Petition for Permission to Appeal Pursuant to Federal Rule of Civil Procedure 23(f) at 2, Newton v. Merrill, Lynch et al., No. 99-8075 (3d Cir. Dec. 6, 1999), and added layers of complexity. The expansion of the class more than four years after the original complaint was filed creates, among other legal and trial management problems, statute of limitations issues depending on when claims arose and were discovered, see Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. 350, 364 (1991), and increases the probability that class members learned of

Plaintiffs then sought class certification. After extensive class discovery, including the depositions of 13 representative plaintiffs, plus limited merits discovery that addressed defendants' execution practices and policies, defendants' data concerning Nasdaq trading and alternative execution sources, and plaintiffs' failure to develop any methodology for determining damages to individual members of the putative class (JA1297), the district court engaged in a "rigorous analysis" of the record and plaintiffs' causes of action and denied plaintiffs' motion. See General Tel. Co. v. Falcon, 457 U.S. 147, 161 (1982). Carefully following both this Court's instructions in other class certification cases and this Court's opinion in Newton II, Judge Debevoise ruled that plaintiffs failed to show that their proposed class shares significant common characteristics, or that common issues predominate, or that the named plaintiffs' claims are typical of the class, or that plaintiffs could adequately represent the class in light of conflicts among class members, or that a class action would be a superior method of proceeding.

With respect to "commonality" and the "predominance" of class issues, Judge Debevoise held that in a Rule 10b-5 case based on misrepresentation, the plaintiffs must prove reasonable reliance on the misrepresentation and resulting injury to themselves. After carefully reviewing the substantial record and this Court's ruling in Newton II, he found that (1) the huge variation in the knowledge and sophistication of members of the putative class meant that plaintiffs' reliance on the alleged implied misrepresentation would have to be proved person by person (see Newton III, 191 F.R.D. at 395-96, 398), and (2) because at least some members of the proposed class had suffered no injury, "whether a class member suffered damages would

defendants' practices and the operation of the Nasdaq market through widespread press coverage of the 1994 complaint.

have to be determined on a trade by trade basis.” Id. at 396. In short, plaintiffs’ claims could be resolved only by “a fact-specific inquiry into the details of every individual transaction” (id. at 397), and individual issues overwhelmingly predominate.²⁰

Judge Debevoise also found that the claims of the named plaintiffs are not “typical” of the class, and that plaintiffs are not “adequate representatives,” because defendants’ liability, if any, to each class member rests on the specific facts of each transaction, such as what the particular customer knew and wanted when it placed its order, whether it relied on any alleged misrepresentation, and whether there was in fact a better-priced alternative to the NBBO (for the same lot size). He found that there were “no better prices” for many transactions, meaning that many class members “suffered no damages and were simply seeking a windfall”; indeed, class members would have to compete with each other to establish which orders would have received priority so as to be executed against the limited availability of any better-than-NBBO bids or offers, creating “inevitable conflict.” Id. at 396, 398. Finally, Judge Debevoise examined and rejected plaintiffs’ suggestion that their expert might eventually develop some unspecified “statistical” method of determining aggregate damages, ruling that the individual claims in this case inherently turn on their particular facts and not statistical estimates. Id. at 397.

Because reasonable reliance, injury, and damages would all have to be established by individual proof, Judge Debevoise found that a class action was not a “superior” method of resolving this controversy. On the contrary, plaintiffs failed to offer the district court any adequate class-based means of resolving these issues in each of the hundreds of millions of

²⁰ Plaintiffs argue on appeal that there was no basis for the district court to find great diversity in class-member sophistication. Br. 18. Not only did plaintiffs’ deposition testimony reveal disparate levels of familiarity with the workings of the securities markets (JA1341-44), but plaintiffs themselves have conceded that their class includes some of the nation’s most sophisticated institutional investors. JA1613; Br. 19-20.

transactions over a four-year period. See, e.g., Newton I, 911 F. Supp. at 764-67 (illustrating the substantial effort involved in reviewing just 13 transactions). Judge Debevoise therefore found that nationwide class litigation would be a “mind-boggling undertaking” and not superior to other, more focused alternatives. He also noted that, even if bifurcation of the action were possible, it would not assist him in trial management because “establishing *liability* would [still] require a fact-specific inquiry into the details of every individual transaction.” Newton III, 191 F.R.D. at 397 (emphasis added).

SUMMARY OF ARGUMENT

The district court’s carefully considered decision to deny class certification is entitled to substantial deference and is reversible only for abuse of discretion. “[B]road power and discretion [are] vested in [the district court] by Fed. R. Civ. P. 23 with respect to matters involving the certification and management of potentially cumbersome * * * class actions.” Reiter v. Sonotone Corp., 442 U.S. 330, 345 (1979). This Court and other Circuits have repeatedly recognized the strong presumption in favor of a district court’s decision whether to certify a class. See Holmes v. Pension Plan, 213 F.3d 124, 136 (3d Cir. 2000). Deference is especially warranted where the district judge has long experience and the record before him is substantial. Joel A. v. Giuliani, 218 F.3d 132, 139 (2d Cir. 2000) (“The trial judge’s views [regarding class certification] are accorded great weight * * * because he is exposed to the litigants, and their strategies, positions and proofs. * * * Simply stated, he is on the firing line and can evaluate the action accordingly”). The burden of establishing every element necessary for class certification is, of course, on the proponent of certification. See Davis v. Romney, 490 F.2d 1360, 1366 (3d Cir. 1974).

Judge Debevoise’s decision rejecting class certification was not an abuse of discretion. Every element of plaintiffs’ Rule 10b-5 claim, from the existence of a violation as to

a specific transaction by a particular class member through the measure of damages, depends on claimant-specific and transaction-specific information. To state a valid claim of securities fraud, plaintiffs must demonstrate the usual elements under Rule 10b-5: a material misrepresentation, scienter, reasonable reliance, causation of injury, and damages. They cannot prove material misrepresentation, injury, or damages with respect to a particular trade without proving that a better, non-NBBO trade was actually available at the time that trade was executed. And they cannot prove reasonable reliance without proving that the particular customer was unaware of the widely known fact that orders were routinely executed at the NBBO. These issues will be hotly disputed before the jury, and each is highly individualized in nature. Accordingly, every requirement for a Rule 23(b)(3) class action (other than numerosity) is missing here.

Material Misrepresentation. As this Court has stated, plaintiffs' claims turn on "whether a trier of fact could conclude from this record that the implied representation made by the defendants included a representation that they would not execute at the NBBO price *when prices more favorable to the client were available from sources like SelectNet and Instinet.*" Newton II, 135 F.3d at 269-70 (emphasis added). Even if plaintiffs succeed in convincing a trier of fact that defendants made such a representation, under Newton II defendants could be found to have made a *misrepresentation* only if a transaction was executed at the NBBO "when prices more favorable to the client were available." Thus, defendants can only have made a material misrepresentation—one that would be deemed important by a reasonable investor—if the class member's order was in fact not executed at the best available price.

It does not matter what alternatives to the NBBO were available to the firm if none would have achieved a superior trade. For example, if an agent represents that he will buy a red 1999 Chevrolet sedan at the lowest possible price, and the agent in fact achieves that goal,

the agent has made no misrepresentation whatever—even if he did not check with three car dealers who did not in fact have lower-priced offers. This case is indistinguishable: there can be no misrepresentation—and certainly not a material one—without a showing that a better trade was available in fact. See Newton II, 135 F.3d at 270-71. This is a showing that in the *vast majority* of cases cannot be made (because, among other things, the total volume of alternative source bids and offers is far too small), and it is a showing that was not made in 12 of the 13 instances that plaintiffs proffered and Judge Debevoise reviewed at summary judgment. See Newton I, 911 F. Supp. at 764-67.

Reasonable Reliance. To show reasonable reliance on the implied representation that a defendant would obtain best execution, a customer must prove that it expected the defendant to check a variety of sources and to try to obtain marginally better terms before executing a trade. But it is clear that many customers in the putative class were aware—and many others were on notice—that the NBBO represented the best price quoted by any market maker *on Nasdaq*. They also knew that alternative sources of bids or offers existed, and nevertheless expected (or wanted, in the interests of speed and certainty) to immediately execute their orders at the NBBO. Particularly in a volatile market, few customers would expect their brokers to be penny-wise and pound-foolish—pursuing small savings through alternative executions while market value slipped through their fingers. Reliance thus depends on the particular customer’s knowledge and expectations at the time that the order was placed, which must be proven customer by customer. Furthermore, the reasonableness of any reliance changed as information available to the class members increased. See Semerenko v. Cendant Corp., 2000 WL 1131928, at *15 (3d Cir. Aug. 10, 2000) (holding that class members may not “rely indefinitely upon the * * * misrepresentations”).

Causation Of Injury. A customer cannot have been injured unless there was in fact a better bid or offer for the particular quantity of the particular security at the time the customer wished to sell or buy. See generally Barnes v. American Tobacco Co., 161 F.3d 127, 135 (3d Cir. 1998), cert. denied, 526 U.S. 1114 (1999). Proof of injury thus obviously depends on examining the precise circumstances at the time (often a matter of seconds) between placement of an order and execution of that trade, to see whether a better trade was available in fact. Where two or more market orders for the same security were placed by putative class members at about the same time, and a better-than-NBBO price for the security was available but was not of sufficient quantity to fill all the orders, it would be necessary to determine which order would have been filled. As Judge Debevoise found, developing hypothetical rules of priority for this and much more complex market situations would raise conflicts within the putative class.

Measure Of Damages. Finally, the measure of any customer's damages, if any, depends on comparing the price at which its order was in fact executed with the price of some better bid or offer shown to have been reasonably available at the time of execution. Again, this is a transaction-specific inquiry.

