

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT
No. 00-1586

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

v.

MERRILL LYNCH, PIERCE, FENNER & SMITH,
INC.; PAINWEBBER, INC.
(D.C. No. 94-cv-5343)

JEFFREY PHILLIP KRAVITZ

v.

DEAN WITTER REYNOLDS, INC.
(D.C. No. 95-cv-213)

UNITED STATES COURTHOUSE
601 MARKET STREET
PHILADELPHIA, PA 19108
DECEMBER 4, 2000

B E F O R E : THE HONORABLE ANTHONY J. SCIRICA
THE HONORABLE JULIO M. FUENTES
THE HONORABLE LEONARD I. GARTH

A P P E A R A N C E S :

MORRIS AND MORRIS
BY: KAREN L. MORRIS, ESQUIRE
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THEODORE M. FORMAROLI, C.S.R.
OFFICIAL U.S. REPORTER

THE DEPUTY CLERK: Oyez, oyez, all persons having business with the Honorable United States Court of Appeals for the Third Circuit are admonished to draw near and give their attention, for this Court is now in session. God save the United States and this Honorable Court.

JUDGE SCIRICA: Good morning. The first matter is Newton versus Merrill Lynch. Ms. Morris.

MS. MORRIS: Good morning, your Honors. Karen Morris on behalf of plaintiffs/appellants. I'd like to request six minutes for rebuttal time, if it please the Court.

JUDGE SCIRICA: Fine.

MS. MORRIS: Thank you, your Honors.

May it please the Court, the conduct at the heart of this lawsuit is uniform common policy adopted by these defendants for the execution of NASDAQ market orders at the NBBO. These defendants adopted policies uniformly applied across the entire class period where the defendants executed NASDAQ market orders with exclusive reference to the national best bid or offer with no taking into account better prices reasonably available. However, for themselves they took advantage of those better prices. They made no disclosure to their clients, to their customers, no disclosure of their policy, no disclosure of the existence of these better prices, no disclosure of their own advantaging themselves of these better prices.

JUDGE SCIRICA: Are you characterizing this as a misrepresentation case or as an omission case, or both?

MS. MORRIS: Your Honor, this is not a misrepresentation case, this is an implied misrepresentation omission case.

JUDGE SCIRICA: And that helps you on your reliance argument.

MS. MORRIS: Absolutely, your Honor, it most certainly does.

We believe that the violation as I have described it is what the en banc court in Newton, which for shorthand, your Honors, I will refer to as the Newton court, if it please you, concluded that a trier of fact from that record presented at that time, albeit a limited one, could conclude that these defendants violated the anti-fraud provisions of the federal securities laws.

At the core of the conduct, your Honors, which I believe is the source of the fundamental misimpression of the district court, is that these were automated systems, computerized systems, that these defendants employed to implement their fraud.

JUDGE SCIRICA: Right. Now, you may be able to, assuming you can presume reliance for certification purposes, don't you still have to prove reliance at the time of trial?

MS. MORRIS: Your Honor, we will have to prove reliance, and we believe --

JUDGE SCIRICA: And tell us how you would do that.

MS. MORRIS: We will prove reliance by demonstrating factually that the defendants made no disclosure, that the defendants never in any account statement, that the defendants never in any communication with their customer base told them the facts as they were. That those same defendants, as the Newton court recognized, had a fiduciary obligation that the burden was on the defendants, on the broker/dealer, to maximize the economic benefit of their customer. And on the critical issue of technology and feasibility of delivering those better prices, it's the responsibility of the broker/dealer to do the necessary checks and to implement that technology. That burden is not on the --

JUDGE SCIRICA: Fine. And how -- and the defendants would respond by saying we have individual defenses to each one of these trades.

MS. MORRIS: And, your Honor, we would say that they do not because there will be a motion in limine or a summary judgement motion where the defendants, who have the burden, will have to come forward with enough evidence that in this uniform setting they communicated factual information about the nature of the misconduct and the availability of these better prices. All the plaintiffs who testified on this record have said we didn't know about Instinet or SelectNet. The Newton court relied on the fact, with respect to the implied misrepresentation, that there was a hidden two-tiered market operating in this NASDAQ market

system at that time. So, at that time, not the year two thousand, but from 1994 through 1996, what we are looking at was a tremendous imbalance in information.

JUDGE GARTH: Could I interrupt you for just a moment?

MS. MORRIS: Yes, sir.

JUDGE GARTH: Just following up on what Judge Scirica was asking you, did the district court, did Judge Debevoise in his opinion denying class certification deal with the subject of manageability under 23, I guess it's (a), (b), 23(b)?

MS. MORRIS: Yes, your Honor. I believe he dealt with it, shall I say, indirectly. I think what --

JUDGE GARTH: But not explicitly.

MS. MORRIS: Not explicitly. I think we believe that the major misimpression of the Court was in not grasping the fact that the factors that the Judge identified that would be relevant to the quote-unquote individual circumstances of a trade, were never taken into account by the defendants during the class period. They automatically executed the national best bid or offer.

JUDGE GARTH: Well, now, I don't understand that, but I'm sure you can help me understand it.

MS. MORRIS: Yes, sir.

JUDGE GARTH: My impression was that there are a number of the members of the class who were concerned, as most people are in the market, with the price obviously of the security, but then there were a number that were concerned with the timing of

when either the purchase or the sale could be made. And that their concern became an individualistic concern and one that would have to have been taken into account by Merrill Lynch, for instance, but that it is on an individual basis, it depends upon the individual. Does he want the money right now because he's putting a down payment on a house, or does it make any difference if it's a week from now after they've explored the Internet?

MS. MORRIS: Your Honor, again, the mistake is that wasn't the automated system. If I had a conversation with my broker and I said I'd like to buy Intel today, get me a price really fast, whether or not you said you wanted it really fast, whether or not you said at some other preference, once the trade was entered in the automated system, the only thing we're contesting is that the automated system didn't check the availability of better prices, and those better prices were reasonably available, which is what the Newton court said a trier of fact could find once the system -- once the order was entered in the automated system, any preference of the individual client becomes irrelevant at that point.

JUDGE GARTH: Well, now, I don't understand that. Maybe I don't understand the mechanics. But when I call Merrill Lynch and say I want to sell a hundred shares of stock X and it takes Merrill Lynch some time to explore what the other prices are, it may result in a lower price perhaps than could have been obtained when the order was put in, isn't that so?

MS. MORRIS: No, your Honor.

JUDGE GARTH: No?

MS. MORRIS: Because, let me explain. What we're talking about is an automated system. So once the order gets placed into the Merrill Lynch system, the only thing this case is about, critically about, is the feasibility in the automated setting of delivering the better prices. Whatever decisions, whatever programming Merrill Lynch went through to design its automated system that would weigh price and speed, that's all part of the automated system. It was commonly applied. There was no negotiation with the client whatsoever.

JUDGE GARTH: I'm not talking about negotiation, I'm talking about the actual ascertainment of what was available other than the bid and offer price.

MS. MORRIS: Yes. We would need to demonstrate, which is a common issue, that the better prices were reasonably available in the system in a way that they can feasibly be delivered. That was the very issue that the Third Circuit sent back to be tried. That was the very issue. So, it's not a question of the individual trade-by-trade analysis --

JUDGE GARTH: Well, when you say that it was sent back, you're talking now about the Third Circuit's decision, which did not, which in effect rejected summary judgement.

