05-8003

**In the United States Court of Appeals
for the Second Circuit**

ANTHONY V. DEMARCO, ET AL.,

Plaintiffs-Respondents,

v.

ROBERTSON STEPHENS, INC., AND PAUL JOHNSON,

Defendants-Petitioners.

**BRIEF OF THE SECURITIES INDUSTRY ASSOCIATION
AS AMICUS CURIAE IN SUPPORT OF PETITION FOR
PERMISSION TO APPEAL PURSUANT TO FED. R. CIV. P. 23(F)**

On Petition from an Order Granting Certification of a Class Action Entered January 24, 2005 by the United States District Court for the Southern District of New York, Judge Gerard E. Lynch, No. 03 Civ. 590 (GEL)

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RULE 26.1 CORPORATE DISCLOSURE STATEMENT

Amicus Curiae Securities Industry Association is a non-profit corporation. It has no parent corporation and no publicly held corporation owns 10% or more of its stock.

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Pet. App.	Appendix to Petition of Robertson Stephens, Inc. and Paul Johnson for Permission to Appeal Pursuant to Federal Rule of Civil Procedure 23(f).
IPO	Initial Public Offering
SIA	Amicus Securities Industry Association

INTEREST OF THE AMICUS CURIAE

The Securities Industry Association ("SIA"), established in 1972, represents the shared interests of some 600 securities firms. SIA member firms, which include mutual fund companies, broker-dealers, and investment banks —among them, at one time, petitioner Robertson Stephens—are active in all United States and foreign markets and in all phases of corporate and public finance. The securities industry, of which SIA's members comprise a large portion, employed some 790,000 persons and generated $213 billion in domestic revenue in 2003.

Many SIA members employ analysts who provide investors with a broad range of research and opinion on securities. The standards applied to determine when securities fraud claims relating to analyst opinions may be certified as class actions are thus of substantial importance to SIA and its members. More generally, SIA's members are frequent targets of coercive class action suits and have a strong interest in ensuring that district courts certify such actions only after conducting the rigorous analysis called for by the Supreme Court, which the district court here failed to do.

SIA addressed the same issues presented by the petition here in an amicus brief on the merits in *Hevesi* v. *Citigroup Inc.,* 366 F.3d 70 (2d Cir. 2004), and has often filed briefs in cases concerning other aspects of civil liability under the federal securities laws. SIA believes that the views of its diverse membership will be of assistance to this Court in considering defendants' Rule 23(f) petition.

INTRODUCTION AND SUMMARY OF ARGUMENT

Millions of investors experienced losses following the bursting of the technology market "bubble" beginning in 2000. Plaintiffs seeking to recover those losses have turned their sights on the securities industry, including underwriters of technology IPOs and employers of securities research analysts. They have ratcheted up the threat these damages suits pose to the securities industry by seeking certification of lengthy class periods and of classes that encompass not just customers of defendant securities firms but any person or entity, anywhere in the world, that purchased securities of the issuer in question.

Such suits, once certified, improperly turn securities firms into insurers against catastrophic market declines. Furthermore, class certification vastly increases the likelihood that plaintiffs can extract a settlement. Few firms—no matter how weak the claim of fraud against them or how strong their defenses—can run the risk of a jury trial with such huge sums at stake. See *Coopers & Lybrand* v. *Livesay*, 437 U.S. 463, 476 (1978) ("Certification of a large class may so increase the defendant's potential damages liability and litigation costs that he may find it economically prudent to settle and to abandon a meritorious defense"); *Blair* v. *Equifax Check Servs.*, 181 F.3d 832, 834 (7th Cir. 1999) ("a grant of class status can propel the stakes of a case into the stratosphere," giving plaintiffs and "even some district judges" a "device to wring settlements from defendants"); *Hevesi*, 366 F.3d at 80.