As this examination of the elements of plaintiffs' Rule 10b-5 claim demonstrates, this case fails almost every Rule 23(a) and Rule 23(b)(3) test for certification (commonality and predominance, manageability and superiority, typicality and adequacy of representation) for essentially the same reason: the claim is at bottom not a class claim at all but, at best, an attempt to aggregate individual customer claims about how their transactions were executed. Execution of orders at the NBBO is not inherently legally wrong or evil. If it disserved particular customers under particular circumstances, those circumstances must be proven individually.

Any customer who had a claim that a transaction was handled improperly would be very poorly served by being caught up in a class action that has so far been able to point to just one arguable \$25 injury out of 13 transactions. See Newton I, 911 F. Supp. at 765.

Plaintiffs attempt a variety of responses, none of which hits the mark. First, they suggest that class certification is routine in securities cases. But that is not true in cases like this one. Class certification has *consistently been denied* by federal courts where customers allege that broker-dealers improperly executed particular securities transactions for their accounts in violation of the federal securities laws. Class certification has been ordered where defendants committed a “fraud on the market” that affected the market price of a security and hence injured everyone who bought or sold. But there is no such class-unifying claim in this case. Nor can plaintiffs’ theories of liability or defendants’ affirmative defenses be adjudicated based on a cohesive set of operative facts, such as the distribution of an identical prospectus to public investors causing identical harm.

Plaintiffs also argue that reasonable reliance can be “presumed.” But even if plaintiffs were entitled to such a presumption here, a presumption would merely shift the burden of proof to the defendants. Defendants would still be entitled to rebut the presumption on an individual basis, and the presumption would not eliminate the need for individualized inquiry. Beyond this, there is no basis to shift the burden of proof in a case such as this one, involving an alleged misleading representation regarding execution practices. This Court has held that reliance is “presume[d] * * * only where it is logical to do so.” Sharp v. Coopers & Lybrand, 649 F.2d 175 (3d Cir. 1981) (quotations omitted), overruled on other grounds, 883 F.2d 196 (3d Cir. 1989); In re Data Access Sys. Sec. Litig., 843 F.2d 1537 (3d Cir. 1988) (en banc). The presumption is not logical in this case, where plaintiffs concede that some members of their

putative class were aware of the potential for price improvement through their own use of alternative execution systems (see Br. 20)²¹ and where the pertinent information was available from public sources and upon reasonable inquiry. The proposed class includes those who subscribed to and traded on Instinet, others who read about this case in the middle of the class period and continued to place market orders with defendants, others who worked in the securities industry, and still others who discussed with their brokers the means by which their trades would be executed. See generally Newton III, 191 F.R.D. at 395-96. Even if it were logical for *some* class members to receive the benefit of the presumption, Judge Debevoise was certainly correct in concluding that entitlement to the presumption was not common among all class members.

Plaintiffs further argue that their expert's "formulas" and "statistical techniques" can establish injury and allocate damages. Br. 40-44. Judge Debevoise was entirely correct to reject that argument. First, plaintiffs—who had the burden of proof as to every requirement of class certification—never disclosed to the district court their expert's "formulas" or "techniques." Second, in a Rule 10b-5 suit like this one, every class member must prove that he, she, or it suffered actual injury. See Cimino v. Raymark Indus., Inc., 151 F.3d 297, 302 (5th Cir. 1998). ("This type of procedure does not allow proof that a particular defendant's asbestos 'really' caused a particular plaintiff's disease"). A customer whose order was executed at the best available price was not injured and is not entitled to any recovery whatever, either individually or as a share of a class recovery (which share would then be unavailable to other persons). As this Court has held, proof of individual injury in this case necessarily requires a comparison of each transaction price with other prices actually available at the same moment.

²¹ Although plaintiffs make this concession only as to institutional investors, the same is true of securities industry professionals and other sophisticated investors, all of whom are included in the proposed class.

Newton II, 135 F.3d at 270-71. The district court also correctly found that different class members would be competing to have their orders filled from the same, limited alternative sources, raising inter-class conflicts over any allocation formula. Newton III, 191 F.R.D. at 398.

Finally, plaintiffs had the burden of establishing that a nationwide class action would be “superior to other available methods for the fair and efficient adjudication of the controversy.” Fed. R. Civ. P. 23(b)(3). Judge Debevoise found that plaintiffs had not met this essential part of their burden. In their brief in this Court, plaintiffs do not challenge that finding. Since the point is unchallenged, this Court should affirm on that ground alone. On the merits, however, it is clear that Judge Debevoise was well within his discretion on this point. A class action will not simplify the adjudication of myriad transaction-specific issues.

ARGUMENT

To prove a Rule 10b-5 claims, a plaintiff must show that the defendant made a material misrepresentation to the plaintiff in connection with a securities transaction (TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 745-49 (1975)), that the defendant did so with scienter (Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976)), that the plaintiff reasonably relied on that misrepresentation (Basic Inc. v. Levinson, 485 U.S. 224, 243 (1988), and that the misrepresentation caused non-speculative injury to that plaintiff (Virginia Bankshares, Inc. v. Sandburg, 501 U.S. 1083, 1099-106 (1991)). See Newton II, 135 F.3d at 269, 272-73. Assuming success on each of these elements, each plaintiff must prove the amount by which it was damaged. This Court recognized in Newton II that proof of these elements “is fact dependent,” and turns on “a factual inquiry into all of the * * * circumstances” surrounding “a particular trade or trades”; what is “reasonable diligence” “under the circumstances”; the state of “industry practice”; plaintiffs’ “aware[ness] of the defendants’ exclusive reliance on the NBBO”;

and “defendants’ state of mind when they accepted plaintiffs’ orders.” 135 F.3d at 269, 271-73. Judge Debevoise rejected class certification for precisely that reason. The requisite individualized inquiries into the facts and circumstances of defendants’ relations with each of “thousands of Class members,” the details of “millions of trades” (Br. 12), and the “individual expectations of any given Class member” (Br. 13)—inquiries essential to plaintiffs’ case and defendants’ defenses—meant that plaintiffs could never satisfy the Rule 23 requirements of predominance, commonality, superiority, typicality, or representativeness.

The district court’s decision should be affirmed not only because substantial deference is due to an experienced district court judge on such matters (see Part I, infra), but also because it is correct. As we demonstrate in Parts II and III, infra, the individualized and context-specific inquiries without which liability could not be established—including the key elements of causation of injury and reasonable reliance—are wholly incompatible with class adjudication. See Holmes, 213 F.3d at 137-38 (affirming denial of class certification where the “issue of liability itself requires an individualized inquiry into the equities of each claim”).

I. THE DISTRICT COURT’S DECISION IS ENTITLED TO SUBSTANTIAL DEFERENCE AND ACCORDS WITH CONTROLLING PRECEDENT.

Because of its expertise in trial management, its close familiarity with the record in the case before it, and its ability to foresee practical problems that would arise in class adjudication, a district court is well qualified to determine the feasibility and appropriateness of conducting a particular case as a class action. Its decision on class certification is accordingly given substantial deference on appeal. See In re TMI Litig., 193 F.3d 613, 666 (3d Cir. 1999), cert. denied sub nom., General Public Utils. Corp. v. Abrams, 120 S.Ct. 2238 (2000); In re School Asbestos, 789 F.2d 996 (3d Cir. 1986) (“Manageability is a practical problem, one with which a district court generally has a greater degree of expertise and familiarity than does an

appellate court. * * * Hence, a district court must necessarily enjoy wide discretion”). This Court reviews decisions on class certification for abuse of discretion. E.g., Alexander v. Gino’s, Inc., 621 F.2d 71, 74 (3d Cir. 1980). Under that standard, this Court reviews factual findings for “clear error” (Holmes, 213 F.3d at 137) and reviews application of law to particular facts of the case “with substantial deference, considering not whether [it] would make the same precise determinations, but only whether [the district court’s] determinations are contrary to reason or without a reasonable basis in law and fact.” In re Tutu Wells Contamination Litig., 120 F.3d 368, 387 (3d Cir. 1997). The Court does not engage in the sort of *de novo* review sought by plaintiffs throughout their brief.

The district court’s opinion here is especially deserving of deference. The district court has presided over this case for several years and knows the issues in depth. The court accepted voluminous briefing on the class action issue, had the benefit of a wealth of discovery materials, and entertained oral argument. It then rendered a conscientious and reasoned opinion, accepting and rejecting arguments raised by each side and carefully applying the Rule 23 factors in light of Supreme Court and Third Circuit precedent, while giving close attention to this Court’s en banc decision. As this Court has long recognized, where a trial court thus “appl[ies] the [Rule 23] criteria to the facts of the case,” it has “broad discretion” whether to certify a class action and “should be given great respect by a reviewing court.” Wetzel v. Liberty Mut. Ins. Co., 508 F.2d 239, 259 n.6 (3d Cir. 1975); see also Eisenberg v. Gagnon, 766 F.2d 770, 785 (3d Cir. 1985) (the reviewing court will sustain “the sound exercise of discretion” when a district court articulates “the factors considered and the weight accorded to them” in making a class certification decision). Reversal of Judge Debevoise’s careful decision would set an unfortunate

precedent under new Rule 23(f), signaling that *any* class action ruling is fair game for interlocutory challenge in this Court.

Furthermore, the district court ruled that class certification is improper on multiple Rule 23 grounds: that common issues do not “predominate,” that class proceedings here would be neither manageable nor superior to alternative modes of dispute resolution, that plaintiffs’ claims are not “typical” of those of the proposed class, and that plaintiffs do not adequately represent absent class members. Each of these independent grounds, standing alone, defeats class certification. In order to reverse, this Court would have to conclude that Judge Debevoise abused his discretion as to each of these fact-specific determinations. Whether or not this Court would have reached the same judgment, it cannot be said that the district court committed an abuse of discretion as to any, let alone every one, of its alternative grounds for decision.