MS. MORRIS: Absolutely. And what that decision said was the critical issue, as we read it, is you have to look at feasibility. If we can demonstrate at trial, and this is a common issue, if -- it's our burden to show at trial that these

Instinet and SelectNet prices could be -- excuse me -- entered into, be entered into the system in a way that it made them reasonably available.

JUDGE GARTH: Now, I don't understand the "reasonably available" because I guess I don't understand the market mechanics.

MS. MORRIS: Yes, sir.

JUDGE GARTH: What I want to know is that if I were to call up Merrill Lynch today --

MS. MORRIS: Um-hum.

THE COURT: -- at nine in the morning and say I want to sell and I want to -- I want the money just as fast as I can get it because I need it, how long does it take them, if they are not going to respond with the bid and offer?

MS. MORRIS: Okay. Your Honor, you enter your order, okay, you called your broker up.

THE COURT: Right.

MS MORRIS: You say I want to sell a thousand shares of IBM. They immediately enter it into the automated system, if it's a market order. We're not contesting, that, but that's where any individual question ends. Because the only question now for the trier of fact is whether or not when the automated system checks the NBBO, it should also have checked Instinet and Selectnet prices. Because what the defendants did once your order went in to that automated computerized system was match the NBBO price. They're not asked to bid on the NBBO, no human being

is interfering. Indeed, the defendants said that in their own briefing in this Court where they said that if these things are executed through an internal system that automatically executed client orders against the firm's market-making inventory at the NBBO. And I can provide the citation, if you like. So we're not contesting --

JUDGE GARTH: Yes, what is it, please?

MS. MORRIS: It's the supplemental brief for appellees, your Honor, which was submitted on October 20, 1997, and that cite, I believe, is at page 10.

So, the point is that we're not contesting how quickly they submitted the order to the automated system, we're saying that if you could in a responsible fashion, which is that "reasonably available" means and it's a common question, get those Instinet and SelectNet prices into your automated system and match them, there's no human intervention. The trade --

JUDGE GARTH: How long does it take for the magic -- is there a time interval for the magic to take place, according to the record?

MS. MORRIS: According to the record, your Honor, I -- we have not had merits discovery in this case, and so --

JUDGE GARTH: Well, now you're telling -- is the information you're telling me found in the record? If I look in the record, can I discern how long it takes from the time the order is placed until the response at the better price is made from the exploration that Merrill Lynch has made?

MS. MORRIS: Not -- no, you cannot, that merits discovery hasn't happened. But, your Honor, what I'm trying to explain is that because it would be automated, we're not disputing how long it took them to get the order to their automated system, whatever that was it was. What we're saying --

JUDGE GARTH: Well, it was a response.

MS. MORRIS: Correct, because if the Instinet and SelectNet prices could feasibly be done so fast as NBBO, that's the crux of the claim. They're checking it for their own orders, but the refuse to redesign their automated system --

JUDGE GARTH: But suppose it took, and this is completely hypothetical because I have no basis of knowing, suppose it took two days or three days to get this information from the --

MS. MORRIS: Your Honor, that's the entire question that's being sent back on the merits, that's the whole point. If we can show --

JUDGE GARTH: No, that's not the whole point, forgive me.

MS. MORRIS: Yeah, okay.

JUDGE GARTH: If I am not interested in waiting two or three days, I want my -- I want to know what I'm committed to at 9 o'clock in the morning --

MS. MORRIS: Correct.

JUDGE GARTH: -- on December the 14th --

MS. MORRIS: Exactly, your Honor.

JUDGE GARTH: Yeah. Can I get that information right then and there?

MS. MORRIS: Yes, because if we can demonstrate that the better prices are reasonably available, which is what Newton said on the record we could show, even on that limited record, the system would be checking it within seconds. They'd be checking those numbers within seconds, just the way they did with the NBBO on the computer.

JUDGE GARTH: Okay.

MS. MORRIS: There would be no two or three day wait.

JUDGE SCIRICA: Let me go back to the individualized reliance issue.

MS. MORRIS: Yes.

JUDGE SCIRICA: Did I understand you to say that when we're thinking of manageability and superiority that we don't have to worry about that because this case will never be tried?

MS. MORRIS: No, not at all.

JUDGE SCIRICA: Now hold on a second.

MS. MORRIS: I'm sorry.

JUDGE SCIRICA: You said -- the red light's on, but you're going to be on our time for a while.

MS. MORRIS: Okay.

JUDGE SCIRICA: I thought you said that you are going to win it on summary judgement, so we needn't worry about actually trying these individual issues.

MS. MORRIS: Your Honor, forgive me because I didn't complete my answer, so I apologize.

JUDGE SCIRICA: All right.

MS. MORRIS: I would imagine the way this would happen is that there will be some motion practice with respect to the levels of proof because the defendants will come back with a rebuttal. We'll put in evidence that they never disclosed it, that there was no disclosure of the practice by the defendants, and that the customers as a whole were entitled to rely on the broker/dealer, a quintessential example of why these kinds of presumptions apply in federal securities law cases.

JUDGE SCIRICA: Well, they apply on typical fraud in the market cases.

MS. MORRIS: No, your Honor, they apply in omissions cases as well right here in this circuit in the Hoxworth and Ettinger cases, for example, and in Prudential.

JUDGE SCIRICA: There was, there were -- well. Maybe we can get into that later. There were uniformities in those cases that I'm not sure that I see in this case.

MS. MORRIS: The uniformity here, your Honor, is that they uniformly failed to make any omission -- any representation of the practice and that the implied misrepresentation, like an omission, entitles the customer to rely. We would also demonstrate that these individuals in the context of the market at the time, that that reliance was wholly reasonable. And critically, your Honor, this is the type of case, it's a uniform

practice and reliance is a secondary issue. And, yes, it would be manageable.

The defendants will have to come forward and show that there are segments of this class, I suppose they will argue, that knew. And if they point to segments of the class that knew, we have every confidence that those would be subclassable. For example, they may point to institutions, and you might ask me why did we not eliminate institutions from our class definition. Because there is nothing on this record that says that institutions knew at the time and we felt that we had to define our class objectively as --

JUDGE SCIRICA: How would you -- I'm sorry, go ahead.

MS. MORRIS: As all those persons who were subjected to the misconduct. If, for example, there were institutions when we get merits discovery that didn't get automatic NBBO execution because the defendants had a different policy about them, they would be excluded, they would be subclassed.

JUDGE SCIRICA: What kind of subclasses do you think we're talking about here?

MS. MORRIS: Well, I think, your Honor, again we have not had merits discovery. We can look at the policy --

JUDGE GARTH: Now, I'm just surprised at this. Is it your proposition that you can ask for a class without being able to represent that you have met the requirements of either 23(a) or 23(b) because you haven't had merits discovery? Should we then require that before we ever certify a class that the record

should be such that we can tell whether or not there are individual or typical commonality questions?

MS. MORRIS: Your Honor, I'm saying that at the class certification stage, I'm required to meet those obligations you've outlined. There is nothing in this record the defendants have brought forward, no evidence whatsoever, that there are individual issues about parts of the customer base. The customer base got subjected to the NBBO --

JUDGE GARTH: I'm not talking about the customer base, I'm talking about has every one of the class suffered damage? Has --

MS. MORRIS: Your Honor, that's not required. Under the Prudential holding, we don't have to show now who exactly was injured. We will have to show that, and we take on that burden wholeheartedly, which is why we presented the affidavit of Professor Mendelson.

JUDGE GARTH: Suppose half of the class hasn't suffered any damages? Or maybe that leads in to Judge Scirica's question as to whether there should be a subclass where there has been no damage suffered.