This is such a case. The district court certified a 9-month-long class of thousands of Corvis investors asserting claims that seek to shift responsibility for the entire market decline of the security during 2000 and 2001 to a single analyst's allegedly misleading opinions, regardless of the countless other factors that affected market price—most notably the issuer's own financial performance and prospects. That ruling was not based on "rigorous analysis" of Rule 23's requirements, as the Supreme Court mandates. *General Tel. Co.* v. *Falcon*, 457 U.S. 147, 161 (1982). Rather, class certification was premised on the district court's belief that plaintiffs would be able at a later stage to make a "colorable presentation" or "some showing" that the analyst's opinions affected the price of Corvis stock throughout the class period so as to trigger the fraud-on-the-market presumption of reliance. Pet. App. A13, A15.

In so holding the district court extended the presumption of reliance far beyond the limits of "common sense and probability." *Basic* v. *Levinson*, 485 U.S. 224, 246 (1988). The court presumed on the basis of a conclusory expert report—one the court admitted was "weak" and contradicted by defendant's expert (Pet. App. A14)—that research analyst opinions entering a marketplace full of competing opinion and information have an enduring effect on a stock's price, even though they are soon drowned out by new data and commentary. Applying its impermissibly lax "some showing" standard to credit plaintiffs' expert's speculative conclusions—and ruling in conflict with decisions of other courts—the district court refused to "'wade into'" the parties' experts' disputes to "thoroughly tes[t]" whether plaintiffs could presume reliance on a class-wide basis or whether determining reliance would instead require thousands of individual mini-trials incompatible with class adjudication. Compare *Hevesi*, 366 F.3d at 78-79; *Gariety* v. *Grant Thornton, LLP*, 368 F.3d 356, 366 (4th Cir. 2004); *Szabo* v. *Bridgeport Machs., Inc.*, 249 F.3d 672, 675-676 (7th Cir. 2001). The district court also <u>expressly rejected</u> the "higher standard" for application of the fraud-on-the-market presumption applied by Judge Rakoff in *DeMarco* v. *Lehman Bros.*, 222 F.R.D. 243 (S.D.N.Y. 2004). Pet. App. A12.

The district court thus refused to take a "close look" to determine whether plaintiffs met their burden to demonstrate that class certification is warranted. *Amchem Prods.* v. *Windsor*, 521 U.S. 591, 615 (1997). To the contrary, the court's "some showing" standard allows plaintiffs to obtain class certification merely by hiring an expert to opine, no matter how implausibly, that reliance and other elements of Section 10(b) liability may be proved class wide. Such a toothless standard encourages "blackmail settlements" (Henry Friendly, Federal Jurisdiction 120 (1973)), which "extract a deadweight loss from investors" to the detriment of the entire economy. Ralph Winter, *Paying Lawyers, Empowering Prosecutors, and Protecting Managers: Raising the Cost of Capital in America*, 42 Duke L.J. 945, 952 (1993); see *Central Bank* v. *First Interstate Bank*, 511 U.S. 164, 189 (1994).

It is of the utmost importance to SIA members that this Court promptly correct the district court's error and resolve conflicts among trial courts as to the appropriate standard for class certification of private Section 10(b) suits and for presuming reliance on research analyst opinions. The important issues presented in the petition escaped review when the *Hevesi* case settled after this Court granted Rule 23(f) review. Those issues have only become more critical and unsettled with the subsequent conflicting decisions in this case, in *In re IPO Sec. Litig.*, 2004 WL 2297401 (S.D.N.Y. Oct. 13, 2004) (certifying classes using the "some showing" standard), Rule 23(f) Petition filed Oct. 27, 2004, No. 04-8026, and in *DeMarco* v. *Lehman Bros.*, 222 F.R.D. 243 (denying class certification because plaintiffs failed to establish a "prima facie" case for presuming reliance). This Court should grant the petition and address this case in tandem with the pending *IPO* cases.