To the contrary, Judge Debevoise’s decision heeds the Supreme Court’s warnings that “rigorous analysis” is “indispensable” in reviewing requests for class certification (General Tel., 457 U.S. at 157, 161), and that courts ruling upon class certification must exercise “caution when * * * disparities among class members [are] great.” Amchem Prods., Inc. v. Windsor, 521 U.S. 591, 625 (1997). The Supreme Court has made clear in recent decisions that a “sprawling” and “enormously diverse” class like that sought by plaintiffs (*id.* at 622 & n.17)—a class that raises “the likelihood that significant questions, not only of damages but of liability and defenses of liability * * * affec[t] * * * individuals in different ways”—does not comply with Rule 23. Ortiz v. Fibreboard Corp., 527 U.S. 815, 845 n.20 (1999). Rather, a proposed class must be “sufficiently cohesive” (Amchem, 521 U.S. at 623) that issues of fact and law are “applicable in the same manner to each member of the class.” General Tel., 457 U.S. at 155.

Cohesiveness cannot be manufactured merely by stating issues at such a high level of abstraction that they appear common to all class members, when the determinative issues at trial would be “peculiar to * * * individuals” e.g., whether “in the context of a particular trade,” and taking account of price, order size, trading characteristics, and cost, speed, and difficulty of execution, “the trade would be better executed through a source of liquidity other than NBBO”). Amchem, 521 U.S. at 624; Newton II, 135 F.3d at 270-71 & n.2. Nor may a class be certified when the only manageable way to try the case as a class action would involve “sacrificing procedural fairness” and “abridg[ing]” a “substantive right”, by depriving defendants of the opportunity to raise individualized defenses and introduce evidence on the particular facts of class members’ claims. Rules Enabling Act, 28 U.S.C. § 2072(b); Amchem, 521 U.S. at 613, 615; see also Barnes, 161 F.3d at 146-47 (class action inappropriate because “defendants would be permitted to cross-examine each and every class member” regarding their individual circumstances). This Court’s recent decisions have insisted on exacting compliance with Rule 23. E.g., Holmes, 213 F.3d at 136-38 (need for “individualized inquiry” was incompatible with class certification); Barnes, 161 F.3d at 142-43 (class failed to satisfy “the cohesiveness requirement enunciated by both this Court and the Supreme Court” because “causation” and “defenses” “present too many individual issues to permit certification”); Georgine v. Amchem Prods., Inc., 83 F.3d 610, 624-34 (3d Cir. 1996), aff’d, 521 U.S. 591 (1997). So have other courts of appeals. E.g., Broussard v. Meineke Discount Muffler Shops, Inc., 155 F.3d 331, 345 (4th Cir. 1998); Cimino, 151 F.3d at 312. Judge Debevoise cannot be faulted for following these very recent decisions.

Plaintiffs’ suggestion that securities law claims are especially appropriate for class certification (Br. 29) ignores the Supreme Court’s recognition in Amchem that only “*certain*”

securities claims satisfy Rule 23's requirements. 521 U.S. at 625 (emphasis added). The Advisory Committee note cited by the Supreme Court (id.) draws the very distinction that Judge Debevoise found controlling. While a fraud perpetrated on many investors by the use of a widely disseminated misstatement that works a "fraud on the market" may lend itself to class adjudication, "a fraud case may be unsuited for treatment as a class action if there was material variation" in individual class members' circumstances that are relevant to proof of injury, reliance, or other elements of a Rule 10b-5 claim. Adv. Comm. Notes to Fed. R. Civ. P. 23(b)(3), 28 U.S.C.A. p. 385. Accordingly, courts routinely deny class certification where claims against broker-dealers turn, as plaintiffs' claims do, on divergent issues of injury, causation, reasonable reliance, materiality, communications with customers, and customer expectations. See Basic, 485 U.S. at 242 (necessary proof of "individualized" facts in securities cases prevents class certification because individual issues "overwhelm the common ones").

For example, in Romano v. Merrill Lynch, 834 F.2d 523 (5th Cir. 1987), the court affirmed the denial of class certification for a Rule 10b-5 claim that a broker had an undisclosed, uniform practice of investing customer funds in a money market account without authority, because that "adjudication would require a highly specialized inquiry into the relationship between each customer and his account executive, and an examination of the individual investment objectives of the client." Id. at 530. In Shivangi v. Dean Witter Reynolds, Inc., 825 F.2d 885, 890 (5th Cir. 1987), the court upheld denial of certification for plaintiffs' Rule 10b-5 challenge to a broker-dealer's failure to disclose the different compensation to account managers for principal and agency transactions because customers had varying amounts of information, necessitating individual inquiry. And in Seiler v. E.F. Hutton & Co., 102 F.R.D. 880, 889 (D.N.J. 1984), the court denied certification of a class of purchasers of a particular issuer's

securities through a single broker, observing that “where it is alleged that a brokerage firm or other investment counseling organization has defrauded a group of investors, the courts have generally denied class certification because of the highly individualized nature of the communications of the defendant’s employees with their clients.”

Federal court rulings denying class certification of claims that brokers improperly executed securities transactions are numerous and entirely consistent. See, e.g., Rowe v. Morgan Stanley Dean Witter, 191 F.R.D. 398, 406-15 (D.N.J. 1999) (rejecting class certification for churning, unsuitable investment, and unauthorized trading claims against a broker because of a host of individualized issues); Bear v. Oglebay, 142 F.R.D. 129, 131-34 (N.D.W. Va. 1992) (securities fraud claims against a broker-dealer were not suitable for class adjudication where issues of reliance and materiality required individualized proof because “[t]he ‘total mix’ of information” known or reasonably available to class members varied); Forkin v. PaineWebber, Inc., 1988 WL 152023, at *3 (C.D. Ill. Oct. 13, 1988) (“individual questions” concerning elements of plaintiffs’ securities laws claims against a broker made class certification inappropriate); Angelastro v. Prudential-Bache Sec., 113 F.R.D. 579, 583-85 (D.N.J. 1986) (same); Glick v. E.F. Hutton & Co., 106 F.R.D. 446, 450-51 (E.D. Pa. 1985) (same); Moscarelli v. Stamm, 288 F. Supp. 453, 461-63 (E.D.N.Y. 1968) (same); Hirschi v. B&E Sec., 41 F.R.D. 64, 67-68 (D. Utah 1966) (same); Schaffner, 339 F. Supp. at 334 (“The charge in the complaint of poor executions * * * will require a comparison of every transaction for every trust with other executions obtained at the same time”).²²

²² In closely related contexts, courts have reached identical conclusions. E.g., Zimmerman v. Bell, 800 F.2d 386, 390 (4th Cir. 1986) (no class certification where “the potential for variance in shareholder circumstances” relating to injury, reliance, and materiality is “significant”); Polin v. Conductron Corp., 552 F.2d 797 (8th Cir. 1977); O’Neil v. Appel, 165 F.R.D. 479, 506-07 (W.D. Mich. 1996) (“where individual hearings are required on questions of reliance, causation

Eisenberg v. Gagnon, on which plaintiffs surprisingly rely, illustrates the circumstances in which class adjudication is appropriate for a Rule 10b-5 claim—circumstances unarguably absent here. The class at issue in Eisenberg involved only 90 plaintiffs who made “identical investments,” who “relied on virtually identical written materials,” and whose claims “did not present extraordinarily complex questions of causation and reliance”—unlike a case where “individual causation issues might prove a more significant obstacle.” 766 F.2d at 786-87. Despite Eisenberg’s simple facts, this Court declined to rule definitively on the certification issue based on its review of the “cold record,” and allowed the district court to consider “the efficacy of class action treatment as the circumstances change.” Id. at 787. All these factors support Judge Debevoise’s ruling here, where: (1) tens of thousands of class members engaged in hundreds of millions of different transactions over a four-year period, and a comparison of those transactions to others available through alternative sources is essential; (2) each class member had a different relationship with its broker and had a different level of knowledge and sophistication; (3) issues of injury and reliance (among others) turn on close investigation of all those facts; and (4) the trial judge has made a reasoned, informed decision, based on numerous independent grounds, that the action does not comport with Rule 23.²³

and damages, the case is hardly the picture of judicial economy envisioned by Rule 23”); Gelman v. Westinghouse Elec. Corp., 73 F.R.D. 60, 64-69 (W.D. Pa. 1976), aff’d, 612 F.2d 799 (3d Cir. 1980); see also Castano v. American Tobacco Co., 84 F.3d 734, 745-46 (5th Cir. 1996); Hewitt v. Joyce Beverages, 721 F.2d 625, 628 n.2 (7th Cir. 1983).