MS MORRIS: Your Honor --

JUDGE GARTH: Or perhaps even that they did better with the NBBO than what they would with anything else.

MS. MORRIS: To require at the class certification stage that I show which people were injured or not or that everyone is injured will turn Rule 23 on its head. I fully

embrace my obligation to demonstrate individual damage through, for example, the submission of the affidavit of Professor Mendelson. That is our obligation.

JUDGE SCIRICA: How do you meet the adequacy of representation requirement if there is the expectation they're going to be subclasses and you have not been able to define what those subclasses are at the certification stage?

MS. MORRIS: Because, your Honor, all of the people who were subjected to the automatic NBBO execution, that's everybody who got automatic NBBO execution for their market orders, that's how the class is defined, that already eliminates parts of their customer base because there may be parts of their customer base that didn't get automatic NBBO because they had other arrangements with them. They're not even in the class.

JUDGE SCIRICA: Do we have any idea what the value of these claims might be, an individual claim?

MS. MORRIS: Your Honor, the claims could range -- they could be a hundred dollars a person, they could be a thousand dollars a person, fifty dollars a person, depends on the size of the order. And the submission that the defendants made to you on the 28(j) submission --

JUDGE SCIRICA: So, some of these could be stand alone claims, some of them may not be, is that it?

MS. MORRIS: No, your Honor, on -- very, very few. The cost of litigating the uniform misconduct of these defendants is

tremendous. It would be the death knell of this case, it could not go forward.

JUDGE SCIRICA: What the about institutional investors, it would seem to me they would have stand alone claims.

MS. MORRIS: Your Honor, the institutional investors -- to the extent that those institutions weren't even subjected to the practice, they're not even part of the class as it stands right now. And to now defy -- defeat class certification, the vast majority of these claims will get no redress.

JUDGE SCIRICA: What about arbitration?

MS. MORRIS: Completely and utterly impractical, your Honor. These people can't afford for a hundred dollars or seventy five dollars or a thousand dollars to come forward and say I'm going to arbitrate this case. They can't afford to do it. The kinds of expertise and the kinds of technological expertise that will be required to evaluate the defendants' systems to demonstrate that critical issue of feasibility can't be done on an individual basis.

JUDGE GARTH: Judge Debevoise said you could bring some lawsuits and maybe establish liability and then go on from there.

MS. MORRIS: Your Honor, what I will face is a motion by the defendants limiting the scope of my discovery. If the jury can't hear the system-wide nature of the conduct, which is why it was in the defendants' interest to do it, they were picking up bits and pieces of money on every trade that they subjected to this practice, and that's how they made the money,

that's how it was worth it to them. And if I end up being constricted in demonstrating that proof to a jury, I'm not going to be able to make out the case.

JUDGE FUENTES: Did Professor Mendelson state a projection of damages for the entire class at the trial court?

MS. MORRIS: I'm sorry, Judge.

JUDGE FUENTES: Did your expert state expected damages for the entire class at the trial court?

MS. MORRIS: Your Honor, we haven't had access to the data yet. He set forth in his affidavit that he would proceed with that, but he obviously could not actually come up with the aggregate number at this time without any access to the data.

JUDGE FUENTES: One of Judge Debevoise's concerns is that certain plaintiffs are essentially going to get something for nothing if this class is certified. Could you comment on that?

MS. MORRIS: Absolutely, your Honor. There will be no windfall on this case. Professor Mendelson is confident that he will be able to develop a plan of allocation that is reliable, that is able to identify class members for whom there was not a better price available and had no damage under those -- across the class.

JUDGE SCIRICA: How would you avoid plaintiffs who have suffered no injury, how would you prevent their getting any allocation of the entire award?

MS. MORRIS: Because, your Honor, Professor Mendelson will be able to develop, as he says in his affidavit, a plan of allocation that -- using the data. So that he'll use the very powerful statistical techniques that are going to be peer reviewed, and obviously there will be a Daubert hearing in this case, he will use those techniques, tested against actual data, and he will then be able to determine which class members were damaged and which weren't.

JUDGE GARTH: I think we should have had Professor Mendelson then down in Florida just recently. I think we might have avoided a lot of problems.

MS. MORRIS: Your Honor, Professor Mendelson is a highly, highly respected individual.

JUDGE GARTH: I'm sure he is.

MS. MORRIS: And he was cited in the 28(j) of the SEC report. And I look forward to the Daubert hearing that I know we will have in this case, and the defendants will have every opportunity to tear apart his methodology.

JUDGE SCIRICA: Well, but we're at the certification, as you noted, we're at the certification stage.

MS. MORRIS: That's right, your Honor.

JUDGE SCIRICA: And how much do we really have to know about the allocation of damages at this particular stage?

MS. MORRIS: At this particular --

JUDGE SCIRICA: Well, you know, the -- some courts have been quite critical about the allocation of damages in class

actions as to who's doing it. In many instances it's the plaintiffs' lawyers who end up making the allocation. I'm not quite sure how this is going to be done in this particular case.

MS. MORRIS: Your Honor, the way I believe it should go forward is that like other federal securities class actions, this case will have an aggregate damage class-wide number that will be provided at trial. Professor Mendelson will testify, the defendants will have every opportunity to cross-examine him. And if that class-wide number is reasonable and reliable, that will be the crux of that common issue.

In terms of the plan of allocation, that will also be tested by the Court, whether it's by a special master or whether it's by the district judge, him or herself. And again, Professor Mendelson's allocation plan and his methodology for identifying those class members with zero damage and with damage will be tested, and that's a common issue.

JUDGE FUENTES: Do you have any details of that plan? How would you identify those class members who have no damages.

MS. MORRIS: Your Honor, what the professor's methodology would do is take certain categories of information that the economic literature has already established, peer-reviewed, established literature has already said are powerful explainers of effective market price, that is, of the damage in this case. And there are additional powerful explanations, powerful categories of information; they can be the nature of the trade, the size of the trade; they can be, for example, the

nature of the security, how many market makers follow it. These kinds of principles have been relied upon in the peer review literature to determine, for example, the difference between the NBBO and, for example, the Instinet or SelectNet.

He would take those -- that formula that he would develop through regression analysis and test it against actual data. And his methodology would, and his burden would be to demonstrate to the satisfaction of the trier of fact that his methodology reliably, reliably, because of the check against the actual data, his formula tells you what the damage is per class member. That's his obligation and that's what he'll do. We're not talking about individual damage to -- (Inaudible).

JUDGE SCIRICA: Now, let's assume that he does not satisfy the standard that the Court thinks he should, where are we then? In what posture would the case be if Professor Mendelson's formula is not adopted?

MS. MORRIS: If he cannot persuade the Court or the trier of fact that he has a reliable formula for that allocation plan, then that's something clearly that would have to be subject to challenge.

JUDGE GARTH: Subject to challenge? But you've already been -- according to you, the class has already been certified.

MS. MORRIS: Forgive me, your Honor. The plan of allocation, that plan of allocation at the individual level, not the aggregate level, that plan of allocation, if I understood --

JUDGE SCIRICA: The individual level.

MS. MORRIS: -- the question correctly, if the Court did not have confidence in that plan and there was not a manageable methodology for allocating those damages, then that would be problematic in terms of manageability. But we do not believe that's going to be the case.

JUDGE GARTH: Does that mean then that the class would not be certified until the Court was satisfied that the methodology of the professor was acceptable?

MS. MORRIS: No, your Honor.

JUDGE GARTH: Oh, so you would have the class certified without having met the requirements then of 23(a) and (b) subject to the professor's -- the acceptance of the professor's methodology, is that it?