ARGUMENT

This case presents exactly the sort of "novel" and "unsettled" question of law for which Rule 23(f) review was designed, where an "order granting certification" in an "are[a] of uncertainty" may end the litigation by forcing "a defendant to settle rather than incur the costs of defending a class action and run the risk of potentially ruinous liability," precluding resolution of an important issue that is before multiple courts in this Circuit. Rule 23(f), 1988 Adv. Comm. Notes. Indeed, this Court in granting the Rule 23(f) application in *Hevesi* has already determined that the issues presented "have a significant effect on the law of class actions" and satisfy this Circuit's standards for interlocutory review. 366 F.3d at 77-79. Conflicting district court decisions since *Hevesi* further demonstrate the need for Rule 23(f) review.

I. EXTENDING THE FRAUD-ON-THE-MARKET PRESUMPTION TO ANALYSTS' ALLEGED MISSTATEMENTS OF OPINION DOES NOT COMPORT WITH COMMON SENSE AND PROBABILITY.

While "certain" securities fraud cases are suitable for class certification (*Amchem*, 521 U.S. at 625), those that require the jury to resolve individual questions of fact to determine liability are not. *E.g.*, *Newton* v. *Merrill Lynch*, 259 F.3d 154 (3d Cir. 2001); *Zimmerman* v. *Bell*, 800 F.2d 386 (4th Cir. 1986); *West* v. *Prudential Sec.*, 282 F.3d 935 (7th Cir. 2002); see *Moore* v. *PaineWebber*, 306 F.3d 1247, 1253 (2d Cir. 2002). Plaintiffs' claims that they were injured by a single equity analyst's allegedly misleading opinions cannot be resolved without the jury engaging in both time-specific and investor-specific inquiries into each class member's reliance on those opinions—inquiries that would predominate at trial.

The typical securities fraud case involves an issuer's misrepresentation of information concerning the company's finances, disclosure of which produces an abrupt change in the price of securities. There—given the uniquely authoritative nature of a company's statements about its own business—it may be reasonable to presume that those who traded during the period of the misrepresentation relied on a market price that impounded incorrect information put forth by the issuer. This case is dramatically different. Plaintiffs challenge one analyst's *opinions*, which lack the unique status and lasting price impact of insider statements that make presuming reliance on insider statements a matter of "common sense and probability." *Basic*, 485 U.S. at 246; see *DeMarco* v. *Lehman Bros.*, 222 F.R.D. at 246-247.

To the contrary, a misrepresentation by an "outsider" like an analyst cannot cause "a long-term rise in price" in an "efficient market" because "[p]rofessional investors"—whose judgments determine the price of securities and who attach little weight to the opinion of any single analyst—draw "more astute inferences and the price effect disappears." *West*, 282 F.3d at 940. Moreover, a research analyst's opinions enter a marketplace full of competing opinion and information and are quickly drowned out as new data and commentary appear.

During the putative class period many different analysts expressed opinions on Corvis, traditional and online media reported on the company, and Corvis continuously announced news about its business. In the efficient market plaintiffs allege, presuming lengthy periods of price inflation from a single analyst's opinions cast into a maelstrom of data and predictions is unjustified. With the predicates for the *Basic* presumption lacking, investors individually have to prove that they relied on false elements of an analyst report at the time they made each purchase. That "prevent[s plaintiffs] from proceeding with a class action" because "individual issues" then "overwhel[m]" any common ones. *Basic*, 485 U.S. at 242.

II. THE DISTRICT COURT ERRED BY ADOPTING A "SOME SHOWING" STANDARD TO AVOID DECIDING DISPUTES CENTRAL TO WHETHER RULE 23'S REQUIREMENTS ARE MET.

The key to the district court's extension of the fraud-on-the-market presumption from insider misstatements of fact to outsider opinions was its "colorable" or "some showing" standard of proof. That lax standard allowed the plaintiffs to rely on the presumption even though their expert's admittedly "weak" theory that analyst opinions inflated the price of Corvis stock for 9 months was refuted by defendant's expert economist and at odds with common sense. Pet. App. A14.