²³ Plaintiffs’ other authorities (all of which affirm discretionary class certification rulings) likewise fail to support their claim that class certification is proper here. In Hoxworth v. Blinder, Robinson & Co., 980 F.2d 912, 913 (3d Cir. 1992), default judgment had already been entered, obviating proof of liability (including any individual issues). Liability, moreover, rested on a unitary policy of charging excessive markups on transactions, injuring all members of the class and leaving only a mechanical computation of damages. Id. at 923-24. In Ettinger v. Merrill Lynch, 122 F.R.D. 177, 179-80 (E.D. Pa. 1988), the district court certified a class based on allegations that all class members received the same misleading circular which induced them to buy a security and that defendant had assessed an unlawful markup on every customer, so that

Ignoring the Supreme Court and Third Circuit’s most recent class action cases and the host of cases against brokers in which class certification has been denied, plaintiffs place enormous weight on one inapposite decision, In re Prudential Insurance Co., 148 F.3d 283 (3d Cir. 1998), cert. denied sub nom., Krell v. Prudential Ins. Co., 525 U.S. 1114 (1999). In Prudential, this Court deferred to a district court’s discretionary determination to certify a class action for *settlement* purposes, not certification in a case that would have to be *tried*. That a class is for settlement only is taken “into consideration when examining the question of certification” and greatly affects manageability. Id. at 308; see Amchem, 512 U.S. at 619. The settlement in Prudential, moreover, was predicated on the existence of a comprehensive Alternative Dispute Resolution (“ADR”) procedure, established under a government consent decree to resolve the merits of individual claims. 148 F.3d at 291-95. The settlement’s reliance on this ADR mechanism (id. at 295) and its “blanket waiver” of all defenses (id. at 297) meant that the court never had to resolve a single issue such as causation or injury or to consider any affirmative defense. In stark contrast, disputed liability issues that depend on individualized facts and circumstances would have to be tried in this case, with an opportunity for defendants to present all their defenses. This Court in Prudential also noted the cohesiveness of the single defendant’s unitary scheme (id. at 311-12), the cohesiveness of the plaintiff class (id. at 295 n.16), and the involvement of state insurance commissioners and attorneys general of more than 40 states in the settlement and ADR program, which served to protect against inadequate representation and conflicts among class members. Id. at 295, 298. Here, by contrast, because the claims lack cohesiveness, a plaintiff “would need to prove much more than the validity of his own claim in

each class member suffered the same injury. Neither case has any bearing on this one, where an experienced district judge rejected certification of a class of tens of thousands of diverse members after finding that the core liability issues are individual ones.

order to prove the claims of the absentee class members,” making class certification inappropriate. Id. at 312. Defendants in this case are entitled to put on individualized evidence as to each class member—a right *forfeited* by the Prudential defendants. Judge Debevoise correctly understood that this case is not remotely “comparable” to Prudential. Newton III, 191 F.R.D. at 396. Plaintiffs have produced no plausible argument that the district court “abused its discretion” as to any of its multiple reasons for denying class certification.

II. THE DISTRICT COURT ACTED WITHIN ITS DISCRETION IN HOLDING THAT INDIVIDUAL ISSUES OF INJURY AND RELIANCE ON A MATERIAL REPRESENTATION PRECLUDE CLASS CERTIFICATION

Plaintiffs’ primary contention on appeal (Br. 32-50) is that the district court abused its discretion when it held that proof of injury and reliance require individualized inquiry into the facts and circumstances of each customer and each trade and that the need for such inquiry precludes class certification. The district court acted well within its discretion, however, in reaching this conclusion as to both elements of liability.

A. The District Court Correctly Determined that Fact of Injury Could Not Be Proven Without Individualized Inquiry.

The district court found that whether a class member suffered injury in fact—a crucial element of Rule 10b-5 liability—“would have to be determined on a trade by trade basis.” Newton III, 191 F.R.D. at 396. That is because a plaintiff could have been injured by a defendant’s alleged misrepresentation that it would provide “best execution” *only if* “at the time a trade was executed [a] better price was available from other sources.” The record shows, however, that “in a large number of transactions *there were no better prices from other sources.*” Id. (emphasis added). Even under plaintiffs’ own view of the facts, a better price was available for at best 27 percent of the transactions. See p.8 n.7, supra. Beyond examining price, determining whether a customer received best execution would also require inquiry into other

trade-specific factors like customer expectations, order size, speed, and the trading characteristics of the specific security in question. Newton III, 191 F.R.D. at 396; Newton II, 135 F.3d at 270 n.2. This case, then, is not one in which injury is “provable on a common basis” as to all class members. Newton III, 191 F.R.D. at 397. Rather, particularized “proof of injury * * * is critical for the determination of defendants’ liability to any individual” customer. Shumate & Co. v. NASD, 509 F.2d 147, 155 (5th Cir. 1975).

The record fully supports the district court finding that injury cannot be determined on a class-wide basis. The district court examined 13 transactions in detail and found on the evidence before it that possible injury had been shown in just one transaction. Plainly, the factual showing as to that one transaction is not common to the other representative plaintiffs, let alone the class. See pp. 14-18, supra.

Plaintiffs’ assertion (Br. 33) that they can readily prove injury for the whole class “without reference to the individual circumstances of each of their trades” is wide of the mark. Plaintiffs try to substitute for proof of actual injury the vague notion that “loss causation can be established [on a common, class-wide basis] where a defendant reasonably foresees that its misconduct could cause injury.” Id. But whether harm is foreseeable relates to the issue of “proximate cause,” AUSA Life Ins. Co. v. Ernst & Young, 206 F.3d 202, 216-17 (2d Cir. 2000), and not to whether plaintiff was injured in fact.

The federal securities laws require that, to establish liability, a plaintiff prove in a non-speculative manner that defendant’s misrepresentation caused it “*actual economic loss.*” Semerenko, 2000 WL 1131928, at *17 (emphasis added); see 15 U.S.C. § 78bb(a); see Newton II, 135 F.3d at 269 (to state a Rule 10b-5 claim, “plaintiffs must demonstrate * * * damage resulting from the misrepresentation”); Virginia Bankshares, 501 U.S. at 1099-1106

(rejecting “speculative” theories of “causation of damages”). The rule in other analogous areas of the law is the same. See, e.g., Maio v. Aetna, Inc., 221 F.3d 472, 495 (3d Cir. 2000) (rejecting, in a RICO case, a “theory of present economic loss” that “requires a significant degree of factual speculation”); Barnes, 161 F.3d at 135 (“Unless it is proven that cigarettes always cause or never cause addiction, the resolution of the general causation question accomplishes nothing for any individual plaintiff. * * * [T]he jury would still be required to determine for each class member whether he or she is addicted”).

As in antitrust cases—which plaintiffs say are closely analogous (Br. 37)—the securities laws leave “no room for awarding damages to some amorphous ‘fluid class’ rather than, or in addition, to one or more actually injured persons.” Windham v. American Brands, Inc., 565 F.2d 59, 66 (4th Cir. 1977) (en banc); see also Broussard, 155 F.3d at 342 (requiring “proof of actual, individual damages”); Ungar v. Dunkin Donuts, Inc., 531 F.2d 1211, 1225-26 (3d Cir. 1976) (denying class certification in an antitrust case where each plaintiff had to prove “individual coercion,” and rejecting alternative, non-individualized “modes of proof” suggested by plaintiffs); In re Hotel Tel. Charges, 500 F.2d 86, 90 (9th Cir. 1974) (attempted adjudication of “claims of class members collectively significantly alters substantive rights under the antitrust statutes,” which require individual proof of injury); Eisen v. Carlisle & Jacquelin, 479 F.2d 1005, 1018 (2d Cir. 1973), vacated, 417 U.S. 156 (1974) (customers’ antitrust claim against brokers could not proceed as a class action based on theory of liability and damages to the “class as a whole”). Questions of “foreseeability” have nothing to do with proof that a particular customer suffered actual pocketbook injury because a better trade was reasonably available.

Plaintiffs’ bald assertion that their expert could devise a “formula that measures class-wide damages and from it a plan of allocation” (Br. 41) is also unavailing. Like other

formulas for manufacturing gold, Dr. Mendelson's has been kept secret and could not possibly sustain plaintiffs' burden of demonstration under Rule 23. See Windham, 565 F.2d at 70 (it is not enough for plaintiffs to "declar[e] that they 'expect' to develop a formula"; a court "should not certify a class merely on the assurance of counsel that some solution will be found"). It is apparent, moreover, that this vague suggestion is at odds with Dr. Mendelson's prior recognition that proof of inferior execution "requires additional data regarding available liquidity and execution sources * * * between the time Defendant accepted the market orders and their execution." JA419.

It is also wrong in principle. The cases we have cited make clear that each class member has a right to recover only if it was injured. Defendants' right to have a jury find facts cannot be abridged by the formulas of plaintiffs' experts. No "statistical technique[]" (Br. 41) can conceivably determine from generic facts whether a particular customer was injured because it did not get best execution. Only evidence showing available prices at the time a trade was made and the host of other relevant factors identified by this Court in its en banc decision (135 F.3d at 270 n.2) can do that. Statistical estimates would inevitably leave "a significant degree of factual speculation" about whether a particular customer had been injured, and thus would be insufficient to satisfy the injury element of liability. Maio, 221 F.3d at 495; see also Cimino, 151 F.3d at 302 ("This type of procedure does not allow proof that a particular defendant's asbestos 'really' caused a particular plaintiff's disease"). Where a plaintiff suggests this sort of evidentiary "shortcut" as being "necessary in order * * * to proceed as a class action," it is a sure "caution signal" that class certification is "impermissible." Broussard, 155 F.3d at 343.

Plaintiffs cite In re School Asbestos Litigation, 789 F.2d 996 (3d Cir. 1986), and Bogosian v. Gulf Oil Corp., 561 F.2d 434 (3d Cir. 1977), for the proposition that a class may be

certified even where each class member must prove injury on his own facts. Neither case holds any such thing. In School Asbestos Litig., this Court affirmed the district court's discretionary certification of a Rule 23(b)(3) class despite "reservations as to the breadth" of the district court's commonality findings, because the district court had "identified common factual issues" and the theory of the case was that asbestos fiber in ambient air was sufficiently high to have injured *all* class members who breathed it. 789 F.2d at 1009-10. Nonetheless, this Court warned that manageability is "a serious concern" and stressed that if "the litigation cannot be managed, decertification is proper." Id. at 1011. Bogosian likewise involved an alleged common injury: an unlawful "markup" charged uniformly to all members of the class. This Court explained that if the trier of fact found an impermissible nationwide markup, "it would be clear that all members of the class suffered some damage," but the Court nevertheless remanded the case to determine whether common issues predominated. 561 F.2d at 455-56; see also id. at 452, n.12 (class action would not be appropriate if proof of liability "depended on specific instances" of defendants' conduct). Neither case bears any resemblance to this one, in which individual proof is necessary to determine which class members, if any, failed to receive best execution and thus suffered injury. When an "issue of liability" like injury in fact "requires an individualized inquiry" into the circumstances of each customer's claim, a trial court does not abuse its discretion by denying class certification. Holmes, 213 F.3d at 137-38; see, e.g., In re Agent Orange Prod. Liab. Litig., 818 F.2d 145, 165 (2d Cir. 1987) (the "relevant question [for purposes of class certification] is not whether Agent Orange has the capacity to cause harm, the generic causation issue, but whether it did cause harm and to whom. That determination is highly individualistic").