MS. MORRIS: Your Honor, give me one moment because I know I'm not going to give you the direct yes or no you may be looking for, forgive me, so I want to explain. Under the federal securities law precedent, these plaintiffs, where they have a cohesive interest in demonstrating each of the critical elements out of which the violation arises, materiality, misrepresentation and scienter, what the courts have said is the issue of damages is secondary, however --

JUDGE GARTH: Proof of damages is not though. The issue -- the calculation may be secondary.

MS. MORRIS: That's correct, and that was --

JUDGE GARTH: But what about the proof?

MS. MORRIS: Your Honor, the proof of damage, and this is a critical error of the district court, what's required at class certification, there are two parts of damage: Loss causation. Are there any intervening causes to explain the client's injury; and calculation of damage. And what we argue is that on loss causation there are no intervening causes, and we talked about how the matching system worked and the automated nature of it, that once the order was placed there was no negotiation, no choice anymore. On the side of the calculation of damage, we are required to show that it can be done in an aggregate class wide basis reliably and without conjecture or speculation.

JUDGE GARTH: Now will you answer my question, if you will? You said you were going to give me a yes or no answer.

MS. MORRIS: Forgive me, you Honor, if you could repeat the question, I'm sorry.

JUDGE GARTH: Well, you're asking a lot of me.

MS. MORRIS: I'm sorry.

JUDGE GARTH: Yes.

JUDGE SCIRICA: Judge Garth is up to the task.

MS. MORRIS: I'm sure he is.

JUDGE GARTH: You would ask us, I gather, to certify the class as having met the requirements of 23(a) and (b) subject to having it divested if the trier of fact does not find acceptable the professor's methodology; is that correct?

MS. MORRIS: That's correct, and that's completely consistent with the preliminary nature, the tentative nature of any class certification.

JUDGE GARTH: I haven't read any case on class certification where a class has been satisfied -- has been certified without having the requirements of the rule met in the first instance.

MS. MORRIS: But, your Honor, they are met here, we put in an uncontested an affidavit --

JUDGE GARTH: Well, that's a different thing. Now that's a different thing. You just told me that one element at least would not be satisfied, yet you want the class --

MS. MORRIS: Which, your Honor, I -- forgive me. I did not mean to tell you I haven't satisfied all the elements. To the contrary, I believe we fully have satisfied every element. The issue of manageability is one part of the superiority determination. And I believe, because the defendants didn't even seek to cross-examine or depose Professor Mendelson, his affidavit stands that he's able to satisfy this. He will obviously need the data to do it ultimately and the defendants will have a chance to challenge him, but he is prepared to demonstrate through a mathematical formula, based on regression analysis and checks against the actual data, both aggregate damage and individual damage. Both. So we believe we have fully satisfied those elements right now.

JUDGE GARTH: You mean his methodology would be able to single out from this vast group of plaintiffs those individuals who suffered no damage at all on a particular day at a particular time when they placed their order, is that so?

MS. MORRIS: That's so and by formula, your Honor, better yet, which is why it's manageable.

JUDGE GARTH: Okay, thank you.

MS. MORRIS: All right, thank you. Thank you for the additional time.

JUDGE SCIRICA: We'll have you back in rebuttal. Is there anything that we missed that you want to tell us about right now?

MS. MORRIS: I think, your Honor -- I hope I've responded to your questions.

JUDGE SCIRICA: You have, very well.

MS. MORRIS: Thank you.

JUDGE SCIRICA: Thank you very much.

Mr. Shapiro.

MR. SHAPIRO: May it please the Court, Steve Shapiro on behalf of the appellees.

JUDGE SCIRICA: You may want to raise the mikes a bit.

MR. SHAPIRO: I think this is fine, thank you.

JUDGE SCIRICA: Well, no, we want to get you on tape, so just -- no, no --

MR. SHAPIRO: You can raise these up.

JUDGE SCIRICA: That's it, that's it.

MR. SHAPIRO: All right. Counsel's position I think is that we should certify first and ask questions later. That is not the way Rule 23 works.

JUDGE SCIRICA: Well, you know, courts do certify and then later decertify when more information is available.

MR. SHAPIRO: I was struck by the Windham case, an en banc holding of the Fourth Circuit, that said it's not enough to promise you are going to do something in the future to show that you've satisfied Rule 23. When you move for class certification, it's your burden to establish that the elements have been satisfied. And this is a six-year old case, it's not a new case, and counsel picked the time to move for certification and wasn't able to satisfy Rule 23.

And the principal reasons are the reasons Judge Garth gave, and that is there are individual questions of injury here that are incredibly difficult and require a person by person and transaction by transaction inquiry.

JUDGE GARTH: But Professor Mendelson apparently has solved that quandary. I gather from what your friend just said that every uninjured individual, everyone of these individuals who has not suffered any damage whatsoever, will be able to be identified through a formula that he has.

MR. SHAPIRO: It's quite remarkable. He says he's going to do this. He has just about two or three sentences saying: In the future, I'm going to solve all these problems in an undefined way with no indication of what he's going to do.

And this is an area of the law where the en banc court said you've got to be case-specific, you've got to look at individual facts and circumstances.

And, indeed, Judge Debevoise, when he looked at only thirteen transactions here in the Newton I case, he had to go minute by minute, indeed second by second to see if there was anything else at that moment in time that was a better price, that was reasonably available, that was in the right quantity, and these were hotly disputed questions of whether there was anything available at that moment. Some of these offers on Instinet and SelectNet are just good for two or three minutes; some of them go for other limited periods of time; some of them go to just particular market makers and not to everybody out there in the market; some of them were just offers to negotiate. And we're going to have to do this for hundreds of millions of transactions, one by one. And it was an enormously burdensome thing for Judge Debevoise to do just on thirteen different trades.

JUDGE GARTH: How does it work? I asked that question of your friend and the answer that I got pretty much was that it is instantaneous. And I'm wondering if you could play out, as they would in Peoria, a scenario whereby I ask to purchase a thousand shares of X stock, can you tell me what happens?

MR. SHAPIRO: Absolutely, your Honor.

JUDGE GARTH: Good.

MR. SHAPIRO: There are ten thousand different scenarios, it's not just one scenario. If a big institutional customer calls up and says I want to trade 50,000 shares of OTC stock, sometimes they give instructions on how that should be done; sometimes the broker will have to break it up into pieces and shop it around; some of these are at the NBBO price, some are not. When an individual calls and says I just have 50 or a hundred shares of IBM, it's up to the trader to decide how to execute that trade.

Now, there is an automated system that applies to certain threshold amounts of securities. They can push a button, it's executed in three or four or five seconds. But the SEC has said for those small orders, in the en banc brief filed in this very same case, they said that NBBO is generally sufficient to achieve best execution. And they said they were unaware of any other system that was reasonably available during the class period for the execution of those smallest orders. That's pages 2 and 4 of the SEC's amicus brief before the en banc court.

JUDGE FUENTES: But I understand that you were using the better quote on the Internet on a large percentage basis. If I remember the figure correctly, about 90 percent of the time you were using the better quotes than the NBBO.

MR. SHAPIRO: When you can get a trade on Instinet you can often save a small amount, perhaps a 16th of a point. The problem is there is only infrequently something available. And if you look at the volume on Instinet and SelectNet, it was about

13 percent at the beginning of the class period, it goes up to about 20 percent. So when Steve Shapiro calls his broker and says make a trade, that broker is going to have to look around first, according to these plaintiffs, in SelectNet and then in Instinet and then the in-house order books, and the market can change dramatically while the broker is doing that, so --

JUDGE SCIRICA: Yes, but why, but why were the big -- why were the makers choosing the Instinet and not the NBBO?