Courts of appeals have firmly rejected certification standards that forbid resolving disputed issues bearing on Rule 23's requirements. The Seventh Circuit in *Szabo*, 249 F.3d at 676, explained that "an order certifying a class usually is the district judge's last word on the subject" and that Rule 23 inquiries "require the exercise of judgment and the application of sound discretion": "a judge should make whatever factual and legal inquiries are necessary under Rule 23," even if "the judge must make a preliminary inquiry into the merits." That duty does not conflict with the rule of *Eisen* v. *Carlisle & Jacquelin*, 417 U.S. 156, 177-178 (1974), which prohibits class certification rulings based on the strength of a plaintiff's claim on the merits. See Rule 23, 2003 Adv. Comm. Notes (distinguishing between "an evaluation of the probable outcome on the merits," which is impermissible at the class certification stage, and inquiry "into the 'merits,' limited to those aspects relevant to making the certification decision on an informed basis," which is essential). Numerous decisions agree. *E.g.*, *West*, 282 F.3d at 938 (district court "may not duck hard questions by observing that each side has some support, or that considerations relevant to class certification also may affect the decision on the merits" but must "fac[e] and squarely decid[e]" even "[t]ough questions" pertinent to whether Rule 23's requirements are satisfied); *Gariety*, 368 F.3d at 366; *Newton*, 259 F.3d at 166; *Tardiff* v. *Knox County*, 365 F.3d 1, 4-5 (1st Cir. 2004); *Castano* v. *Am. Tobacco Co.*, 84 F.3d 734, 744 & n.17 (5th Cir. 1996). Supreme Court precedent after *Eisen* requires that exacting evaluation. See *Falcon*, 457 U.S. at 160 (a court should "probe behind the pleadings before coming to rest on the certification question"); *Coopers & Lybrand*, 437 U.S. at 469; *Amchem*, 521 U.S. at 615, 623.

That district courts must decide disputed issues necessary to apply Rule 23 is mandated by the Rule itself. Rule 23(b)(3) requires "findings" that common issues predominate. To facilitate such findings, the 2003 amendments changed the time for a class certification decision to "an early practicable time" to allow "discovery into the 'merits' * * * relevant to making the certification decision on an informed basis," explaining that it is "critical" that the district court "tes[t]" whether "issues likely to be presented at trial * * * are susceptible of class-wide proof." 2003 Adv. Comm. Notes. The amendments further eliminated "conditional" certification, because a "court that is not satisfied that the requirements of Rule 23 have been met should refuse certification until they have been met." *Ibid.* But the district court's "some showing" standard makes every certification tentative by withholding full consideration of the issues bearing on class certification. See Pet. App. A15 n.7 (class will be "de-certified" if basis for presuming reliance is not later established).

Recent decisions confirm that this Court has not endorsed a "colorable" showing standard. In *Parker* v. *Time Warner*, 331 F.3d 13, 21 (2d Cir. 2003), this Court reversed a class certification ruling that was "based on assumptions of fact rather than on findings of fact." In *Hevesi*, 366 F.3d at 77-79, citing *West*, it saw "a substantial legal argument" that district courts must "thoroughly tes[t]" and make a "specific finding" regarding the premises underlying a class certification request. Those decisions recognize that class certification should rest on findings of fact and confirm that the party with the burden—here plaintiffs—must make the requisite showing by a preponderance of the evidence. See *Sirota* v. *Solitron Devices*, 673 F.2d 566, 571-572 (2d Cir. 1982) (court must have "a sufficient evidentiary record from which to conclude" Rule 23 is satisfied).

CONCLUSION

This Court should grant the petition for permission to appeal.

Respectfully submitted.

February 15, 2005

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Counsel for Amicus Securities Industry Association

CERTIFICATE OF SERVICE

I, Timothy S. Bishop, counsel for the Securities Industry Association and a member of the Bar of this Court, caused copies of the Brief of the Securities Industry Association as Amicus Curiae, and accompanying motion for leave to file that brief, to be served on the following counsel on February 15, 2005, via United Parcel Service, overnight delivery:

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I caused an original and ten copies of the brief and motion to be sent to the clerk for filing on February 15, 2005, via United Parcel Service, overnight delivery.

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