Plaintiffs consistently ignore the difference between proof of injury and computation of damages, even though Judge Debevoise carefully explained that distinction and

stressed the need for individualized inquiry relating to “[p]roof of damage,” not “the mere calculation of damages.” Newton III, 191 F.R.D. at 396; see, e.g., Amerinet v. Xerox Corp., 972 F.2d 1483, 1494 (8th Cir. 1992) (collecting Supreme Court precedent holding that there is a “clear distinction” between “fact” and “amount” of damages).²⁴ Even as to the amount of damages, moreover, it is impossible to see how any generic formula Dr. Mendelson could volunteer would provide “an intelligent estimate [of damages] without speculation or conjecture” (Br. 41)—still less a damages calculation that satisfies, as to each class member, the statutory requirement that “no person permitted to maintain a suit for damages under [Rule 10b-5] shall recover * * * a total amount in excess of his actual damages on account of the act complained of.” 15 U.S.C. § 78bb(a). A class-wide formula that may provide a particular customer with more than actual damages “abridge[s the defendant’s] substantive right” under that provision and hence may not be a basis for class certification. 28 U.S.C. § 2072; see Amchem, 521 U.S. at 615. Thus, even as to amount of damages, this case does not lend itself to class adjudication. Defendants are entitled to insist on particularized proof of damages, to introduce particularized evidence, and to cross-examine on that issue. See, e.g., Kline v. Coldwell, Banker & Co., 508 F.2d 226, 236 & n.9 (9th Cir. 1974) (amount of damages would require individualized inquiry despite the “generalized proof” proffered by plaintiffs, because “the defendant as to each transaction would be entitled” to give “particularized” evidence).

B. Plaintiffs Cannot Prove Reasonable Reliance on a Material Misrepresentation on a Class-Wide Basis.

²⁴ The district court also explained why it would not bifurcate the proceedings: while bifurcation might be proper in some cases to address individualized amount-of-damages issues, it is not appropriate, or in any way efficient, to bifurcate separate, individualized proceedings addressing multiple, critical liability issues like injury and reliance. Newton III, 191 F.R.D. at 396-97. Such a procedure would inevitably degenerate into an endless series of burdensome mini-trials and is not permissible under Rule 23. See, e.g., Castano, 84 F.3d at 745 n.21; p. 78 n. 35, infra.

To establish liability under Rule 10b-5, a plaintiff must prove its “reasonable reliance” on the defendant’s misrepresentation. Peil v. Speiser, 806 F.2d 1154, 1160 (3d Cir. 1986). Here, plaintiffs have the burden to show that, because of defendants’ implied representation of best execution, each of the tens of thousands of customers in the putative class reasonably expected that its transactions would be executed through an alternative trading source when that source offered a marginally better price than the NBBO. Judge Debevoise correctly found that such proof cannot be made on a common, class-wide basis but instead requires individualized consideration of each customer’s situation, because customers’ transactions “involved multiple circumstances which bear decisively upon the issue of reliance.” Newton III, 191 F.R.D. at 395; see id. at 398 (“some class members may have relied on the representation of best execution; some may not have”).

In particular, Judge Debevoise found, “[t]he degree of sophistication” and extent of knowledge of the putative class members “varies widely,” because defendants’ customers ranged from “new” traders at one extreme to “institutional investors” at the other, and included customers of every degree of sophistication in between. Id. at 395. Some customers had their own direct access to alternative execution sources like Instinet or the ability to negotiate directly for better-than-NBBO prices.²⁵ Sophisticated investors certainly knew exactly how defendants executed their orders.²⁶ And many more customers had access to public information about

²⁵ Securities and Exchange Comm’n, Report Pursuant to Section 21(a) of the Securities Exchange Act of 1934 Regarding the NASD and the NASDAQ Market, at 16 n.33 (Aug. 8, 1996) (“[l]arge institutional customers and sophisticated individual customers often attempt to negotiate for prices better than the inside quotes. * * * Many institutional customers have access to other avenues of price discovery, including proprietary trading systems and direct telephone contact with market makers”); see also JA1142.

²⁶ The record makes it clear that proposed class representatives knew how their orders were being executed. For example, one of the original plaintiffs, Gloria Binder, continued to bring

Nasdaq execution practices from the general media,²⁷ from the well-publicized filing of the original complaint in this case 22 months before the end of the now-proposed class period, and from numerous published SEC Releases and Reports.²⁸ Because, as this Court has held, “any evidence, derived from knowledge of industry practice or elsewhere that the plaintiffs were generally aware of the defendants’ exclusive reliance on the NBBO would, of course, be quite probative of whether the plaintiffs had the expectations they claim,” these very different levels of customers’ knowledge and sophistication create individualized issues of reliance on defendants’ alleged misrepresentations. Newton II, 135 F.3d at 272.

market orders to PaineWebber after she had sued PaineWebber for “undisclosed” practices in handling such orders. JA882, 940, 954; see also JA1047.

²⁷ Starting in 1992, even before the beginning of the class period, and continuing with increasing frequency throughout the class period, articles in the national press commented on broker executions at the NBBO, particularly in comparison to executions on Instinet. See, e.g., Cochran, The Striking Price, Barrons, Jan. 6, 1992, at 50 (“Instinet provides a computer linkup that displays bids and offers. * * * If the market’s 10-10 1/2 , [a broker] may bid 10 3/8 on Instinet, and any professional seller can hit that bid for 3/8 of a point better than can be realized over-the-counter”); Torres, How Street Turns Your Stock Trades to Gold, Wall St. J., Feb. 16, 1993, at C1 (“The NASD has given Wall Street firms a semiprivate system * * * called SelectNet. * * * Prices are often better (spreads are narrower) on SelectNet than the best bid or offer price on the national Nasdaq system”); Morgenson, Fun and Games on Nasdaq, Forbes, Aug. 16, 1993, at 74 (“Not everyone pays more for using Nasdaq. Institutions and big traders can advertise their wants or offerings on Reuters’ Instinet * * * . Nor does any broker we know of offer to put small customer orders on Instinet. The best individuals can do to minimize o-t-c trading costs is to instruct their brokers to execute trades on the Chicago Stock Exchange”); Getler, Reuters’s Instinet Is Biting off Chunks of Nasdaq’s Territory, Wall St. J., Oct. 4, 1994, at C1 (“Institutions say they like Instinet because dealers on the system tend to trade among themselves at narrower spreads than those being displayed on Nasdaq—hence lowering institutional traders’ costs of active money management”); Kadlec, Young Traders Can Be Gamble for Street, USA Today, Sept. 27, 1995, at 3B (Dealers “now may offer one price on a public Nasdaq trading system, while offering a better price on a network for professional investors, such as Instinet”); Norris, The S.E.C. Tries to Insure that Investors Get Better Stock Prices, NY Times, Sept. 28, 1995, at D8, col. 3 (“Currently, brokers sometimes quote better prices on Instinet, a proprietary system used by many institutions, than they do on Nasdaq”).

²⁸ See pp. 5-6, supra (citing SEC public disclosures of execution practices before and during the class period).

In addition, the particulars of customers' relationships with their brokers varied widely.²⁹ So did customers' trade-specific preferences. Thus, "[a]mong the plaintiffs and proposed class members, there were those who were not concerned about price, others who placed limit orders to secure a particular price, or still others who wanted an immediate sale or purchase" at market price. Newton III, 191 F.R.D. at 395-96; see pp. 14-16, supra. Some investors tailored their orders, placing limit orders for trades they considered price-sensitive and market orders for trades they considered time-sensitive.³⁰ Obviously, customers who "were not concerned" about small differences in price or wanted an "immediate" trade had no expectation that defendants would shop around alternative sources for a marginally better-than-NBBO price, and sophisticated investors concerned about price knew how to structure their orders. Market 2000 at 19-20, 1994 SEC Lexis 130, at *56.

Plaintiffs, moreover, must prove their reliance on a *material* misstatement made in connection with a specific securities transaction. Peil, 806 F.2d at 1160; Blue Chip Stamps, 421 U.S. at 731. This Court has explained that where "a plaintiff has actual knowledge of material facts"—or where a plaintiff acting with "due care" should have known those facts, having regard to the plaintiff's "sophistication" and "access to the relevant information"—the plaintiff has no "cause of action under 10b-5, since there would be a lack of 'materiality.'"

²⁹ The class representatives maintained relationships with their brokers for individual reasons, such as portfolio performance, quality of service, and personal ties (see e.g., JA1007, 1026, 1045, 1083, 1102, 1139, 1177, 1214, 1232, 1251, 1269, 1287), and execution of small market orders at the NBBO was an industry wide practice under then-existing regulatory guidance. See Newton I, 911 F. Supp. at 761. The named plaintiffs and other members of the class are therefore unlikely to be able to show that they would have acted differently (i.e., changed brokers to obtain different execution practices) had they known all the facts allegedly misrepresented. They could not conceivably carry their burden of proof with common, class-wide evidence. See Virginia Bankshares, 501 U.S. at 1099-106.

³⁰ See, e.g., JA991, 1023 1042 1061, 1248, 1343. Other investors executed some trades directly over alternative systems while sending other trades to defendants. JA410-12, 1612-13.

Straub v. Vaisman & Co., 540 F.2d 591, 596-98 (3d Cir. 1976); see also Zimmerman, 800 F.2d at 390 (an individual plaintiff’s unreasonable failure to “ascertai[n] facts generally available” renders a misrepresentation or omission not “material”; “[t]he availability of information may not be common to the class,” and this precludes class certification). Given the range of customers’ sophistication and knowledge and the widespread and increasing public dissemination of defendants’ execution practices during the class period, it would be a matter for individual inquiry whether a defendant’s alleged misrepresentation was material because it “significantly altered the ‘total mix’ of information” available to a customer such that the customer “would consider it important” with regard to a particular trade. Sharp, 649 F.2d at 187; see TSC Indus., 426 U.S. at 449.³¹ Nor can the materiality of a small difference in the price of a security be determined without inquiry into whether the particular customer considered the possibility of saving a small amount on the particular trade important enough to forgo immediate execution and risk an adverse change in the market—with potentially large economic consequences—while the broker reviewed alternative sources. See pp.7-10-13, 19, supra.