MR. SHAPIRO: Oh, it's the difference between wholesale and retail.

JUDGE SCIRICA: I understand.

MR. SHAPIRO: If there is a huge block of securities for sale on Instinet and you're a market maker and you have to replenish your stock of securities, on those occasions when there is something there, you can get it. But now when the customer, Judge Garth, says I want to sell a thousand shares of my stock, chances are remote that there is going to be anything available on Instinet, SelectNet or an in-house order book. And while that broker is looking around, you can lose your life savings. Some of these stocks plummeted a hundred percent in value in a single day on the NASDAQ. We've seen what a roller coaster the NASDAQ is.

That's why the en banc court and the SEC said: Folks, we have to look at the facts and circumstances of these individual trades, we look at the context of the trade, we have to look at all the facts and circumstances. The SEC was

insistent on that. And that really is why this doesn't work as a class action.

The most important individual circumstance, of course, is the fact of injury question and with this limited volume we're going to find that for most of these transactions, perhaps 80 percent, there simply wasn't a better trade available. Nobody's been injured at all. And then we're going to find that in this same class, which includes these institutions, most of the traders, most of the customers are big institutions and not individuals and those big institutions knew about NBBO and SelectNet and Instinet as well as we did, they were subscribers to these same systems. And if they wanted to use them, according to the SEC, they would just call and say: Look, I want to trade this block in this particular fashion, go here, go there, or they can rely on the broker to do what the broker thought was best for the particular transaction. But there are these very important questions of injury, customer expectations, and of course --

JUDGE FUENTES: Did you say, did you say a moment ago there was no injury at all? I thought that's what you said.

MR. SHAPIRO: I'm sorry?

JUDGE FUENTES: You do concede there was injury here?

MR. SHAPIRO: Oh, we don't. In most cases there was no injury at all. In 80 percent of the cases there were simply no other trades available at the right time and in the right quantity. Then, for the remaining 20 percent, you are going to have disputed issues about the broker's prudence, about the

customer's expectations, whether it was reasonable under the circumstances --

JUDGE SCIRICA: In other words, only 20 percent of the plaintiffs' class suffered injury in this case?

MR. SHAPIRO: Even less than that when you really look at the best execution realities. For most of these customers, using the NBBO was the best thing, it was in the best interests of the customer quickly --

JUDGE GARTH: How can we quantify that at this stage, nobody has -- except for the 13 cases, has anybody really looked at it?

MR. SHAPIRO: Oh, yes. If you look at plaintiffs' own expert, Professor Mendelson, he gave an affidavit, he said that the volume on SelectNet and Instinet, if you put it all together, was about 13 percent of all the volume that would be needed to satisfy this class. That is a tiny fraction. And then if you go later in the class period, it's up to maybe 20 percent. So, it's a -- it's just a -- it's a tiny percentage of this class that even arguably has a best execution claim.

JUDGE SCIRICA: Were you under an obligation to contest Professor Mendelson's representations of his certification standard?

MR. SHAPIRO: Your Honor, we argued that what he proposed, which was virtually nothing, was insufficient for class certification. But plaintiffs didn't give any plan or system of allocation or formula. When you look it up in the record, you

are going to be stunned. It's just two sentences that say: I'm going to do something in the future, but I'm not going to tell you what it is. And that's directly contrary to what he had said previously in his affidavit where he said you have to look to all the facts and circumstances to see if there is a better transaction.

And, in fact, this representation about injury through aggregation, sampling, extrapolation, we're going to determine which hundreds of millions of transactions entail some injury, that's contrary to the case law, too.

I was struck by Judge Fuentes' opinion for this Court in the Allegheny Hospital case where there was an argument made in a RICO and an antitrust and a fraud proceeding that you can just use aggregation and sampling and extrapolation and come up with some plan of allocation. And the Court said: Come on, that's too speculative to arrive at injury, that wasn't even good enough for standing purposes.

And here we're talking about something that is even more speculative. We don't have anything from this expert, and it was their burden of proof. The Windham court en banc said: Look, folks, if you ask for class certification, you bear the burden. Don't tell us you are going to do something in the future. You bear the burden to show how you are going to make this class action work.

JUDGE GARTH: Is it your position that proof of damage is an essential element that has to be established by the

plaintiffs before a class can be certified, question one? Question two, if that is so, and I want to hear your answer on it, where will we find the two paragraphs of Professor Mendelson's alchemy and affidavit? And number three -- and I'm getting these all in at once before I get interrupted by my colleagues -- I would like to hear what effect, if any, the Securities and Exchange Commission's final rule was that you were good enough to send us on this litigation? Can you keep those three questions in mind?

MR. SHAPIRO: I can try. I'll start with the SEC rule release. We thought it was striking because the Commission was concerned about over simplistic adjudications of best execution claims. They didn't like the idea that you just use a bunch of statistics and generalities to decide whether there is best execution. They said just what the en banc court said here, you've got to look to the context of the particular trade, look to the question of injury, look to customer expectations, look to the reasonableness of the action in light of the volatility of the market and the need for expedition. So, we -- and they also said that each customer is going to have different perspectives on these issues. Some customers want speed. If you are selling your stock on December 31st for a tax advantage, you don't want your broker fishing around for penny savings on executions, that has to be done then and there. Or if you're selling stock in Microsoft because you think they're going to be divested later in the day, that's got to be done then and there. Or if you are

buying an IPO that's going to go up a hundred percent in a day, then, heavens, you can't have your broker wasting time. So, what the SEC is saying is customer expectations have to be looked at one by one.

I wonder if we have the cite.

(Short pause).

Your Honor, maybe I could find that more readily at the end. Is that all right if I look for it after? There is a specific page which I can give you which has (Inaudible).

JUDGE FUENTES: Yes, you can do it.

JUDGE GARTH: You can let us know.

MR. SHAPIRO: And I can tell the Court, because I read it this morning, it's about three sentences long. He says: I'm going to develop a system for allocating damages among the class using recognized statistical techniques, sampling and extrapolation, and that it's going to be reasonable and satisfactory. That's the substance of it. There is no explanation of what it is. And we submit that that cannot be sufficient to support class certification, the burden of proof in a case like this.

And your first question, Judge, about --

JUDGE GARTH: About proof of damage, exactly.

MR. SHAPIRO: Proof of damage. Under 10(b)(5), the fact of injury is an essential liability element, it's not some detail that comes in at the end like calculation of damages, it's critical to the 10(b)(5) cause of action. And a case cannot be

certified if the district court determines in its discretion that there are going to be individual questions about fact of injury that are difficult and complex and disputed.

In the Prudential case, the Court was just looking at issues of standing, it wasn't looking at what had to be done to try a case. And what the Supreme Court is telling us in matters like Amchem is: Let's take a practical, real world look at what this trial would entail. Well, we know what this trial would entail because Judge Debevoise went through these one by one to see if there was anything out there that could possibly give a better price. He found one out of thirteen, a twenty-five dollar savings. And it was very arduous, he had to look second by second, there was all kinds of false information about things that seemed to be available that weren't really available when you looked hard because they were sent just to a particular market maker and not to everyone, sometimes they were just available for two or three minutes.

And the experts debated about this, and it was a complex issue. And think of the poor jury here who would have to look at hundreds of millions of these transactions and try to go one by one and figure out: Was there something better that was available? Did this class member get served well by the particular execution that was used? Was it reasonable or unreasonable to proceed the way that the broker did? Was efficiency important?

JUDGE GARTH: Well, did you raise manageability before Judge Debevoise? Because his opinion is singularly deficient in that respect.

MR. SHAPIRO: Well, as we know, manageability is a subpart of predominance.

JUDE GARTH: Of course it is.

MR. SHAPIRO: And he found that predominance was not demonstrated here, he said that several times. And in the course of that analysis he said that going trade by trade would be a mind-boggling undertaking. And in his earlier opinion he demonstrated exactly why it would be mind-boggling and impossible to do for a hundred million transactions. So I think you don't have to read very far between the lines to see what he was saying, he meant that it was unmanageable because it was totally mind-boggling and impossible to do for hundreds of millions of trades.

JUDGE GARTH: Did you answer Judge Scirica, I may have lost it, when he asked you whether you had an obligation to respond to Professor Mendelson's affidavit whether it was two pages or two paragraphs?

MR. SHAPIRO: Well, we responded by saying that this was not sufficient to certify the class. There was nothing proffered that would require a Daubert type hearing or deposition of this expert.

JUDGE SCIRICA: What's wrong with a conditional certification and then if Professor Mendelson's projections do not stand up, decertifying the class at that point?

MR. SHAPIRO: We think that that gets Rule 23 backwards. It's the plaintiffs' burden to demonstrate when they choose to move that the matter is ready for class certification, it's a 6 year-old case. And their expert could have proffered something, but he simply gave us one paragraph of musings.

We also think under the case law that we cite in our briefs that these guesstimates and estimates from experts, in a case like this where the prior district court proceedings have shown the need for one by one careful examination that this is inherently a situation where the estimate/guesstimate approach just doesn't suffice, especially where Mr. Mendelson himself in a prior affidavit said just what we did and just what the en banc Court said, and that is you have got to look at the particular circumstances, you have got to look at what was available for this particular transaction at that moment in time. You've got to make sure there really was an offer there that was extant for the correct time period. And then, even if there was an alternative available, you've got to ask the question of reasonableness.

Ultimately the fraud claim here turns on a failure to give best execution. Well, the SEC has said that for most transactions, the NBBO is best execution. And maybe the plaintiffs can show some special circumstances here that for a

particular transaction, a very large transaction that somehow got automated and there is only one or two market makers out there and it wasn't a competitive thing to do to send it to those market makers, perhaps that is a case where the special circumstances would be sufficient to say that was unreasonable.

JUDGE FUENTES: Here's one, here's a quote from the plaintiff's brief. "On one day, Merrill Lynch executed 29 of 34 trades on Instinet for its own account at prices superior to NBBO."

MR. SHAPIRO: Yes.

JUDGE FUENTES: 29 out of 30 is a very high percentage.

MR. SHAPIRO: Well, when you -- Judge, when you can find a transaction on SelectNet or Instinet, usually you do find a very slight price advantage. That's why the market makers look to SelecNet and Instinet for these wholesale type transactions. The problem is that on most days and for many, many securities, you're not going to find anything there.

JUDGE FUENTES: Is this an aberration?

MR. SHAPIRO: Well, not an aberration, but I would say that if you look at the volume statistics that plaintiffs themselves presented to the Court, only on 20 percent of the occasions would there be an Instinet or SelectNet trade available. It's a tiny volume compared to NASDAQ. And the reason is these alternatives aren't continuous trading markets, they are just bulletin boards where people can hang up an order: I want to sell ten thousand shares of IBM at a particular price

and it's open for three minutes. Well, if somebody happens to be looking for just that thing at just that moment in time, you can get it, but for most of these individuals there is nothing like that and that's what Judge Debevoise's inquiry demonstrated here.

JUDGE FUENTES: But it makes it appear that for their own trades your client is willing to take a few moments to see if there is a better price, but for the small trader they're not willing to take that time.

MR. SHAPIRO: It's the difference, your Honor, between the function of a market maker that is continually in the business of buying and selling and an individual investor, like Judge Garth, who says I want to sell my stock right now and, by George, that market is moving, don't tell me you're laboring around looking at this, that and the other. The Restatement of Agency says the meaning of a market order is sell immediately because the market can change. And if any market has ever changed in the history of securities, it's this NASDAQ market. It's been a roller coaster. We have stocks changing a hundred percent in a single day. And some of these alternatives that counsel is talking about are very time consuming, you have to scroll through the SelectNet system to look for what's there, then, according to them, you go to the in-house book, then you have to go to Instinet and call up different things.

Now, none of this was embodied in the NBBO system until the SEC changed the rules in 1996. They decided on a prospective, phased-in basis that they would incorporate this

other information and it would be done by rule making. But that took a phase-in of over a year, it took an entire industry-wide rule making to do this. Prior to that what the Commission says is absolutely right, they said in their brief before the en banc court that they were unaware of any other system that was reasonably available for the execution of small orders at better prices. And that's the SEC talking, they're not pro defendant in their outlook, they're pro plaintiff in their outlook and that was their conclusion in their brief to this Court.

So when counsel tells you that there is some inherent fraud here that needs to be remedied, that we need to twist Rule 23 all out of shape to prevent unjust enrichment or unfairness, remember what the SEC said, that NBBO was the best execution generally speaking and that there was no better system they were aware of during the class period.

JUDGE GARTH: Mr. Shapiro, I'm concerned about one aspect of both of your arguments, and that is that if indeed it is as you contend that all of the requirements have to be met and are a burden of the plaintiff or the movant who is seeking class certification, does this mean that in every class certification case the merits of the application had to be explored so that there can be firm representations which would satisfy each of the elements of 23(a) and (b) before class could be certified?

MR. SHAPIRO: Well, the plaintiff is the driver, of course, your Honor, in deciding when they know enough to seek class certification. And what the Supreme Court has said in

cases like Amchem is that you have to look at what really is going to be tried under the substantive law, what are the elements, and look to whether the class is really cohesive in a common sense practical way. Could we try a hundred million of these cases in one trial in a way that wouldn't erode our substantive rights under the Seventh Amendment and under the Rules Enabling Act? Well, you really can't. These folks want to come into Court, not be cross-examined on issues of their knowledge, their reasonable reliance and so forth and have the whole case determined by Professor Mendelson. Well, maybe Professor Mendelson can manage his testimony, but the jury isn't going to be able to make a fair resolution of this.

JUDGE GARTH: Now let's go back to the question that I asked, particularly since Judge Scirica, who is intimately connected with the rule-making in the federal courts and I'm sure may be interested, I don't know, but -- are merits -

JUDGE SCIRICA: I have a passing interest.

JUDGE GARTH: You've got a passing interest. Should the merits be explored by any group that is seeking to have a class certified so that the question that we have been dealing with this morning would be something that would be in the record that we could look at before the determination was made? And, of course, that leads to a little sub A underneath that, and that is are the merits something that can be inquired into in any class certification action?

MR. SHAPIRO: Yes, your Honor. We have cited the Supreme Court case in a footnote in our brief, I'll have to find it for the Court, that says that the class action issues are enmeshed with the merits issues. You don't adjudicate the merits issues, you don't have an Eisen versus Carlyle mini trial on the merits, but you have to understand what the merits issues are, what the proof will be required of the plaintiff, what defenses are going to be presented before the jury. You do have to have a very clear understanding of the cause of action and how to prove it, and that's what the Amchem case was all about. It was easy to argue in the abstract --

JUDGE SCIRICA: No, but in Amchem, there had been several trials, everyone knew exactly -- liability had been proven, the range of damages had been set, I mean that area was well known, everything was known about the asbestos cases. But I'm wondering, are you saying that Eisen is being whittled away by the lower courts and that we really have to start looking at the merits in these kinds of cases?