The district court properly held that highly individualized reliance questions precluded satisfaction of Rule 23’s requirements. As the Supreme Court recognized in Basic, when “proof of individualized reliance” is necessary to establish liability, that “prevent[s] plaintiffs] from proceeding with a class action, since individual issues then * * * overwhel[m] the common ones.” 485 U.S. at 242. See, e.g., Castano, 84 F.3d at 745 (“a fraud class action cannot be certified when individual reliance will be an issue”); Zimmerman, 800 F.2d at 390 (when “reliance on misrepresented facts will vary from shareholder to shareholder” because of

³¹ Rule 10b-5 provides a remedy for securities fraud, not breach of fiduciary duty. Santa Fe Indus. v. Green, 430 U.S. 462, 473, 477 (1977). If a plaintiff had access to the information at issue in its claim, there can be no securities fraud. E.g., Zimmerman, 800 F.2d at 390; Zobrist v. Coal-X, Inc., 708 F.2d 1511, 1518 (10th Cir. 1983).

their different “extent of knowledge,” “individual inquiry for each shareholder” is necessary and the case “lack[s] the common characteristics required for class treatment”); Simer v. Rios, 661 F.2d 655, 674 n.35 (7th Cir. 1981) (“cases involving large-scale fraud in the area of securities” raise “difficulties of certifying a class” because “reliance var[ies] as to each class member”); see also Banca Cremi, S.A. v. Alex. Brown & Sons, Inc., 132 F.3d 1017, 1028 (4th Cir. 1997) (“A plaintiff’s failure to prove that it justifiably relied on a broker’s alleged omission or misstatement”—as where the plaintiff knew or with due diligence “should have discovered the truth”—“is necessarily fatal to a securities fraud claim”).

Plaintiffs’ only response to the district court’s findings and this well-established body of law is to contend (Br. 44-46) that they are entitled to a rebuttable presumption of reliance under Affiliated Ute Citizens v. United States, 406 U.S. 128, 153 (1972), which shifts the burden of proof to defendants. Even if plaintiffs were entitled to such a presumption, it would be utterly irrelevant to the question of whether the district court abused its discretion in denying class certification. Plaintiffs concede the presumption is rebuttable. Defendants therefore have “the right to present a full defense on the issue[.]” of reliance, including individualized evidence (and cross-examination) as to each of the factors relevant to each customer’s reasonable reliance. Western Elec. Co. v. Stern, 544 F.2d 1196, 1199 (3d Cir. 1976; see also Barnes, 161 F.3d at 146-147; Peil, 806 F.2d at 1161; Kline, 508 F.2d at 235. That individualized inquiry is just the kind that Judge Debevoise found precluded class certification.

In this case, moreover, the presumption of reliance is not applicable. “The reason for shifting the burden on the reliance issue has been an assumption that the plaintiff is generally incapable of proving that he relied on a material omission.” Sharp, 649 F.2d at 188. Plaintiffs’ claim alleges that defendants impliedly *misrepresented*—i.e., caused class members to believe—

a specific fact: that brokers would look at all sources of bids and offers rather than execute trades immediately at the best bid or offer on the Nasdaq. See Newton II, 135 F.3d at 269-70. In these circumstances, involving an alleged misrepresentation rather than an omission, the logic behind the presumption does not apply. See id. (reliance is presumed “only where it is logical to do so. * * * Only in unusual circumstances is this burden shifted from the plaintiff to the defendant”).³²

This Court has also held that the presumption applies only in “certain cases,” principally those involving “[t]he fraud on the market theory of reliance,” where it is justified because of the predictable effect on “a security’s value” of providing misleading information uniformly across the whole market. Semerenko, 2000 WL 1131928, at *10-11, *17. There is no allegation of fraud on the market in this case. It also is not “logical” to presume reliance where the record conclusively shows “that in a large number of transactions there were no better prices from other sources” reasonably available. Newton III, 191 F.R.D. at 396. It would be even more illogical to presume *reasonable* reliance where the record affirmatively shows that broker execution practices were in the public domain and actually known to many class members. See p. 56 n. 27, supra. Consequently, “[t]o allow [the] presumption here would be both illogical and inequitable to the defendants.” Angelastro, 113 F.R.D. at 584. For all these reasons, the presumption is not applicable and would not apply in common to all class members even if it were. Plaintiffs’ presumption argument therefore falls far short of showing that Judge Debevoise abused his discretion in finding that reliance had to be established on an individual basis.

³² Virtually any misrepresentation may be restated as an omission, but to permit that would allow the “presumption to swallow the reliance requirement.” Joseph v. Wiles, 2000 WL 1089514, at *9 (10th Cir. Aug. 4, 2000); Young v. Nationwide Life Ins. Co., 183 F.R.D. 502, 510 (S.D. Tex. 1998) (rejecting plaintiffs’ “attempt to fall within the ‘omission case’ category * * * because such a circular argument would result in every case of misrepresentation becoming a case of omission”); see also Binder v. Gillespie, 184 F.3d 1059, 1064 (9th Cir. 1999); Banca Cremi, 132 F.3d at 1028 n.13; Bear, 142 F.R.D at 1331.

III. THE DISTRICT COURT ACTED WITHIN ITS DISCRETION IN FINDING THAT PLAINTIFFS FAILED TO CARRY THEIR BURDEN OF ESTABLISHING THAT THE CLASS MET THE REQUIREMENTS OF RULE 23.

Plaintiffs' brief in this Court studiously ignores the requirement that they bear, before the district court, the burden of establishing that their proposed class meets the requirements of Rule 23. See In re General Motors Corp. Pick-Up Truck Fuel Tank Prods. Liab. Litig., 55 F.3d 768 (3d Cir. 1995); Davis, 490 F.2d at 1366. They were required to show both that this class satisfies each of the criteria of Rule 23(a)—commonality, typicality, and adequacy of representation—and that “questions of law or fact common to members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods of fair and efficient adjudication of the controversy.” Fed. R. Civ. P. 23(b)(3). Plaintiffs' failure to carry their burden on *any* of these elements required denial of class certification. Judge Debevoise was clearly correct in finding that plaintiffs failed to carry their burden with respect to these required elements. Plaintiffs cannot show (and in some instances have not even tried to show) that Judge Debevoise abused his discretion in *each* of his findings.

A. The Proposed Class Fails the Commonality and Predominance Requirements.

Rule 23(b)(3) requires the district court to find that questions of law or fact common to the class “predominate” over issues affecting only individual members. This inquiry “is not simply a matter of numbering the questions in the case, labeling them as common or diverse, and then counting them up.” Bogosian, 561 F.2d at 461. Rather, the district court is authorized to make practical judgments regarding “conservation of litigation effort.” Katz v. Carte Blanche Corp., 496 F.2d 747, 756 (3d Cir. 1974). At bottom, the question is whether a proposed class is “sufficiently cohesive to warrant adjudication by representation” in light of the

“legal and factual questions that qualify each class member’s claim as a genuine controversy.” Amchem, 521 U.S. at 623. A district court’s “more stringent” review of whether common issues *predominate* “subsume[s] * * * or supersede[s]” the inquiry into the existence of common issues, because a mere showing of “questions of law or fact common to the class” that would satisfy Rule 23(a)’s commonality requirement is insufficient to satisfy the “far more demanding” Rule 23(b)(3) predominance requirement. Id. at 609, 623-24. This Court has held that a class necessarily fails to satisfy the predominance requirement when “[n]o one set of operative facts establishes liability” as to each class member, “[n]o single proximate cause applies equally to each class member,” and “affirmative defenses * * * depend on facts peculiar to each plaintiff’s case.” Georgine, 83 F.3d at 628.

The en banc decision in this case made clear that plaintiffs must prove (1) a misrepresentation of material fact, (2) scienter, (3) reasonable reliance, and (4) fact of injury and damages. Newton II, 135 F.3d at 269. We explained above why the district court was correct in holding that injury and reasonable reliance on a material misrepresentation present overwhelmingly individualized issues. See pp. 27-29, supra. The district court acted within its broad discretion in determining that these individualized issues predominate over any common questions that may exist. See Andrews v. American Tel. & Tel. Co., 95 F.3d 1014, 1024 (11th Cir. 1996) (practical problems of showing reliance, fact of injury, and damages barred class certification in fraud case); Hotel Tel. Charges, 500 F.2d at 88-89 (reversing class certification due to impossibility of common proof of elements of fraud).

Plaintiffs’ abstract contention that defendants made a “common misrepresentation” to all members of the class is also incorrect. As we have explained, the alleged representation that defendants “would execute plaintiffs’ orders so as to maximize

plaintiffs' economic benefit" (Newton III, 191 F.R.D. at 393) was perfectly true in every instance in which defendants in fact achieved the best available price and other terms—the vast majority of transactions at issue. See TSC Indus., 426 U.S. at 462-63 (securities liability cannot be imposed on the theory that it was materially misleading to fail to disclose facts suggesting “market manipulation” absent proof that there was “in fact” market manipulation); p. 28, supra.³³ Nor can scienter be determined on a nationwide basis over a four-year period, because, as this Court previously explained, proof of scienter in this case depends on judgments about the particular expectations of differently-situated plaintiffs and defendants' understanding of those expectations, as well as evolving technology, industry practice, and regulatory standards. Newton II, 135 F.3d at 273.