MR. SHAPIRO: No more than the Supreme Court itself has said in a couple of its opinions. It has said that although you don't have an Eisen style mini trial and you don't have to litigate the issues before you decide whether it's a class action, you do have to identify what the elements of the cause of action are, what the defenses are, what the predictable lines of proof are, and that it's the plaintiffs' burden of proof to show that all of this can be done feasibly in one proceeding without

splintering into an endless series of mini trials that would completely swamp the Court and would be exceedingly unfair to the defendant and exceedingly unfair to other class members.

JUDGE SCIRICA: What kind of subclasses, assuming this were certified and went to trial, what kind of subclasses would you envision would be necessary in this kind of case?

MR. SHAPIRO: The supreme irony here is that you can subclass and subclass, and slice and dice, but you don't accomplish anything because the same individual issues are there. Was this claimant injured because there was in fact a better trade available? Did this claimant know or should the claimant have known about the facts that they're claiming were withheld? Does the statute of limitations preclude the claim, which is an inquiry notice provision, a one year statute of limitations that is going to be hotly disputed and very fact specific? And those questions prevent any slicing up of this into subclasses.

I've noticed that the modern trend in cases like Castano from the Fifth Circuit, Windham from the Fourth Circuit, Rios from the Seventh Circuit, all say this subclass rationale can't be used to undermine the predominance inquiry because in every case you could tease out some issue here or there and say, okay, we'll have a trial on that issue, but that doesn't settle the question of liability in the case. Much like the Barnes case where the Court said maybe you could have some inquiry on general causation, but that doesn't answer the question whether a particular claimant was actually injured.

And that's the same problem that we face here. So, the subclasses are no answer to all of this and it would still degenerate into mini hearings, mini trial after mini trial, and you have no predominance within the subclass. That's why the courts have not accepted that solution.

I would refer to Castano and Windham from the Fourth Circuit en banc opinion and Rios from the Seventh Circuit that have good discussions of the subclass problem.

On the issue of reliance, counsel has said that, well, we can solve all of our problems just with a presumption of reliance. Well, the theory that they're tendering is that even if they had only been told more about best execution, they would have taken their business somewhere else, fired their brokers and gotten best execution from another unidentified broker. Well, this is a speculative chain of causation. And, in fact, these class members were told on their confirmation slips from us that the executions would take place pursuant to the customs and the usages of the NASD. And, of course, NBBO is one of the customs and usages and it's a well known custom and usage, it's been in the newspaper, the Wall Street Journal, the New York Times, USA Today, it's been in numerous SEC releases, in the Federal Register. So to simply presume that this improbable series of casual events is going to take place is quite inequitable and quite unfair. And to say we're going to pretermite all of that because it's a class action, we can't even cross-examine people about this in a case asserting fraud, when the underlying

practice is no secret as Judge Debevoise found, seems highly inequitable.

And this Court has said burden shifting is reserved for extraordinary circumstances, not for the usual situation, and only when it's fair and equitable to shift that burden. And the Supreme Court had made that same point in Basic versus Levinson, only when you have a rational causal chain can you indulge this presumption of causation.

This is nothing like Affiliated Ute Citizens, which my friends rely on, where the broker just stood mute, didn't do anything. Well, we gave confirmation slips, and at Joint Appendix page I believe its 671, and the Court will see that the customs and usages of the NASD were referred to explicitly and there was an agreement between the customer and the broker that the trade could take place according to those customs and usages. So, we didn't stand silent. And the matter was in the public domain, which is quite different from Affiliated Ute where those Indians who sold their shares had no way of knowing on earth that their shares were being sold for twice the price that the brokers bought them for. So, that's not an apt analogy at all.

Now, the question comes up whether the Court would change the status of securities law precedent here if it denies class certification. In fact, we cited case after case in our brief that reached the same results in this particular context where you have complaints about particular securities transactions for particular brokerage accounts and there are

individual issues about causation of injury, knowledge, communications between customer and broker. In case after case, the courts have refused to certify those class actions and we submit that that's exactly the situation here. This Court would be adhering to a long line of existing precedent.

And when counsel tells the Court that the Prudential case from this Circuit is the controlling authority, I know the Court isn't going to agree with that because Prudential was a settlement class action and not a single issue of liability, not a single defense on the merits had to be adjudicated. And the Court pointed out that it is quite relevant whether you have a settlement in the case because that bears on manageability. If a matter is settled, you don't have to have these mini trials on whether there was a better trade available or not; none of that is necessary, all the issues are waived.

And in that case, Prudential, there was an ADR system that was set up that made sure that the right amount of money was paid to the right person, there were none of these lingering problems about who gets what amount of money, who's entitled to what. And there were none of the concerns about competition within the class that are so acutely sensitive here. So I think when counsel relies on Prudential, they're are not citing --

JUDGE GARTH: When you say competition between members or among members of the class, is that the conflict that you have written about, sir?

MR. SHAPIRO: Yes, your Honor, it is. And Judge Debevoise referred to that. When you have a very limited pie of SelectNet and Instinet trades and you've got to carve it up, and here we have just a handful of individual investors that are trying to represent big banks, insurance companies, mutual funds, sophisticated investors, and they're saying our expert's going to come up with an allocation formula that will decide what's right for Chase Manhattan Bank and for Fidelity Mutual Fund, well, how could they possibly stand in those oversized shoes? They really can't. And they're going to have to compete with each other, which creates conflict problems and lack of adequate representation.

Well, a final point that I think is important here is that this is not de novo review in this Court of the class action ruling. Judge Debevoise made a reasoned decision in this case, he's an experienced trial judge, he cited the latest cases from this Court and from the Supreme Court, he looked carefully one by one at the issues, he applied a wealth of experience he had in this case in dealing with questions of injury and he made a reasoned, well-explained opinion. I don't see how a decision like that could be characterized as abuse of discretion even if there is room to debate about whether he's completely explained this, completely explained that. I think it's the kind of decision, especially under the new Rule 23(f) when this Court's going to be faced with appeal after appeal, that really merits

deferential review, and we accordingly urge the Court to affirm this discretionary ruling.

JUDGE SCIRICA: Any other questions? Thank you, Mr. Shapiro.

MR. SHAPIRO: Thank you.

JUDGE GARTH: You won't forget to get that citation for me.

MR. SHAPIRO: I believe it is JA-1450.

JUDGE GARTH: JA-14 --

MR. SHAPIRO: 50.

JUDGE GARTH: 1450?

MR. SHAPIRO: Yes, 1450, your Honor, through 1451. I'll double check that before we break. My co-counsel just handed it to me and I think that is the correct cite.

JUDGE GARTH: Thank you.

MR. SHAPIRO: Thank you.

JUDGE SCIRICA: Ms. Morris.

MS. MORRIS: Your Honors --

JUDGE SCIRICA: Pull that down. You may want to crank it down a little.

MS. MORRIS: Is that good?

JUDGE SCIRICA: That's good.

MS. MORRIS: I feel as though I just listened to a case I'm not litigating because of matching and because of automation, and if I haven't explained either of those concepts adequately to you, please ask me to do so if they're unclear in any way.

Individual issues that the defendants are trying to reinject into the liability side of this case, including now on injury in fact, simply do not obtain.

JUDGE GARTH: Well, then, I do not understand it. I had thought that I had asked those questions earlier of you, Ms. Morris, but apparently I did not or I was inarticulate.

I do not understand what the process is when someone calls up the broker and says I want to sell a thousand shares of X stock. I want to know how long it takes to do what has to be done and whether or not the scheme of horrors that your friend has set out in terms of conflict, in terms of competition, in terms of the availability of that stock, how long that takes and how the process works. Give me a scenario. Play it through for me.

MS. MORRIS: Let me play it through because it's critical because if I can convey this to you, I will win and you will reverse.

What happened here is that you come forward, you want to buy a thousand shares of stock or five hundred shares of stock. You present your market order. You say to your broker: I want to want to get a hundred shares. Your broker automatically types that order into a system. Let's say you're in Dubuque. That gets routed to the trading center in New York and it gets automatically executed. Those are their words. That's undisputed. They never refute that. And all we're saying

is that when the computer in those split seconds is checking the NBBO, it should have been checking Instinet and SelectNet.

And when Judge Fuentes asked how is it that you managed to get all those good trades for yourself on Instinet and SelectNet, what the Newton court said, and I quote, and this is at page 272: "We believe the evidence is sufficient to allow a reasonable trier of fact to conclude by the time of the class period both technology and the over-the-counter markets had developed to a point where it was feasible to maximize the economic benefit to the client by taking advantage of better prices than the NBBO."

My job at trial, Judge, is to put on common proof that the automated system in split seconds will be able to match, not execute on as Mr. Shapiro will have you understand it, but to literally match those Instinet and SelectNet prices. If I can't prove it, I lose on liability; and if I'm right, then injury in fact is a common issue. There are no individual issues that get into --

JUDGE GARTH: But suppose the stock isn't available?

MS. MORRIS: Your Honor, the whole concept of high matching and what the defendants did with the NBBO, they matched it, they didn't look at the volume, they matched it up to a certain amount. Those rules we're prepared to accept but --

JUDGE GARTH: I don't understand --

MS. MORRIS: Let me help out.

JUDGE GARTH: If you want me to understand it --

MS. MORRIS: Yes, sir.

JUDGE GARTH: -- you are going to have to take it very slow. I'm not very smart, and you are just going to have to bear with that.

MS. MORRIS: No problem.

JUDGE GARTH: As --

MS. MORRIS: But I don't have to believe that.

JUDGE SCIRICA: We've been bearing with him for many years, I understand.

MS. MORRIS: Please go ahead, your Honor, I'm sorry.

JUDGE GARTH: If, as your friend says, there are instances in which the stock is not available through Instinet or through whatever other sources there may be other than through the NBBO, if it is not available and this matching, as you say, is attempted, what happens when the stock is not available?

MS. MORRIS: Your Honor, what the Newton court said was, do the periodic check and give your client the benefit of the technology you have. So if all we're saying is that, the fraud is that when they designed their systems, they didn't include Instinet and SelectNet prices quotes as a check. If there didn't happen to be a better price there, that person didn't get injured. But that doesn't mean the violation didn't happen. The violation according to Newton grows out of the fact that when they executed those market orders, the broker/dealer already knew they did not have a system that included a check for Instinet and SelectNet in those split seconds.

JUDGE GARTH: Well, if a violation occurred as you say and there either was not the stock or the price was not as favorable as the NBBO and there was no injury, doesn't this become a matter of individual proof?

MS. MORRIS: Absolutely not, your Honor, because what the federal securities law cases talk about and why this is so critical to the enforcement of the anti-fraud provision, and look at the Chaesins case, it's critical and follow it through on Newton, what it says is we certify classes as a violation arises out of the intent of the defendant at the time of that order never even to check, as long as the better prices were reasonably available technologically, as long as we could have designed our system to deliver it, then we had an obligation to try and we didn't even look.

And why? Because exactly what Judge Fuentes said, because there was not a wholesale market, that argument was rejected in Newton. We're not relitigating whether or not a violation could be proven here. The Newton court said a violation could be proven here. What we're going to do --

JUDGE GARTH: You are talking about our en banc court?

MS. MORRIS: Absolutely, your Honor.

JUDGE GARTH: I thought that all it did was to reject summary judgment.

MS. MORRIS: No, your Honor. What it did was clarify -
- it rejected a special circumstances test that the district court had adopted in granting summary judgment and it said no,

you don't understand what the plaintiffs are saying. The violation is the common conduct of policy, which was the word the Court used, the policy in not checking, in not giving the benefit of the technology in their automated systems.

JUDGE GARTH: In our Court, you're telling me that our Court also said that even though a violation may have occurred, if there was no damage that nevertheless this could constitute a cause of action?

MS. MORRIS: Your Honor, under the federal securities laws --

JUDGE GARTH: No, did our Court say that?

MS. MORRIS: No. Your Honor, of course damage has to be shown, but we can show that, that's why we presented Professor Mendelson's affidavit.

JUDGE GARTH: Ah, okay.

MS. MORRIS: And we have met our burden. We never said we won't have to show damage. Of course we do. But we've met our burden. And you don't let federal violators of the anti-fraud provisions off the hook because not every class member was injured. That's not the law.

JUDGE GARTH: Well, we didn't intend to do that. I always thought that a violation was always actionable by an individual, but the question we have is whether or not that same violation is actionable if there was a violation by a class made up of individuals who were harmed and individuals that were not.

MS. MORRIS: Absolutely. You can certify that class and it's my job, as you brought out on the questioning to me on the opening, to satisfy --

JUDGE GARTH: Okay, we've come full circle.

MS. MORRIS: -- to satisfy you that our expert will do what is required.

JUDGE GARTH: Thank you.

MS. MORRIS: Yes, your Honors, thank you very much.

JUDGE FUENTES: Wait, wait, wait, I have a question.

MS. MORRIS: Yes, sir.

JUDGE FUENTES: You might have addressed it. I thought Mr. Shapiro said that the difference between the Internet price quote and the NBBO is like the difference between wholesale and retail, which I didn't quite follow. Could you address that?

MS. MORRIS: Absolutely. That is not correct. What the Newton court held, what the en banc decision held was if those prices could be reasonably made available, feasibly, and that's a disputed issue of fact that that's common, could it be done quickly enough, that's the issue about the automation, of putting it into the computer for the check, if it could be done feasibly, then it had to be delivered to the client. That's the broker/dealer's obligation.

The defendants argued this wholesale issue down below and they have lost on that question, the Circuit Court, the Third Circuit reversed. No, if there are better prices reasonably available, they have to be obtained. Now, if you'd like to

understand where the wholesale profit comes from, I can explain that. It would only take a moment.

JUDGE FUENTES: No. One last question that I have. Is your complaint about the defendants' the failure to have a system in place that can check the best price or their failure to check it?

MS. MORRIS: Their failure to have a system in place to check the best price --

JUDGE FUENTES: A computer software --

MS. MORRIS: -- that was reasonably available. That's right, when it was available to do so, that's right. And that's the common issue that I'm going to try and I'm going to have responsibility for persuading a trier of fact of.

Thank you, your Honors.

JUDGE SCIRICA: Anything else you would like to say to us?

MS. MORRIS: No, your Honors. Thank you very much.

JUDGE SCIRICA: Okay, thank you, Ms. Morris. The was extremely well argued. The briefs were very helpful. We are most grateful. We would like to have a transcript made of the argument and with each of you sharing the cost. If you will check with the clerks at the conclusion of the argument, they'll tell you how to do that. Thank you. We'll take the case under advisement.

(Proceeding then ended)