Moreover, even if plaintiffs could somehow prove their affirmative case on a class-wide basis, defendants would be entitled to raise individualized defenses. For example, because plaintiffs extended the class period to include new class members who traded long after the filing of the original complaint, defendants have a statute of limitations defense that applies to certain plaintiffs. See Lampf, 501 U.S. at 364. The extension of the class period also exacerbates differences in reasonable reliance among class members. See pp. 56-57, supra. Some plaintiffs placed both market and limit orders, showing that they knew how to specify a price for their trades and demonstrating that, in certain trades, they valued price over immediacy. Those plaintiffs are, therefore, subject to defenses to which other class members are not. The existence of such a variety of defenses that “depend on the facts peculiar to each plaintiff's case”

³³ The district court believed that a misrepresentation might be proven on a class-wide basis. See Newton III, 191 F.R.D. at 395. But a material misrepresentation could not be proven by any class member who in fact received the best available price. Materiality “must be determined on a case-to-case basis according to the fact pattern of each specific transaction.” Radiation Dynamics, Inc. v. Goldmuntz, 464 F.2d 876, 888 (2d Cir. 1972); accord Gelman, 73 F.R.D. at 68 & n.8.

independently justifies Judge Debevoise’s decision. Georgine, 83 F.3d at 628; see also Barnes, 161 F.3d at 146-149; J.H. Cohn & Co. v. American Appraisal Assocs., Inc., 628 F.2d 994, 998-99 (7th Cir. 1980).

A determination as to whether individual or common issues “predominate” —by virtue of their relative centrality to the litigation, their relative importance to the cause of action, or their relative complexity—is uniquely within the district court’s discretion. As long as the district court identified individualized issues, which Judge Debevoise did here, its judgment that those issues predominate over other issues should not be disturbed. See Katz, 496 F.2d at 756 (where the district court has “identified the issues common and diverse, we would undoubtedly defer in most instances to its conclusion as to predominance, since that requirement relates to the conservation of litigation effort, and the trial court’s judgment will probably be as good as ours”); see also Holmes, 213 F.3d at 138-39.

B. Plaintiffs’ Proposed Class Action is Inherently Unmanageable and Does Not Satisfy the Superiority Requirement.

Under Rule 23(b)(3), a class may be certified only if the district court finds that the plaintiff has shown that a “class action is superior to other available methods for the fair and efficient adjudication of the controversy,” which requires consideration of “the difficulties likely to be encountered in the management of the class action.” Judge Debevoise found that the proposed class flunked this test as well, since an “[e]xploration of each and every customer’s NASDAQ transactions with defendants * * * would be a mind-boggling undertaking.” Newton III, 191 F.R.D. at 398. Plaintiffs have not even challenged the district court’s ruling on this point, and they have waived the issue on appeal. Nagle v. Alspach, 8 F.3d 141, 143 (3d Cir. 1993); Merkle v. Upper Dublin Sch. Dist., 211 F.3d 782, 791 (3d Cir. 2000). That waiver of an independently sufficient ground for affirmance is fatal to plaintiffs’ case.

Judge Debevoise’s finding regarding superiority and manageability was, in any event, clearly within the scope of his broad discretion. Manageability “encompasses the whole range of practical problems that may render the class action format inappropriate for a particular suit.” Eisen v. Carlisle & Jacquelin, 417 U.S. 156, 164 (1974). These “practical problems” are at the heart of the district court’s expertise. See, e.g., Andrews, 95 F.3d at 1022 (determining whether a class action is manageable is discretionary because the district court “‘generally has a greater familiarity and expertise’ with the ‘practical * * * and primarily * * * factual’ problems of administering a lawsuit ‘than does a court of appeals’”). The district court must therefore “be granted a wide range of discretion.” Link v. Mercedes Benz, 550 F.2d 860, 861, 864 (3d Cir. 1977) (declining to second-guess the district court’s determination of “fact” regarding manageability of 300,000-member class).

Judge Debevoise’s superiority determination is unassailable. The sheer size of a proposed nationwide class, covering hundreds of millions of transactions over four years, is a red flag and would alone be enough to support Judge Debevoise’s finding that the mass of individual issues in this case cannot manageably be tried in a class proceeding. Link, 550 F.2d at 864; see Georgine, 83 F.3d at 632-633; Hotel Tel. Charges, 500 F.2d at 90 (“It cannot be lightly overlooked that as a class gets larger it may transform the litigation into a gigantic burden on the Court’s resources beyond its capacity to manage or effectively control”). But size is not the only reason for finding the class here unmanageable. During oral argument in Newton II—even before plaintiffs doubled the size of the class and nearly tripled the number of transactions covered by their complaint, see p. 22 n.19, supra—Judge Greenberg, an experienced former trial judge, observed that the wealth of individual issues would make trial of this case as a class action effectively impossible:

I didn't see how you could try this as a class action because it seemed to me there were too many variables with respect to the individuals involved as the plaintiffs and also with respect to the large number of transactions.

JA764. Nothing about this case has gotten simpler or reduced the number of “variables” since Judge Greenberg made this observation. As Judge Lumbard remarked in a similar nationwide class action covering brokerage transactions extending over several years, this case is a “Frankenstein monster posing as a class action” (Eisen v. Carlisle & Jacquelin, 391 F.2d 555, 572 (2d Cir. 1968)); the Supreme Court agreed. Eisen, 417 U.S. at 169 (“this litigation has lived up to Judge Lumbard’s characterization of it as a ‘Frankenstein monster posing as a class action’”). Trial of this case as a class action would be all but unthinkable—“mind-boggling,” in Judge Debevoise’s words, Newton III, 191 F.R.D. at 398 and plaintiffs have provided no reason for doubting Judge Debevoise’s determination that “a class of this magnitude and complexity could not be tried.” Georgine, 83 F.3d at 632.³⁴

The district court properly rejected plaintiffs’ suggested bifurcation of the trial between issues as to which common proof could be offered and all other issues. As Judge Debevoise recognized, fact of injury is a liability issue that cannot be tried on a common basis here, either in a single trial or in bifurcated proceedings. The efficiency gains of plaintiffs’ proposed bifurcation would be illusory anyway. “Whether dealt with in a unitary trial or in a severed trial, the problem of proof of the individual claims and of the essential elements of individual injury and damage will remain and severance could only postpone the difficulty.” Windham, 565 F.2d at 72. The second-phase litigation of tens of thousands of class members’

³⁴ Plaintiffs’ real objective is not trial but an unwarranted settlement. See Blair v. Equifax Check Servs., Inc., 181 F.3d 832, 834 (7th Cir. 1999); Castano, 84 F.3d at 746; Kline, 508 F.2d at 238 (Duniway, J., concurring) (“I doubt that plaintiffs’ counsel expect the immense and unmanageable case that they seek to create to be tried. What they seek will become * * * an overwhelmingly costly and potent engine for settlements, whether just or unjust”).

claims would consume an unthinkable quantity of judicial resources. See Newton III, 191 F.R.D. at 398; Abrams v. Interco Co., 719 F.2d 23, 31 (2d Cir. 1983); Windham, 565 F.2d at 68 (“where the issue of damages and impact does not lend itself to * * * a mechanical calculation, but requires ‘separate mini-trial[s]’ of an overwhelming[ly] large number of individual claims, courts have found that the ‘staggering problems of logistics’ thus created make the damage aspect of [the] case predominate, and render the case unmanageable as a class action”) (footnotes omitted).

Beyond this, the magnitude of any bifurcated proceedings would necessarily require use of multiple juries, in violation of the Seventh Amendment. The Seventh Amendment guarantees the right to have all factual issues tried to a single jury and not to have any fact tried by a jury later “reexamined” by a second jury. Gasoline Prods. Co. v. Champlin, 283 U.S. 494, 500 (1931). Thus, two juries may not hear evidence in the same case where the “factual issues overlap.” Allison v. Citgo Petroleum Corp., 151 F.3d 402, 423 n.21 (5th Cir. 1998). It is inconceivable that this case—in which nearly all of the issues turn on facts pertaining to individual trades—could be bifurcated between two juries in such a way that the second jury would not revisit and redecide facts already passed on by the first.

Judge Debevoise was also correct in rejecting plaintiffs’ argument that failure to certify the class would penalize class members who suffered only small damages. See Hotel Tel. Charges, 500 F.2d at 90-91 (potential unfeasibility of individual litigation “does not eclipse the problem of unmanageability”). As Judge Debevoise recognized, many class members suffered no injury at all and simply seek a “windfall.” In any event, convenience to small class members of proceeding by class action cannot trump defendants’ substantive right to an adjudication of liability and damages as to each claimant. Kline, 508 F.2d at 233-36. And a class action is *not*

more convenient for hypothetical small claimants if each of them must prove the elements of a Rule 10b-5 claim based on individual facts, as the law requires. The “convenience” plaintiffs seek is the convenience of recovery *without* proof that class members received something less than the best price—a recovery to which the law does not entitle them. 15 U.S.C. § 78bb(a). Such a result would be completely improper. Amchem, 521 U.S. at 613, 615 (Rule 23(b)(3)’s manageability test is satisfied only if trial of the case as a class action can be accomplished “without sacrificing procedural fairness” and without “abridg[ing], enlarg[ing] or modify[ing] any substantive right”); see also Deposit Guar. Nat’l Bank v. Roper, 445 U.S. 326, 340 (1980) (“That small individual claims otherwise might be limited to local and state courts rather than a federal forum does not justify ignoring the overall problem of wise use of judicial resources”).

Moreover, as Judge Debevoise noted, the members of the proposed class have ample alternative means to seek redress for any wrong they actually suffered. See Newton III, 191 F.R.D. at 398. Individual claimants may seek arbitration of their claims. See NASD Rule 10301(a) (“Any dispute, claim, or controversy” between a customer and a broker “shall be arbitrated * * * as provided by any duly executed and enforceable written agreement or upon the demand of the customer”); see also Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 226, 233 (1987) (holding that the “federal policy favoring arbitration” applies to Rule 10b-5 claims and noting the “inherent suitability of arbitration as a means of resolving § 10(b) disputes”); Rowe, 191 F.R.D. at 416-19 (dismissing class allegations in securities fraud cases and compelling arbitration). Moreover, assuming the validity of plaintiffs’ claims, many class members—such as institutional customers, who are estimated to account for 70 percent of the transactions at issue in this case (see p. 15, supra—may have suffered substantial damages and would have every incentive to litigate the matter on their own. See Amchem, 521 U.S. at 617

(class action is not appropriate where many class members have “effective strength to bring their opponents into court”); Georgine, 83 F.3d at 632.

C. The Representative Plaintiffs Do Not Satisfy the Typicality Requirement.

Plaintiffs also do not come close to satisfying the requirement that “the claims or defenses of the representative parties [be] typical of the claims or defenses of the class.” Fed. R. Civ. P. 23(a)(3); see General Tel., 457 U.S. at 157 n.13 (“commonality and typicality requirements * * * tend to merge”). “The typicality * * * requirement[] of the Federal Rules ensure[s] that only those plaintiffs * * * who can advance the same factual and legal arguments may be grouped together as a class.” Mace v. Van Ru Credit Corp., 109 F.3d 338, 341 (7th Cir. 1997); see also General Tel., 457 U.S. at 155-56 (the case must “turn on questions of law applicable in the same manner to each member of the class” and the class representative must “possess the same interest and suffer the same injury as the class members”). Based on his extensive knowledge of this case, Judge Debevoise found that neither the named plaintiffs nor their claims could be considered typical of other class members. Newton III, 191 F.R.D. at 397-98; see Weiss v. York Hospital, 745 F.2d 786, 809 n.36 (3d Cir. 1984). He was plainly correct.

Proof that defendants failed to secure the best price for one class member in one trade could not prove that defendants failed to secure the best price (let alone failed to provide best execution) for another class member on a different trade in a different security days or years later. Proof that an individual client who never discussed execution with his broker and never placed limit orders reasonably relied on a belief that the broker would seek the best price by surveying alternative sources of liquidity proves nothing about the reasonableness of reliance by a sophisticated investor who regularly discussed trade executions with his broker, let alone the reasonableness of reliance by an institutional investor that regularly executed trades on Instinet.

It is clear that “[a] named plaintiff who proved his own claim would not have proved anybody else’s claim.” Sprague v. General Motors Corp., 133 F.3d 388, 399 (6th Cir. 1998). Because the classes are a “hodgepodge of factually as well as legally different plaintiffs * * * no set of representatives can be ‘typical’ of [the] class.” Georgine, 83 F.3d at 632. “The premise of the typicality requirement is simply stated: as goes the claim of the named plaintiff, so go the claims of the class. That premise is not valid here.” Sprague, 133 F.3d at 399.

D. The Proposed Class Does Not Satisfy the Adequacy of Representation Requirement.

Rule 23(a)(4) provides that a class may be certified only if “the representative parties will fairly and adequately protect the interests of the class.” To meet this additional requirement, the class representatives’ interests must be closely aligned with those of the putative class. See Georgine, 83 F.3d at 630; Wetzel, 508 F.2d at 247. Rule 23(a) mandates “an inquiry into potential conflicts among various members of the class * * * because the named plaintiffs’ interests cannot align with those of absent class members if the interests of different class members are not themselves in alignment.” Georgine, 83 F.3d at 630.

Plaintiffs make no serious effort to contest Judge Debevoise’s finding that they could not adequately represent the proposed class because, “were an attempt made to compute damages through statistical means, the resulting sum would have to be allocated among those who suffered damage under plaintiffs’ theory of liability and those who suffered no damage and were simply seeking a windfall.” Newton III, 191 F.R.D. at 398. Plaintiffs give the issue only a glancing reference in a footnote, which is plainly insufficient to preserve it on appeal. Laborers’ Int’l Union v. Foster Wheeler Energy Corp., 26 F.3d 375, 398 (3d Cir. 1994); see Nagle, 8 F.3d at 143.

Even overlooking plaintiffs' failure to contest this issue, Judge Debevoise acted within his broad discretion in finding that plaintiffs failed to carry their burden of showing adequacy of representation. Because of the highly diverse circumstances in which class members placed orders and the clear insufficiency of non-Nasdaq bids and offers to satisfy more than a small fraction of those orders, conflict would inevitably develop over the principles to be used to determine which class members' orders could have been executed against superior bids and offers and the temporal priority of those orders. Class members (including large institutions) will necessarily have sharply differing interests in these issues. A handful of individual investors proposing their own self-serving formula for computation and allocation of damages cannot possibly be representative of all of them. See Ortiz, 527 U.S. at 857 (problems of allocation within disparate class create intra-class conflicts and weigh against class certification); General Motors, 55 F.3d at 800-01 ("antagonism" between interests of institutional and individual plaintiffs precluded class certification).³⁵

E. Variation in Plaintiffs' State Law Claims Precludes Class Certification.

Severely compounding the difficulties identified by the district court as precluding certification of the proposed class is the fact that two of the three counts of plaintiffs' complaint assert state law claims for breach of fiduciary duty and unjust enrichment. JA954-56.

³⁵ Plaintiffs say (Br. 42 n.13) that the district court had no factual basis for its ruling that plaintiffs' damages formula would yield a windfall for some class members. But plaintiffs' own expert provided the statistics establishing that most class members do not even theoretically have viable claims, JA410-13, and the district court reached the same conclusion. Newton III, 191 F.R.D. at 396. That fact demonstrates that different class members would necessarily compete to get the benefit of the same non-NBBO bids and offers. Plaintiffs also suppose that intra-class differences could be addressed by creating subclasses. But they cite no case holding that a trial court abuses its discretion by refusing to create subclasses not defined by any party, particularly when dividing the class would do nothing to solve the fundamental conflict. See Castano, 84 F.3d at 745 n.21 (courts and parties cannot "[artificially] manufacture predominance" through "nimble use" of subclasses).

Variations in these state law claims would overwhelm any common issues, independently defeating predominance and superiority. See, e.g., Georgine, 83 F.3d at 627, 630, 632; Castano, 84 F.3d at 741, 747, 749-50.

The fifty states approach breach of fiduciary duty and unjust enrichment claims in very different ways. For example, while some states apply a per se rule to determine whether a fiduciary relationship exists between a broker and customer, others give varying weight to a host of factors. See Marchese v. Nelson, 809 F. Supp. 880, 893-94 (D. Utah 1993) (summarizing different approaches); Carol R. Goforth, Stockbrokers' Duties To Their Customers, 33 St. Louis U. L.J. 407, 418-31 (1989). Still other states have not yet addressed the issue or have failed to settle on a single approach. Id. at 418, 431. Even after a fiduciary relationship has been established, states impose different duties on brokers. Id. at 436-40. There is also disagreement among the states regarding the standard of proof by which a breach of fiduciary duty must be proven. Compare Martin v. Heinold Commodities, Inc., 643 N.E.2d 734, 740 (Ill. 1994) (clear and convincing evidence) with Lindland v. United Bus. Invs., Inc., 693 P.2d 20, 25 (Or. 1984) (preponderance of the evidence). The law of unjust enrichment is similarly varied. See Dan B. Dobbs, 1 Dobbs Law of Remedies § 4.1(2), at 557 (2d ed. 1993) (“Unjust enrichment cannot be precisely defined”).

Because of these substantial variations in state law, the district court would have to take on the superhuman task of determining which body of substantive law applied to each class member (see Phillips Petroleum Co. v. Shutts, 472 U.S. 797, 818 (1985) (discussing constitutional limits on choice of law in class action cases)) and would then have to ascertain the

laws of all fifty states. The jury would ultimately face the impossible task of applying fifty bodies of state law to hundreds of millions of securities transactions.³⁶

As in Georgine, “the number of uncommon issues in this humongous class action * * * is colossal,” due to the variable nature of the state law causes of action and the necessity for a fact-specific inquiry with respect to each and every class member. Georgine, 83 F.3d at 627. The class cannot “conceivably” meet the predominance or superiority requirements because of the “multiplicity of individualized factual and legal issues,” which are only “magnified by choice of law considerations.” Id. at 627, 630, 632; see also Castano, 84 F.3d at 741, 747, 749-50.

³⁶ Further complicating this Herculean labor, even within a single state both fiduciary duty and unjust enrichment claims are highly fact-specific. With respect to breach of fiduciary duty, “in order to properly evaluate a broker’s conduct in a specific situation, all the facts surrounding the particular relationship or transaction must be considered.” Goforth, 33 St. Louis U. L.J. at 440. The law of unjust enrichment requires “judgments * * * about what is right between two particular people.” Dobbs at 558. But this Court has squarely held that class certification is improper when a claim requires balancing of individual “equities.” See Holmes, 213 F.3d at 137-38.

CONCLUSION

The district court's denial of class certification should be affirmed.

Respectfully submitted.

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Dated: September 22, 2000

CERTIFICATION OF COMPLIANCE

I, Robert B. McCaw, Esq., of Wilmer, Cutler & Pickering, counsel for defendants-appellees, hereby certify that:

1. Pursuant to Federal Rule of Appellate Procedure 32 (a) (7) (B) & (C), the Brief for Appellees contains fewer than 20,000 words, exclusive of the Table of Contents, Table of Authorities, signature page, and attached certifications, as permitted by this Court's order of August 7, 2000; and
2. Pursuant to Local Rule of Federal Appellate Procedure 28.3(d), at least one attorney whose name appears on the Brief For Appellees is a member, in good standing, of this Court including the following: David A. Brownlee, Robert B. McCaw, Stephen M. Shapiro, and Paul J. Fishman.

I hereby certify that the foregoing statements are true. I acknowledge that if any such statement is willfully false, I am subject to punishment.

Dated: September 22, 2000
